IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JOHN A. MORAN and THE DYSON-KISSNER-MORAN CORPORATION,	:	
Plaintiffs,	:	
and	:	
GRETL GOLTER,	:	Civil Action No. 7730
Plaintiff-Intervenor,	:	
v.	:	
HOUSEHOLD INTERNATIONAL, INC., a Delaware corporation, et al.,	:	
Defendants.	:	
HOUSEHOLD INTERNATIONAL, INC.,	:	
Counterclaim-Plaintiff,	:	
v.	:	
JOHN A. MORAN, CHARLES H. DYSON, and THE DYSON-KISSNER-MORAN CORPORATION,	:	
Counterclaim-Defendants.	:	

DEFENDANTS' POST-TRIAL BRIEF

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I. STATEMENT OF THE NATURE AND STAGE OF THE PROCEEDINGS

This action seeks to invalidate a preferred stock purchase rights dividend plan (the "Rights Plan") adopted by the directors of Household International, Inc. ("Household") on August 14, 1984. Plaintiff John A. Moran, a Household director who unsuccessfully opposed the Rights Plan at the Board meeting, and his company, The Dyson-Kissner-Moran Corporation ("D-K-M"), filed this action three days later, suing Household and 13 of the 14 directors who had voted for the Plan.

Defendants denied the material allegations of the complaint and pleaded several affirmative defenses. Household also interposed a counterclaim against plaintiffs and additional defendant Charles H. Dyson, Chairman Emeritus of D-K-M, alleging misuse of confidential Household information.

On September 21, 1984, defendants moved to dismiss the complaint based upon threshold contentions that: (a) plaintiffs' claims are derivative in nature but plaintiffs had not complied with the demand requirement of Chancery Court Rule 23.1; (b) plaintiffs' claims are not ripe for judicial determination; and (c) plaintiffs failed to join indispensable parties as required by Chancery Court Rule 19.

On the first day of trial, Gretl Golter, a holder of 500 Household shares, was granted leave to intervene as a party plaintiff. Defendants moved to dismiss the intervenor's complaint on essentially the same grounds as supported their motion to dismiss the Moran plaintiffs' complaint.*

Also at the outset of trial, the Moran plaintiffs moved for leave to amend their complaint to plead a derivative fourth count. Defendants do not oppose that motion, provided that their pending motion to dismiss is deemed to apply to the complaint as amended. Defendants continue to press their threshold motions to dismiss and note that neither the Moran plaintiffs nor the intervenor have responded to them.**

This is defendants' post-trial brief with respect to plaintiffs' claims.***

II. SUMMARY OF ARGUMENT

The trial evidence confirmed that the Household Rights Plan was adopted by a conscientious, independent Board of Directors exercis-

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* The intervenor in her post-trial brief (at 52) asks only that this Court invalidate the so-called "Poison Pill antitakeover device" (i.e., the Rights Plan) and thereby seems to indicate that she is dropping all claims (including her ERISA "claim") with respect to other takeover preparedness measures adopted at the August 14 Board Meeting. She also asks for judgment with respect to allegedly unjustified expenditures by Household in prosecuting its counterclaim herein and claims against the Moran plaintiffs in a pending federal action. There was no evidence on this subject.

** Defendants' showing that the Moran plaintiffs' claims are derivative in nature but were not pleaded as such continues to apply to the first three counts of their complaint. Defendants' showing that futility of demand cannot be established applies to Moran's proposed fourth count and to all of the intervenor's claims (Aronson v. Lewis, Del. Supr., 473 A.2d 805 (1984)). And, in any event, all pending claims must be dismissed for lack of ripeness and failure to join indispensable parties.

*** The term "plaintiffs" hereafter will refer to the Moran plaintiffs and the intervenor unless the context indicates otherwise.

ing honest business judgment on a complex issue of corporate governance. While plaintiffs renew their attacks on the directors in their post-trial briefs, the evidence failed to substantiate their charges that the directors improperly sought to advance their own interests at the expense of the shareholders', or fell short of some standard of professional competence. The very most that can be said for plaintiffs' case is that it established a sharp difference of opinion between plaintiff Moran and all the other Household directors as to whether the Rights Plan was an appropriate means of strengthening the Board's ability to negotiate for shareholders in a takeover context and of deterring unfair forms of takeover activity. That is not remotely enough to entitle plaintiffs to relief in this Court.

At the close of the evidence, this Court stated the issues for briefing as follows:

> THE COURT: I think you both did a good job on presenting the law in your opening briefs.
>
> There are two things that I'm looking for, frankly. That's the application of the business judgment rule to this particular transaction, and decisions in comparable settings involving takeover devices, anti-takeover devices. That, it seems to me, is the issue in this case. The basic issue is business judgment.
>
> Subsumed in that, it seems to me, is the issue of whether what was done here, assuming that it was done in business judgment, nonetheless falls outside the pale of the business judgment rule. That, it seems to me, is the issue in this case, because frankly, I'm satisfied, without committing myself, that what was done here was done with a degree of deliberation which would persuade me in an ordinary situation that probably this is a business judgment situation. But what was done here was so unusual and so unique that it may really be a straining of that concept because of the implications of what was done. It may or may not, but that's the way I see it sitting here after two weeks.

MR. KATZ: We appreciate Your Honor advising us what is on the Court's mind now. We will address that in our presentation.

THE COURT: If you can hone in on those questions, it seems to me that we will all be advanced.

— Tr. X 106-07.

The evidence established that the Rights Plan enhances the Household Board's ability to represent shareholder interests in a takeover situation and deters forms of takeover activity which seek to deprive Household shareholders of the full value of their investment. With respect to "decisions in comparable settings involving . . . anti-takeover devices," and whether the Rights Plan is "outside the pale of the business judgment rule," the evidence established that, unlike other defenses common in today's highly-charged corporate environment -- many of which have been expressly upheld under the business judgment rule -- the Rights Plan deters harmful takeover activity without either harming the business in which shareholders chose to invest or conferring benefits on a single large shareholder or a privileged few institutional holders.

In a business environment in which, as the trial evidence showed, directors have felt obliged to make "greenmail" payments in order to forestall "creeping" accumulations of stock, to deplete their company's cash and credit resources by PAC-MAN counter-tender offers and self-tenders in order to defeat unfair or inadequate offers, and to buy "dog" companies or sell off "crown jewels" in order to deter or defeat a bidder -- so that a shareholder who goes to bed Monday night owning a share of one kind of business wakes up Tuesday morning with a radically different investment -- Household's adoption of the Rights Plan was a restrained and responsible action. If the Plan is in any sense unusual or unique — although a number of companies other than Household have adopted it — that is to the directors' credit: for, unlike the more familiar techniques of tender offer defense, the Household Board opted for one which accomplishes the same purposes while leaving the business of Household every bit as attractive to a potential acquiror as it was the day before the Plan was adopted.

Defendants do not condemn or criticize the boards which have adopted these other means to protect their shareholders against takeover activity which they considered detrimental. Those boards had to make the hard judgment that any harm they might be inflicting on their companies was outweighed by the need to protect their shareholders from acquirors seeking to make a "bundle of money" — in plaintiff Moran's apt phrase — at the shareholders' expense. But defendants do not understand how, given the realities of the takeover environment — including these more drastic defensive responses — plaintiffs can argue that the Household directors are "straining . . . [the] concept" of business judgment when they sought to accomplish the same purpose without harming Household's business.

The controlling case law establishes beyond question that the Board had not only the authority, but the responsibility, to do what it thought reasonable to achieve these ends. By any conceivable criterion of comparison, the Household Rights Plan is well "within the pale" of the business judgment rule.

Unable to rebut these facts, plaintiffs resort to several tactics. First, in the guise of "distinguishing" the business judgment cases, plaintiffs simply rewrite them by asserting that these cases require a board to remain passive until an actual bid is made, and that they validate only defensive responses having what plaintiffs call independent "economic substance." These attempts to restrict the business judgment rule are made up out of whole cloth: no case holds that a board cannot take precautionary measures, and must wait until, in their expert Abbott's words, shareholders "have no economic choice." No case holds that the directors of a Delaware company must remain passive and indifferent to a perceived threat of harmful takeover activity until they have no options left but to "rip the guts out of the company" or to unilaterally change the very nature of a shareholder's investment, as Higgins described the Carter-Hawley and Pogo defenses, without contradiction.

Likewise, no case holds or even suggests that courts must determine the independent "economic substance" of a defensive action. And no case supports plaintiffs' implicit assertion that effective defense against unfair takeover activity is not itself of substantial economic significance.

Under the "decisions in comparable settings involving . . . anti-takeover devices" -- as they were decided, not as plaintiffs rewrite them -- the Rights Plan is a valid exercise of business judgment. The Household Board, like all boards of Delaware corporations, remains obliged to consider any takeover bid in good faith and in accordance with a disinterested commitment to shareholder welfare. It is publicly committed to doing so. The record is barren of any basis beyond plaintiffs' speculation, various assumptions by their academic experts and the cynical testimony of Mr. Greenberg to conclude that the Household Board would not act properly and would not be responsive to the same market and shareholder pressures as operate on any other target company board of directors.

Tacitly acknowledging their inability to distinguish the controlling legal authorities, plaintiffs distort and wildly exaggerate what the Rights Plan actually does, based in part on inaccurate record citations. Notably, they assert that the Plan absolutely prevents tender offers and thereby impairs an alleged shareholder "right" to sell in a tender offer. But the Plan has no such effect: the trial evidence shows that tender offers remain a viable means of changing control of Household, even if one assumes -- as plaintiffs do, but contrary to Delaware law -- that the directors will act irresponsibly when faced with an offer.

Moreover, plaintiffs' endlessly repeated assertion of a "right" to a tender offer is simply <u>not</u> the law; even Professor Jensen, who seems to have given birth to the notion, was unable to say where the supposed "right" comes from or where it can be found. It is also an intellectually incoherent concept: one can read and re-read Jensen's testimony without understanding how the existence of such a "right" can be reconciled with the repeated rulings of this and other courts validating board action to defeat tender offers -- and by measures which, as Higgins put it, were "much more dramatic . . . to the company [and] to the value of the remaining securities than what has been done or contemplated here." Plaintiffs' rhetoric is really a smoke-screen for an attempt to erode the well-established legal principle that directors have an essential role in the takeover process.

Nor is plaintiffs' cause advanced by their attempt to put a voting rights "gloss" on their objections to the Plan by asserting that it prevents or impedes proxy contests at Household. Indeed, none of plaintiffs' complaints even alleges that the Plan has such effects, and plaintiffs offered no witness to testify that it did. Moreover, unlike the defensive measures approved by other boards, and deferred to by the courts, the Rights Plan does not give the directors voting control over a large block of stock or pay a dissident a huge sum of money to "go away." Plaintiffs are silent concerning these other situations. But they cannot make their case by presenting no evidence of their own and ignoring defendants'. The record is uncontradicted that the Rights Plan does not in any way affect voting rights, or prevent shareholders from mounting and winning a proxy fight, and that plaintiffs' real grievance is that it strengthens the Board's hand in takeover negotiations and deters certain kinds of tender offer activity.

Under the controlling case law, the fact that the Rights Plan has increased the bargaining power of the Board vis-a-vis prospective acquirors is simply not legally objectionable. Because there is no support for their position in the cases, plaintiffs necessarily ask this Court not to decide legal questions but, in effect, to legislate -- to resolve policy differences which sharply divide the business community concerning the heightened tender offer activity of recent years, and the greenmail and other defensive phenomena which have accompanied it. Plaintiffs and their academic experts ask this Court to decide that tender offer activity is a good thing, and defensive activity a bad thing, for our corporate system.

With respect, defendants submit that this Court cannot give plaintiffs their policy preference. Under basic precepts of Delaware law, this Court's role is to decide whether the Household directors formulated their policy view with the requisite care, and in reliance on qualified experts. They clearly did so; plaintiffs' evidence to support their contrary claims was wholly insufficient. The Court must also satisfy itself that the directors did not act with the sole or primary purpose of entrenching themselves. They clearly did not, and not even Moran was willing to testify that they did. The Court must determine if Household's directors violated their statutory or other legal duties as plaintiffs charged. They clearly did not; as shown below, plaintiffs' arguments that the directors "restricted" alienability within the meaning of DGCL § 202(b), or issued "sham" securities within the meaning of the Telvest case, or were guilty of "inequitable conduct," are without legal merit.

There are numerous appropriate forums for plaintiffs' policy views. The evidence showed that Congress and the SEC are studying the whole question of takeovers and defensive responses with a view toward legislative action. The Delaware General Assembly, with primary legislative responsibility for the governance of Delaware companies, has broad authority to decide the kinds of policy questions plaintiffs have raised. And the Household shareholders can oust the defendant directors -- and Whitehead and Tower -- in favor of Moran if they share his policy views rather than those of all the other directors.

But plaintiffs cannot bypass these other, appropriate forums and put this Court in the position of having to decide whether Moran's policy views, or those of the other Household directors, are the correct ones. That is precisely what the business judgment rule is supposed to prevent.

III. STATEMENT OF FACTS

The uncontradicted evidence demonstrates that Household's adoption of the Rights Plan stemmed from a growing and well-founded concern that the company was unprotected against increasingly common acquisition techniques which are widely regarded as unfair and/or coercive and which have forced target companies to adopt sometimes extreme and destructive defensive responses. The record shows that the Household Board was motivated by a desire to enhance its ability to protect shareholder values, to deter the use of takeover techniques which seek to deprive shareholders of such values, and to avoid leaving themselves with no alternatives but so-called "scorched earth" responses. There is no evidence that the Rights Plan was adopted to serve any other purpose or that the Board intends to use the Plan to deter takeover proposals generally or to prevent a change of control.

A. The Current Takeover Environment

Plaintiffs argue that unsolicited tender offers are "beneficial transactions" and that shareholders have a "right to sell shares in a tender offer" (e.g., PTB 4, 40).* The evidence established a much more complex reality.

While tender offers can indeed be "beneficial transactions," the business environment has been marked by the increasing use of particular takeover techniques which enable bidders to put shareholders under enormous pressures to tender, regardless of whether the price offered fully reflects the real value of the company. Notably, there has been a proliferation of front-end loaded, two-tier offers, often with securities which Abbott described as "wallpaper" proposed for the second-step merger, or -- as in the Mesa bid for GAO -- with no clear indication of the second-step consideration. Abbott III 170-73, IV 59; Jensen IV 233; Higgins VII 21-30, 211-12; Tower X 62-63; DX 25. "Creeping" acquirors purchase minority stock positions, sometimes as little as 10-20%, to achieve practical control without paying any control premium to the shareholders generally (Troubh VIII 17-19; Tower X 70-71; Clark V

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* Trial testimony will be cited by witness and volume number, deposition testimony by witness and "Dep.". Trial exhibits introduced by plaintiffs and defendants will be cited as "PX" and "DX", respectively. Evidence cited in this brief is being filed in separate binders. Trial testimony is indexed by volume number; deposition testimony is indexed by witness. Plaintiffs' and defendants' trial exhibits are indexed by exhibit number. Unreported opinions and other materials cited in this brief as "Exh." are being filed in a separate compendium. Defendants' Pre-Trial Memorandum will be cited as "DPM", Plaintiffs' Pre-Trial Memorandum as "PPM", Plaintiffs' Post-Trial Memorandum as "PTB" and Intervenor's Post-Trial Memorandum as "ITB".

211; Dammeyer X 13-15). Thinly-financed entrepreneurs, promoting low-value bust-up offers, use these techniques, or the threat of them, to obtain "greenmail" (e.g., Higgins VII 30-36; Troubh VIII 24-27; McMahon IX 183-84).

Abbott conceded that a shareholder faced with a front-end loaded offer "has a problem unless management acting on his behalf is able to either stop the tender . . . or . . . get a higher and better offer" (Abbott III 171). Shareholders simply "have no economic choice" and, therefore, "at the last minute, which is what happened in Enstar, everybody tenders" (Abbott III 172-173) (emphasis added). The shareholder recipients of such coercive offers are victims of what is sometimes called the "prisoner's dilemma," which causes individual shareholders to act contrary to what would be in the collective best interests of the shareholders as a whole (see Jensen V 5-8). The ill effects of "creeping" stock acquisitions were also clearly shown by the evidence (e.g., Troubh VIII 17-19, 23-27, 29; DX 12 at H1357-59).

As Abbott suggested, target company directors, recognizing that "you only sell a company once," have had to implement strategies to strengthen the board's hand when confronted with such activity (Abbott III 96, 163). As Professor Jensen stated, the manner in which the benefits of takeover activity are ultimately divided between target and bidder reflects the relative bargaining power of the bidder and the target directors (Jensen V 21). Only the target board can negotiate on behalf of the target's shareholders (Abbott III 173; see also Jensen V 10). The record overwhelmingly confirms that defensive activity by boards of directors is both necessary and beneficial to shareholders (e.g., Abbott III 156-57, 173, 175; Whitehead VI 63, 65; Higgins VII 86-95, 155-56; DX 17).

This defensive activity takes many forms. Directors have authorized a variety of defenses in advance of any actual bid. Thus, by way of example only:

— making acquisitions "just to get rid of the cash that is accumulating" or "buying companies that they otherwise would not have bought at any particular time or for any particular price" (Higgins VII 38);

— making acquisitions of regulated companies (Higgins VII 37);

— placing blocks of stock in "friendly" hands (id.; Troubh VIII 27);

— issuing a "poison pill" preferred stock with a "put" provision that would require the company to redeem all outstanding shares if a triggering event occurred (Troubh VIII 14; Abbott IV 34-35; Higgins VII 70-71; DPM 73n.*).*

The evidence also shows that directors of target companies that are surprised by unfair bids and lack pre-offer defenses have had to resort to post-offer responses having a "dramatic impact" on the target's

* Plaintiffs profess not to understand why issuances of "poison pill" preferred stock are germane here (PTB 56n.*). The issuance of these securities is one of the means which directors have employed to enhance their bargaining position and deter unfair takeover activity, and the evidence shows that not even the "poison pill" preferred prevents takeovers. Troubh, an Enstar director at the time, testified that the Enstar preferred stock was a stronger deterrent to a non-negotiated takeover than the Rights Plan (Troubh VIII 13-14). Yet Enstar was acquired in a negotiated two-tier transaction shortly after the preferred was issued. (Troubh VII 243, 251-55).

own business and on "the value of the remaining securities" (Higgins VII 80). For example:

— Carter Hawley Hale's directors, in selling a crown jewel asset, issuing new voting preferred stock committed to voting with management and purchasing huge quantities of its own stock in the open market, left shareholders with a substantially different investment; Higgins testified that these actions had "ripped the guts out of the company" (Higgins VII 45; DPM 66).

— The Pogo board's issuance of preferred stock to several companies (including one run by its chairman's brother) and then purchasing a substantial amount of its own stock created "a much more highly leveraged company . . . [with] different investment characteristics" (Higgins VII 45; Dammeyer X 25; DPM 66, 68).

— Martin Marietta's "PAC-MAN" counter-tender offer for Bendix produced a company "with absolutely unprecedented debt-equity ratios, negative coverage features such that would in all likelihood . . . change the very operating philosophy [of the business]" (Higgins VII 163).

— The purchase of a weak company by Gearhart, and sales of "crown jewel" subsidiaries by the target company directors involved in the Whittaker and Liggett Group cases (DPM 66-67), materially changed the nature of their businesses; in the Gearhart case, the transaction also materially impacted voting power (Abbott III 72, 109, 112).

— The resort to "greenmail" buyouts by the Disney and Warner boards deprived those companies of cash and credit resources (Abbott III 123-24; Troubh VIII 23-27).

All of these defensive steps were taken by directors without a shareholder vote (e.g., Higgins VII 41-47; Abbott III 116-17). And in most of these cases the boards' actions were deferred to, and expressly upheld by, the courts (DPM 65-69).* Concerning Enstar's "poison pill," this Court observed:

> Viewed fairly, however, the "poison pill" amendments, a measure enacted by the Board when "takeover" fever gripped the industry, could be considered legitimate exercises of Board discretion designed to protect the stockholders against a less than arms-length sale.
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> — Huffington v. Enstar Corp., Del. Ch., C.A. No. 753, Longobardi, V.C. (Apr. 25, 1984), at 7 (Exh. D).

B. The Events Leading Up to the Submission of the Rights Plan and Other Takeover Preparedness Measures to the Household Board of Directors

The record establishes that the Household Board, Moran included, had ample grounds to believe that Household was vulnerable to the types of acquisition techniques that have necessitated defensive responses such as those mentioned above (e.g., Kartalia IX 125-26; Tower X 69-70; Clark V 183-84, 190, 219-27; Moran I 66-67; PX 203 at 7). Indeed, as of August 14, when the Rights Plan was adopted, a company in Household's own industry (Avco) was the subject of a "creeping" stock accumulation program by a company several times smaller (Leucadia); Avco

* The legality of the "greenmail" payments in Disney and Warner has not been adjudicated. It is well settled, however, that payments designed to eliminate a dissident shareholder are generally protected by the business judgment rule. E.g., Cheff v. Mathes, Del. Supr., 199 A.2d 548, 555-56 (1964); Kaplan v. Goldsamt, Del. Ch., 380 A.2d 556, 568-69 (1977); Kors v. Carey, Del. Ch., 158 A.2d 136, 141 (1960).

ultimately made a $100 million buy-out of Leucadia to end its stock accumulation program and to forestall a "bust-up" bid (Clark V 211; Moran I 109-10; Moran II 91-93; PX 203 at 3).*

Moran's own conduct in devising a scheme whereby he and other insiders would make a "bundle of money" by acquiring Household on a low-priced, bust-up basis graphically confirms the directors' judgment that Household is vulnerable to unfair takeover activity. Even if one accepts Moran's protestations that he would not make a "hostile" bid (but see Moran I 72-73, Moran II 181-83; DX 14; DX 12 at H1366), the fact remains

* Plaintiffs attempt to defend "bust-up" transactions (PTB 41-42, 63), and seek to confuse the distinction between such transactions and the more conventional sale of a portion of an acquired company's assets following a fair-priced cash acquisition (e.g., the Texaco/Getty and Socal/Gulf situations). A prospective acquiror with limited resources — unlike Texaco or Socal — will have to stretch to finance an acquisition, and may well have to sell off the assets of the acquired company quickly, perhaps at distress prices, in order to pay off the acquisition debt. Hence, that prospective acquiror will not have the wherewithal to pay full value to the shareholders of the target company (see, e.g., Fahey Dep. 54-55).

The Avco situation is a perfect example: the evidence showed that Leucadia sought to conduct a bust-up takeover of Avco and, indeed, that Leucadia's investment banker (Drexel Burnham of "junk bond" fame) approached Moran and suggested that various pieces of Avco's business might be of interest to either Household or D-K-M (Moran I 109-10; Clark V 228).

This sort of activity, which involves a non-negotiated low-priced offer because of the promoter's thin resources, is to be sharply distinguished from Texaco's all-cash purchase of Getty or Socal's all-cash purchase of Gulf, where the Getty and Gulf boards had the opportunity to negotiate for the benefit of their shareholders with bidders which were "good for the money" (Higgins VII 180).

It should be noted that the buy-out of Leucadia did not end Avco's travail. Since the trial, Irwin Jacobs, who had earlier mounted an assault on Pabst (Troubh VIII 28-30; DX 12 at H1357-59), has purchased 11.3% of the Avco stock, and appears to have embarked on a second attack or a "double dip" as it is known in the mergers and acquisitions field. See Exh. K. The "double dip" device would be deterred, if not eliminated, by the Rights Plan.

that if Moran can see $415 million to be made at the expense of his own shareholder constituents, other promoters can spot a similar opportunity.*

Thus, there is no basis for plaintiffs' claim that "Household's management's actions and the evidence presented show that management was dead set against offers" (PTB 42). To the contrary, the evidence shows that it was outside events, not some management predisposition, which led Household's Board of Directors to become "increasingly aware of takeover attempts" and that Household "didn't have anything in place, any defensive or shareholder protection measures" (Clark V 168; see also Clark V 175-87, 194-206).

The defendant directors were further "sensitized" to Household's exposed position in June. At a special meeting on June 12, the Board approved the acquisition of a controlling interest in Jewel Companies, to rescue Jewel from an unwanted takeover by American Stores.

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* The evidence shows that in late May, 1984, Moran advised Clark that he wanted to talk to him about a D-K-M led leveraged buyout (Clark V 183-84). At their meeting, Moran said that D-K-M believed Household to be worth at least $52 per share and that (to use Moran's own words) a "bundle of money" could be made by D-K-M and members of Household management in a D-K-M led buyout (Clark V 190).

Moran kept after Clark with his "bundle-of-money" scheme. At his request, Clark and Dammeyer visited D-K-M's offices on July 16 to renew the leveraged buyout discussions (Clark V 219). Seeking to whet Clark's appetite, Moran gave them a 22-page analysis showing, <u>inter alia</u>, that a buyout group could reap a profit of $415 million by acquiring Household for $35 per share (Clark V 219-27; DX 22).

The evidence overwhelmingly belies Moran's assertions that Clark and Dammeyer cooperated with him in the buyout scheme (Clark V 185, 193, 207-09, 224-31; Dammeyer X 8-10, Whitehead VI 8-13).

While the acquisition ultimately fell through, the fact that Jewel -- another Chicago-area company -- had been forced to scramble at the eleventh hour in order to try to maximize shareholder values caused the Household directors to reexamine Household's own vulnerability. Clark V 209-211; Clark VI 259; McMahon IX 152-54; Tower X 64-65; PX 97 at H1170A.

At the urging of the Chairman of Household's Executive Committee (outside director Rasmussen), the Board concluded at the June 12 meeting "that management better get busy and get some shareholder protection measures studied and come back with a recommendation" (Clark V 213). Accordingly, Household retained Goldman, Sachs and Wachtell, Lipton, and Clark appointed a committee to develop recommendations with these advisors (Clark V 213-15; McMahon IX 155-57; PX 97 at H1171).

The Rights Plan was carefully considered before being presented to the Board. On July 31, 1984, Clark, Dammeyer and Richard Hull (Household's General Counsel) met with Lipton and Goldman, Sachs to discuss takeover preparedness. Lipton reviewed the current takeover scene in general and the Avco situation in particular (Clark V 236-38; McMahon IX 164-65, 169; DX 44). Clark explained his concerns about Household's exposure to a low-priced takeover or to greenmail and asked what steps could be taken to reduce such vulnerability. The Rights Plan was suggested as an alternative and much of the meeting was devoted to a discussion of it. Clark V 236; McMahon IX 168.

Lipton pointed out that the Plan was a means of strengthening the Board's bargaining position while, because of the redemption feature, preserving its options to deal with different situations. He advised Clark that the Plan would have no adverse impact on Household's ongoing business. Clark neither sought nor obtained advice that the Plan would prevent all takeovers. To the contrary, Lipton stated that it would not. The 20% "control" threshold was discussed and Dammeyer later testified without contradiction that he considered it reasonable. Clark V 237-38; Dammeyer X 13-15, 43-44; see also Tower X 71.

During the following week, Goldman, Sachs ascertained that the market price of Crown Zellerbach's stock had not been adversely affected by its adoption of a similar plan.* They also consulted outside legal counsel, Sullivan & Cromwell, as to their view of the Plan. Goldman, Sachs verified that the Rights Plan would not restrict Household's ability to raise capital. They then advised Household that, assuming the directors were willing to assume the risk of drawing attention to the company by issuing a novel security, the firm would recommend adoption of the

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* Adoption of the Rights Plan has not adversely affected the market price of either Crown Zellerbach or Household common stock. While the stock of Owens-Illinois (which adopted the Rights Plan shortly after Household did) declined from the level prevailing immediately before adoption of the Plan, the evidence showed that the prior market price had been artificially inflated by rumors of an impending takeover attempt. Higgins VII 100, 108-12; Abbott IV 8-9; DX 27, 53. Since plaintiffs repeatedly suggested at trial — without proof -- that these stocks had radically underperformed the market (e.g., Higgins VII 104) we are also filing herewith tables prepared by Salomon Brothers showing indexed stock price histories for all companies that have adopted the Plan through November 13, which clearly refute plaintiffs' assertions (Exh. L).

The evidence also demonstrated that Crown Zellerbach and Owens-Illinois both have independent boards of directors and that in adopting the Plan they were advised by three different investment banking firms (Higgins VII 113-15; DX 29 and 30; see also DX 48).

Plan and related takeover preparedness measures. Clark V 242; McMahon IX 170-75, 177-78, 180-81; Dammeyer X 22-23; Whitehead VI 15-17, 37; DX 13.

After additional staff-work -- including a financial evaluation which led to the $100 a share valuation for the new preferred stock -- and after consultation with several outside directors, management decided to recommend the Rights Plan, and other takeover preparedness proposals, for adoption at the regularly-scheduled August 14 Board meeting (Clark V 242; Dammeyer X 26-29; DX 46). In accordance with customary practice, a "board book" of relevant material was sent out by courier a week or so before the meeting so that the directors could consider management's proposals in advance (Clark V 242-44; PX 191).

C. The Independence of the Household Board of Directors Which Adopted the Rights Plan

Plaintiffs' renewed attacks on the Household Board are belied by the uncontroverted evidence that Household has a predominantly independent Board of Directors, subject to annual elections, which consists of ten outside directors and six who are members of Household's management (Clark V 165-66; Whitehead VI 25-28; Kartalia IX 109-18; DX 2 at 4-7, 8-10).* The independence of the Household Board reflects the

* Moran expressly conceded that eight of Household's directors are outside directors (Moran II 12-13, 16). A ninth (Rasmussen) is a "very, very independent person" (Whitehead VI 28) whom Moran acknowledged he had supported for Chairman of the Executive Committee (Moran II 41-42), a post which is required to be filled by an outside director (DX 10 at 2). And a tenth director (Rauch) was never in Household's employ, although he did serve at one time as outside counsel to the company (Rauch Dep. 9).

implementation of carefully considered policies. The evidence showed that, in early 1983, the directors (including Moran) unanimously adopted the report of an Ad Hoc Committee to review the role of the Board, which had recommended that a preponderance of the directors should consist of individuals who are not members of management and that the Chairman of the Executive Committee, and all other members except the Chief Executive Officer, be non-management directors (DX 9 at 2, 3; DX 10 at 2; Moran II 40).

John Whitehead, co-chairman of Goldman, Sachs whose "clear independence," judgment and integrity are conceded (Moran II 44), testified that his fellow Household directors comprise a "very independent board" which has had "sharp disagreements" with management (Whitehead VI 25-27; see also Kartalia IX 111-12, 118).* Even Moran was unwilling to characterize his fellow directors as a "rubber stamp board" -- except when they disagree with him (Moran II 192).

D. The Deliberations at the August 14, 1984 Meeting of the Household Board of Directors

The evidence does not support plaintiffs' attacks on the quality of the Board's deliberations at the August 14 meeting, the claimed misrepresentations by the Board's special counsel or the allegedly undue haste with which the Board acted (PTB 57-65).

* Any contention that the directors who approved the Rights Plan were "entrenchment-minded" is further weakened by the undisputed evidence that within the next few months two outside directors will leave the Board upon reaching mandatory retirement age and that two inside directors will leave the Board upon their retirement from Household (Clark V 166-67; Kartalia IX 106; Tait Dep. 4; Hendry Dep. 8).

The Board's discussion occupied about two hours of the morning session and continued in an afternoon session that Moran chose to skip to attend a committee meeting at another company (Clark V 259; Whitehead VI 19, 23; Moran I 138). Whitehead squarely testified concerning the Rights Plan that, "I felt I had had enough chance to consider it" (Whitehead VI 22). Another outside director, defendant Kartalia, testified that the August 14 meeting was one of the longest he has attended in his 12 years as a director (Kartalia IX 123). And Dammeyer — on the basis of extensive personal experience, in part as a former Arthur Andersen partner (Dammeyer X 5-6) -- stated that:

> [T]he combination of the extensive presentations by both Wachtell, Lipton and by Goldman, Sachs, and then what I would describe as a very free flowing give and take discussion of the plan and the four recommendations and the various issues associated with that was as extensive, or more extensive, than any that I have witnessed in complex mergers and acquisitions or financing transactions at companies that I have attended their board meetings.
>
> — Dammeyer X 32-33.

During the morning session, Lipton described the current takeover climate and possible actions that Household might take. He explained each of the four proposals management was recommending for Board approval (PX 203 at 2-4). Since plaintiffs have persisted in their attacks on "special counsel" (<u>i.e.</u>, Lipton), it bears emphasis that McMahon of Goldman, Sachs also made a detailed presentation in which he not only stated that the company was vulnerable to a low-priced takeover proposal, but endorsed Lipton's analysis of the current takeover climate and advised the Board that Goldman, Sachs and Wachtell, Lipton had worked closely together in developing the Rights Plan. He told the directors that Goldman, Sachs believed that the proposed takeover preparedness measures, including the Rights Plan, would discourage two-tier offers and other disadvantageous acquisition attempts but would not stop a takeover of the company. McMahon IX 181-208; DX 45; PX 203 at 5; see also Dammeyer X 13.

The Board then reviewed management's recommendations one by one (PX 203 at 5-10). Moran and the other directors unanimously adopted bylaw amendments designed, inter alia, to strengthen the hand of the Board in a takeover contest by regulating the calling of shareholder meetings and the use of written consents. Moran did not suggest that this admittedly anti-takeover measure be submitted to a shareholder vote, or that there was anything wrong with adopting it in the absence of any particular takeover threat (Moran II 85-87; PX 203 at 6).*

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* The Board also amended certain Household benefit plans to permit employees to determine whether Household stock held for their accounts should be tendered in a tender offer. At Whitehead's suggestion the plans were also amended to provide that the employees also be given the right to vote with respect to such shares when a shareholder vote was required (Whitehead VI 55; Moran II 87-88). The directors concluded that these amendments "would improve morale of the people of the company [by] giving them an opportunity to have a voice in what their [company's] potential ownership was" (Kartalia IX 145-46). Even Moran viewed the amendments as exemplifying shareholder democracy (Moran I 202).

Contrary to the intervenor's claim, the effect of ERISA upon the proposal was considered (Clark VI 250). Defendants are not sure whether the intervenor is still seeking an adjudication of any ERISA claim by this Court. See p. 2, n.*, supra. In any event, however, this Court cannot adjudicate any such claim inasmuch as (a) the intervenor has pleaded no ERISA claim; (b) the intervenor lacks standing to prosecute any ERISA claim; and (c) this Court lacks subject matter jurisdiction over claims arising under ERISA. See pp. 3-4 and 6-12 of Memorandum of Defendants in Opposition to Allowing Into Evidence the Proposed Testimony of Professor John Langbein, dated October 1, 1984.

When discussion turned to the Rights Plan, Moran made a strong statement of his negative views and raised a number of questions.* His views were considered by the directors. Whitehead VI 19-20; PX 203 at 6-9.

Moran won no support for his views.** After hearing his objections, several directors expressed approval of the Rights Plan (PX 203 at 10). As they later testified, they believed that Household was a strong company with a bright future but undervalued in the market place and therefore vulnerable to a low-priced takeover attempt (e.g., Clark V 205, 261; Kartalia IX 125, 126, 141; Tower X 69-70; see also Whitehead VI 10-12, 31; Moran I 82; Moran II 83-84). They wanted to deter unfair two-tier front-end loaded and low-priced bust-up tender offers, and to reduce the

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* In response to one of Moran's questions, Lipton expressed the view that the Rights Plan was not invalid under the recent Norlin decision in the Second Circuit invalidating board action which had concentrated voting control over 49% of the company's stock in the directors' hands (see pp. 54-55, infra). Lipton also advised the directors that his firm and Richards, Layton & Finger were prepared to (and both firms subsequently did) render opinions as to the legality of the Plan. While plaintiffs persist in their charge that Delaware counsel's opinion was "affirmatively misrepresented" (PTB 64), they fail to mention the clear deposition testimony of General Counsel Hull that he understood that the Richards, Layton opinion, like the Wachtell, Lipton opinion, did stand for the proposition that the Rights are enforceable (Hull Dep. 8). Moreover, both opinions state or assume on their face that adoption of the Rights Plan is a transaction to which the business judgment rule applies, if its requirements of due care and good faith are met (PX 238 at 3; 243 at 2). See also Transcript of Proceedings herein dated September 17, 1984, pp. 56-57.

** Moran claimed that Clark sought to unfairly prejudice the directors against him by telling them that D-K-M planned to make a hostile tender offer for Household and that the directors therefore had to act quickly to stop it (see Moran I 173-74). However, Whitehead's testimony, and the other evidence, demonstrates that Clark never said any such thing (Kartalia IX 120-23; Tower X 66-68; Whitehead VI 15).

risk of demands for greenmail, by encouraging "any and all" offers (Clark V 262, 266-67; Clark VI 78; Kartalia IX 123-24; Tower X 71-72; PX 313 at 3).

The directors wanted to create a "path of least resistance" which would encourage prospective acquirors to negotiate with the Board so that the directors could try to maximize shareholder values (Kartalia IX 125; Clark V 265-68; Tower X 71-73). They were impressed with the flexibility of the Plan which provides for redemption of the Rights in order to facilitate an advantageous offer (Clark V 263). And they believed that, while the Rights Plan has both advantages and disadvantages, it was reasonably calculated to achieve its objectives (Clark V 271; Clark VI 75-76).*

Further, the directors believed that advance planning such as the Rights Plan is far preferable to the last-minute devices which other companies have been forced to use when faced with an unfair or inadequate offer -- devices which radically altered the structure of the targets' businesses and had "substantial adverse ramifications for them down the road" (Clark V 263-66; Kartalia IX 125-26; Tower X 71-73; Dammeyer X 25). As Tower -- who has had prior experience on both sides of takeover controversies -- put it:

> [A] lot of the alternatives, and some that I'm familiar with, are sort of irrevocable alternatives in which you create a situation which is irreversible. The thing I like about this plan is that under any

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* The extensive deposition testimony concerning the directors' reasons for adopting the Plan is summarized in DPM 47-50.

> number of circumstances the board of directors in their interest of maximizing the shareholders' wealth can redeem those rights through purchase, and therefore an acquiror has a fair chance of acquiring the company if the value is appropriate. They haven't had a scorched earth situation. It's still evergreen.
>
> — Tower X 73.

The trial record leaves no doubt that Tower was perfectly correct: by any possible criterion, the Rights Plan leaves Household "evergreen" when judged against other defensive techniques. Thus, the Rights Plan neither results in any outflow of money from the corporation (Higgins VII 97) nor impairs its financial flexibility (Dammeyer X 24). It has no adverse effect upon Household's balance sheet, assets or income statement (Higgins VII 80-81). It does not impair the day to day conduct of Household's businesses (Clark V 241; Higgins VII 81) or dilute earnings per share (PX 191 at H422). It has no adverse tax consequences for the corporation or its shareholders (Clark V 241; PX 191 at H422). And the Plan has not had any adverse effects upon the market price of Household common stock -- notwithstanding Greenberg's testimony that, if a company had made itself "takeover-proof," the effect on the stock would be "very negative" (Greenberg IV 98-99; Higgins VII 100, 109-12; Abbott IV 8-9; DX 27).

Whitehead opposed adoption of the Plan, but not on the same grounds as Moran. As he testified at trial:

> [A]s I explained at the meeting, my reasons for voting against the plan as I did were different from Mr. Moran's. Mr. Moran voted against it on the substance of the plan, which he felt was undesirable, but I voted against it

> not because I disapproved of the substance, because I was sympathetic to the objectives of the plan, but because I knew that the plan was somewhat untested, novel and would be controversial, and that for Household to adopt it would bring publicity to the company as a company that was worried about being raided by unfriendly suitors. And I did not think that was in the company's interest to attract such publicity, and I was reluctant to see Household receive publicity in this area. And so I felt it was unwise for the company to proceed to adopt it, thought at least it should be deferred for a couple of months until other companies had adopted it, as I felt was likely, and that, therefore, for Household to adopt it at a later stage would make its adoption less visible.
>
> — Whitehead VI 20-21; see also DX 13.

When the vote was taken, Moran lost 14 to 2. And Whitehead, who cast the only other negative vote, has subsequently concluded that he would now support the Plan. As he testified at trial, "the harm I feared having already come to the company in greater measure than I feared, I would today vote in favor of the plan, or vote to keep the plan in effect" (Whitehead VI 41).

E. Plaintiffs' Other Attacks on the Board's Deliberations

Plaintiffs' attack on the Board's deliberations consists largely of assertions that the Board was misled about, or failed to understand, certain alleged "facts" — such as that the Rights Plan prevents tender offers or impedes proxy fights (PTM 60-62). But these are mere "boot-strap" assertions: as will be demonstrated in Section IV B, infra, the alleged "facts" are not facts at all, and neither the directors nor their advisors merit any blame for failing to adopt plaintiffs' argumentative contentions.

Plaintiffs' "procedural" objections stand no better. Their attacks on the directors for relying upon counsel's summary of the Rights Agreement rather than reading it themselves (PTB 58-60) ignore the uncontradicted trial evidence that corporate directors do not, and are not expected to, familiarize themselves with detailed legal documents (Whitehead VI 24-25; Troubh VIII 3-5; Clark VI 88-89; Abbott IV 42).* And it would open up a Pandora's box were courts to rule, as plaintiffs implicitly contend, that if corporate directors can be shown by artful questioning not to appreciate or remember all the complexities of a given legal document, their action in approving the transaction to which it relates must be voided.

Plaintiffs scrape the bottom of the barrel in their discussion entitled "One-Sided Presentation" (PTB 62-65) which, among other "arguments," takes Goldman, Sachs to task for using what plaintiffs call "emotion-charged epithets," and for failing to tell the directors that a tender offer is made at a premium or explaining why 20% stock ownership is a fair level at which to presume that control of a company has shifted. The Household directors are not children; the Board comprises prominent individuals of substantial practical experience, including not only Whitehead, the head of a major investment banking firm, but the president of a company (director Tower) which, the evidence shows, just recently

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* Thus, for example, in the case of Enstar's decision to issue the so-called "poison pill" preferred stock, Troubh, an Enstar director at the time, testified that he had not read the certificate of designation (DX 37) and did not consider himself derelict (Troubh VIII 3-5). Likewise, plaintiffs' expert Abbott testified that clients of Morgan Stanley whom he represented in complex leasing transactions did not read the underlying documentation and were not irresponsible for failing to do so (Abbott IV 42).

was involved in making a two-tier, front-end loaded tender offer (Tower X 61-63).*

Plaintiffs also are tellingly silent about why, if their points were so fundamental to the merits of the Plan, the defendant directors and director Tower have adhered to their decision -- and Whitehead has now joined it -- even after their extensive questioning on all the issues raised in this case. Nor do plaintiffs explain why Moran, who expressed himself strongly against the Plan, and showed a sophisticated awareness of current takeover developments, did not mention any of them at the meeting.**

* As Tower candidly testified, the precise purpose of structuring the transaction with a "front-end load" was to cause selling shareholders concern "that they might miss out on the opportunity of maximizing their price" (Tower X 63). Moreover, there is no merit to plaintiffs' repeated claim (PTB 8n.*, 41-42) that Tower's endorsement of U.S. Steel's front-end loaded offer for Marathon somehow "impeaches" defendants' assertions as to the unfairness of this particular acquisition technique. Tower's testimony makes clear that the U.S. Steel offer was a negotiated response to a lower front-end loaded offer by Mobil that had already subjected the Marathon shareholders to pressure to tender (Tower X 60-61).

** For example, the record is clear that Moran did not quarrel with the 20% "control" threshold of which plaintiffs now make so much, although it was prominently set forth in the Plan summary given to the directors and Moran concededly was well aware of it (PX 183, at 1, 3; Moran II 166). Presumably, he, like Tower, knows full well of the general understanding in the business world that a 20% interest is "really tantamount to having control, or can be interpreted as having control" (Tower X 71; see also Dammeyer X 13-15). Moran must also have recognized that, as Clark testified, the possibility that someone might seek to make a 20% stock acquisition for non-control purposes -- an investment of some $400 million -- is extremely dubious (Clark VI 86-87; see also Whitehead VI 58).

The evidence showed that companies have adopted various defenses against such "creeping" stock accumulations in which control is achieved upon terms that do not treat all shareholders fairly and equally. This,

(footnote continued)

F. There Was No Evidence That the Household Board Adopted the Rights Plan for Improper Reasons

Plaintiffs failed to present any credible evidence that the Household directors had voted for the Rights Plan for the sole or primary purpose of entrenching themselves. Plaintiffs offered no evidence whatever that the directors were motivated by a wish to preserve their emoluments of office, to immunize themselves from shareholder challenge or to make Household invulnerable to any takeover attempt. Indeed, it was Moran's vote, if any, that was self-interested.*

(footnote continued)

of course, is why companies such as Avco, Disney and Warner Communications have found themselves forced to take the much more damaging step of buying out the "creeping" stock accumulator (Clark V 211; Abbott III 123-24; Troubh VIII 23-27). This is why Becton-Dickinson went to court to oppose Sun's "midnight raid," and although it ultimately won its case, Troubh testified without contradiction that it went through enormous corporate disruption in the meantime which might have been prevented if it had had a defensive measure such as the Rights Plan already in place (Troubh VIII 17-23).

* The evidence demonstrated that, as Moran well knew, D-K-M has little need for shareholder protection of the type provided by the Rights Plan. Under Household's charter, a two-thirds vote of the holders of Household's preferred stock is required to approve mergers and other consolidations, and hence D-K-M's ownership of 36% of that stock gives it a blocking position (Moran II 22-28; DX 4, 5). Moran, on the other hand, had a definite self-interest, arising out of D-K-M's scheme to acquire Household on the cheap, in ensuring that the shareholders at large would not have comparable protection.

D-K-M formulated its plan to acquire Household on the basis of material inside information which Moran learned in his capacity as a director of Household (Clark VI 91-94; Moran III 9-10). Moran shared this information with his associates, none of whom is a Household director, and sought to use it to structure a transaction in which Moran, Dyson and D-K-M would reap huge profits at the expense of the Household shareholders (Moran III 10-11; Dyson Dep. 42; PX 262-64, 267). And Moran evidently gave no thought at all to the possibility of a transaction in

(footnote continued)

Likewise, there is no evidentiary basis for plaintiffs' false premise -- which permeates their post-trial briefs -- that the Household Board will use the Rights Plan to deter advantageous acquisition proposals and thereby deprive the shareholders of the opportunity to obtain millions of dollars in increased wealth. To the contrary, the Household Board is publicly committed to considering in good faith all offers that may be made or proposed. And as Clark stated in a letter to shareholders dated September 21, 1984:

> The Board reconfirms its intention that if anyone makes an attractive acquisition offer that treats all shareholders equally and fairly and asks that the Board redeem the outstanding Rights, the Board *will do so.*
>
> — PX 313 at 3 (emphasis in original).

The Board fully intends to honor this commitment (Clark V 267; Clark VI 78; Kartalia IX 126-30; see also Moran II 189-90).

(footnote continued)

which D-K-M would share with the other shareholders, in proportion to their respective interests in the corporation, the gains representing the difference between Household's market price and its real value (Moran III 16). See also DPM 26-36.

The legal principles applicable to fiduciaries in cases such as this are fully set forth in Defendants' Pre-Trial Memorandum (at pp. 99-106). On the basis of these authorities, and on the record herein, the Moran plaintiffs are barred by "unclean hands" from obtaining any relief from this Court of equity. By the same token, Household is entitled to judgment on its counterclaim against Moran, Dyson and D-K-M.

IV. THE ACTION OF THE HOUSEHOLD BOARD IN ADOPTING THE RIGHTS PLAN IS FULLY PROTECTED BY THE BUSINESS JUDGMENT RULE

A. This Case is Governed by the Business Judgment Rule

Defendants have previously demonstrated that the business judgment rule requires the courts to uphold corporate action if the directors acted in good faith and for any rational business purpose, absent some showing of illegality (see IV C., infra). Moreover, the good faith of the directors is presumed — particularly where, as here, a majority of the board consists of independent outside directors. This basic rule of corporate governance applies to takeover-related actions as well as to all other business decisions. See generally DPM 61-70.

Indeed, it has been repeatedly held under Delaware law that the plaintiff has the burden of pleading and proving that self-perpetuation or some other improper purpose is the "sole or primary purpose" of challenged corporate action. For example, in Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), cert. denied, 450 U.S. 999 (1981), the Third Circuit, speaking through Chief Judge Seitz (a former Chancellor), declared:

> 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.
>
> — Id. at 292-93 (emphasis added).*

Similarly, in the Delaware Supreme Court's recent Pogostin decision, where plaintiffs contended that directors' action opposing a tender offer had the purpose and effect of entrenching management, the Supreme Court squarely held that a complaint which failed to plead specific facts showing such an improper purpose was defective, stating:

> . . . plaintiffs seek to establish a motive or primary purpose to retain control only by showing that the City board opposed a tender offer. Acceptance of such an argument would condemn any board, which successfully avoided a takeover, regardless of whether that board properly determined that it was acting in the best interests of the shareholders.
>
> — Pogostin v. Rice, Del. Supr., 480 A.2d 619, 627 (1984).

And in Thompson v. Enstar Corp., this Court reasoned as follows in rejecting an attack upon the directors' decision to enter into a friendly merger transaction in which a "lock-up" was granted:

> The burden is therefore upon the plaintiffs to show that there is a reasonable probability that the directors' acts are not protected by the business

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* In so holding, the Court distinguished Bennett v. Propp, Del. Supr., 187 A.2d 405 (1962), which plaintiffs erroneously rely upon here (PTB 45) (629 F.2d at 293). The Court also expressly approved the lower court's charge to the jury that "so long as other rational business reasons support a director's decision, the mere fact that the decision involves a retention of control does not constitute a showing of bad faith to rebut the business judgment rule" (id. at 292).

> judgment rule. The plaintiffs have not shown that the 10 outside directors were in any way disqualified to act independently and they are therefore entitled to the presumption of propriety afforded by the rule unless it can be shown that they acted improperly.
>
> — Thompson v. Enstar Corp., Del. Ch., C.A. Nos. 7641, 7643, Hartnett, V.C. (June 20, 1984, revised July 5, 1984, revised Aug. 16, 1984), at 7 (Exh. I).*

The business judgment rule is fatal to plaintiffs' case. The evidence showed that the Rights Plan was adopted in good faith by an independent Board acting for rational business purposes and that other independent boards, acting on the advice of other outside investment bankers, have also adopted the Plan. The evidence also showed that the Rights Plan enhances the bargaining power of the Board vis-a-vis potential acquirors and deters unfair takeover techniques. Yet plaintiffs would have this Court invalidate the Plan and thereby strengthen the hand of a prospective acquiror seeking to pay the lowest possible price.

Any such action could only make sense on an assumption that the Household Board cannot be trusted to act responsibly and to redeem

* Plaintiffs' suggestion (PTB 43-45) that this Court's decision in Enstar requires defendants to prove the fairness of the Rights Plan is a mis-reading of that case. Vice Chancellor Hartnett stated (in words plaintiffs quote) that a "lock-up" arrangement should be given "careful scrutiny," but he also made clear (in words plaintiffs omit) that ultimately "the test of whether a lock-up provision should be upheld is whether management acted reasonably" (slip op. at 12). The Court thus made clear that lock-ups are not subject to an entire fairness test but rather to the business judgment rule carefully applied. And the Court concluded that the Enstar plaintiffs had not met their burden of proof under the business judgment rule (id. at 12, 13).

the Rights in appropriate circumstances. But that assumption is directly contrary to the presumption of good faith embodied in Delaware law. As this Court stated in another of the Enstar cases:

> The "worst scenario" suppositions of the Plaintiffs are based on speculation. For instance, they want the Court to assume that there will be a sale and yet there is no guarantee that a sale will occur. They want the Court to assume that the Board will breach its fiduciary duties and conclude a sale that is not in the best interests of the stockholders or which is not fair. Should we speculate that this would occur? Even if it did occur, would not the stockholders have an opportunity to either seek an injunction to prevent the sale or to vote it down?
>
> — Huffington v. Enstar Corp., Del. Ch., C.A. No. 7543, Longobardi, V.C. (Apr. 25, 1984), at 8 (Exh. D).*

Plaintiffs failed to introduce any evidence of an "entrenchment" purpose or some other improper motive and, therefore, have failed to rebut the presumption of good faith. And their briefs ignore defendants' showing that Household has a predominantly independent Board which is committed to policies designed to ensure the dominance of outside directors now and in the future (see pp. 20-21, supra).

Accordingly, plaintiffs seek to distinguish the relevant cases under the business judgment rule. But their "arguments" to this end cannot withstand analysis.

Thus, first, plaintiffs argue that the business judgment rule is not an "independent source of power," and that directors' good

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* See also Gearhart Industries, Inc. v. Smith International, Inc., 741 F.2d 707, 724 n.10 (5th Cir. 1984).

faith cannot itself validate Board action (PTB 36-43). But this is a red herring. Defendants do not claim that the business judgment rule authorized the transaction, but that the rule protects the Board from second-guessing. The Rights were issued pursuant to DGCL § 157, and the certificate of designation of the underlying preferred stock was filed pursuant to DGCL § 151(g). These statutes authorize the issuance of securities pursuant to the Rights Plan not one whit less than, to use plaintiffs' examples from other takeover-defense situations, DGCL § 160 authorizes "[r]epurchase programs and self-tenders like those in Carter Hawley and Pogo" (PTB 53) or "DGCL § 122(4) and comparable statutes in other jurisdictions" authorize "crown-jewel" asset sales (PTB 52-53).*

Second, plaintiffs assert that this case falls outside the business judgment rule because the Rights Plan does not relate to "a specific takeover attempt" (PTB 50). This is an astounding contention. Plaintiffs are saying that the directors of a Delaware company must sit passively by and take no action until "the blood is on the water" and their room to maneuver critically reduced. Plaintiffs assert that prudent advance planning is prohibited by Delaware law, although last-minute

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* Defendants have previously shown (DPM 81-90) that, contrary to plaintiffs' interpretation of the statute (PPM 61-63), DGCL § 157 does not prohibit the issuance of rights which provide for a flip-over into securities of a successor corporation. The trial record shows, moreover, that flipover or "anti-destruction" provisions in corporate securities are common and indeed that Household's stock option plan and D-K-M's Household preferred stock both have such a feature (Higgins VII 115-17; Moran II 33-36; DX 5, 7). Plaintiffs' only argument in response (PTB 33-36) is that the flip-over feature of the Rights is supposedly designed to prevent takeovers rather than to preserve the value of the Rights. But this argument is both unsound, see IV B, IV C, infra, and wholly irrelevant to the statutory analysis of DGCL § 157, which prohibits neither type of security.

defensive responses, which may inflict damage on the company's underlying business, are countenanced. Plaintiffs seek to reduce a legal doctrine of general applicability to a narrow rule pertinent only to particular types of business decisions.

Plaintiffs do not and cannot cite any authority for the proposition that antitakeover devices that operate prospectively are outside the scope of the business judgment rule. Both sides' investment bankers, Abbott as well as Higgins, specifically testified that it is a regular part of their firms' businesses to recommend preparedness measures in the absence of an actual offer -- which would make no sense if plaintiffs' argument were sound (Abbott III 138-39; Higgins VII 95-96). Moran's support, at the August 14 meeting, for the amendment to Household's bylaws regulating consent solicitations bespeaks his recognition that prophylactic measures adopted in advance of any specific takeover attempt are perfectly lawful. This Court's refusal to enjoin Bell & Howell's issuance of a so-called "poison pill" preferred stock, designed to deter future front-end loaded and partial offers, likewise supports the validity of such prophylactic devices. National Education Corporation v. Bell & Howell Co., Del. Ch., C.A. No. 7278, Brown, C. (Aug. 25, 1983) (Exh. F). Chancellor Brown's opinion does not even suggest that the business judgment rule was inapplicable because of the prospective effect of the particular anti-takeover device involved there.* And plaintiffs simply ignore the testimony of their own expert that even a defense which

* Plaintiffs ignore Bell & Howell in their "analysis" of the business judgment rule apparently because, as they note elsewhere (PTB 31), the Court did not hold that Bell & Howell had affirmatively established that the preferred stock issuance was legal. This argument, however, reverses the burden of proof in this case.

is used to block a particular offer also serves as a deterrent to future, unknown offers (Abbott III 112-13, 117-18; see also Higgins VII 46-47).

Third, plaintiffs try to whittle away the business judgment rule by arguing that the Household Board could not seek to deter unfair takeover tactics because, in plaintiffs' phrase, they are "entirely lawful" (PTB 41). But the issue is one of economics, not legality. The business judgment rule recognizes directors' prerogatives under DGCL § 141(a) with respect to "the business and affairs of every corporation organized under this chapter." It permits directors to bring their collective judgment to bear upon matters of business policy -- which the courts are ill-equipped to decide -- to take steps calculated to advance what they perceive to be in the shareholders' economic interests (DPM 55-69). Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984); Auerbach v. Bennett, 393 N.E.2d 994, 1000 (N.Y. 1979).

Fourth, plaintiffs try to shrink the business judgment rule further by arguing (PTB 50-52) that it is inapplicable here because the Rights Plan supposedly lacks independent economic substance. But none of the controlling cases adopts -- or even suggests -- such an independent "economic substance" test (DPM 61-69). Repeatedly and explicitly the cases recognize that preventing harmful takeover activity is itself of great "economic substance." See, e.g., Pogo Producing Co. v. Northwest Industries, Inc., C.A. No. H-83-2667 (S.D. Tex. May 24, 1983), at 9-11 (Exh. G).*

Furthermore, the Rights Plan clearly does have substantial economic significance. As noted above, the Plan seeks to channel takeover offers to the Board and thereby enhance the power of the Board to negotiate the highest possible price for Household shareholders in a situation where only the Board can realistically perform such a negotiating role (Abbott III 173). It prevents the Board from being "over a barrel" in such takeover negotiations, as Jewel Companies very nearly was just last June. It deters prospective acquirors from bypassing the Board and employing coercive acquisition techniques which leave shareholders with no economic choice but to tender regardless of the fairness of the price. It also ensures that, if a non-negotiated second-step transaction is effected, the Household shareholders will receive real value and an ongoing, substantial equity interest in the surviving enterprise, notwithstanding the acquiror's wish to issue what Abbott called

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* Plaintiffs assert in this connection that "[i]n not a single case [cited by defendants] did the device block the hostile takeover to which it was specifically addressed" (PTB 54). This assertion is both illogical and untrue.

Plaintiffs seem to be saying that an anti-takeover device is within the business judgment rule only if it ultimately proves to be unsuccessful. None of the cited cases -- most of which arose in a preliminary injunction context before the ultimate outcome was or could be known -- remotely supports any such notion.

Further, plaintiffs distort the facts. They surely know that the defensive tactics at issue in Carter Hawley were successful, that The Limited dropped its offer and that Carter Hawley remains an independent company. Plaintiffs surely know that, by way of example only, the defensive tactics in Pogo defeated the offerors' bid for control, that Brunswick's sale of the "crown jewel" subsidiary involved in Whittaker stopped the hostile offeror's takeover bid, and that the "PAC-MAN" defense in Martin Marietta ultimately resulted in the target remaining independent while the "raider" (Bendix) disappeared (Abbott III 107).

"wallpaper" in the second-step merger (Abbott III 170; Abbott IV 59) or the acquiror's refusal to make <u>any</u> commitment about the second step (DX 25).

Finally, plaintiffs' argument (PTB 54-56) that the Rights Plan is "beyond the pale" because of its allegedly far-reaching impact upon shareholder "rights" turns the business judgment rule cases upside down. The business judgment rule recognizes that, in takeover and non-takeover situations alike, it is the directors, not the shareholders, who have the responsibility -- and the burden -- for the corporation's governance.* The cases recognize and enforce the principle that shareholders

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* Indeed, this Court has recently held that the business judgment rule applies to board action even if the directors believe the action is <u>contrary</u> to the wishes of a majority of the shareholders. <u>American International Rent A Car, Inc.</u> v. <u>Cross</u>, Del. Ch., C.A. No. 7483, Berger, V.C. (May 9, 1984) (Exh. A). There, the directors had convened a shareholders' meeting to consider repealing a bylaw but, when opposition developed, removed the question from the shareholders and amended the bylaws themselves. Rejecting plaintiffs' attack on the directors, this Court stated:

> . . . [P]laintiff has not met its burden of rebutting the presumption of the business judgment rule that the Board acted to amend the bylaw in the good faith belief that such action was in the best interests of the company and its stockholders. <u>See</u> <u>Aronson</u> v. <u>Lewis</u>, Del. Supr., No. 203, 1983, Moore, J. (March 1, 1984). <u>Nor am I persuaded that it is a per se breach of fiduciary duty for the Board to act in a manner which it may believe is contrary to the wishes of a majority of the company's stockholders</u>. If the Board has such a belief it would be expected that the stockholders' opposing views be given due consideration by the Board. However, <u>I do not believe that stockholder opposition automatically overrides the other factors that the Board considers in exercising its business judgment</u>.
>
> -- Slip op. at 7-8 (emphasis added).

This reasoning is fully consistent with the testimony of Troubh describing the Enstar directors' approval of the "poison pill" even though the Enstar shareholders had earlier defeated a "fair price" amendment (Troubh VII 248-51; see also <u>e.g.</u>, Higgins VII 165).

have a right to their directors' honest business judgment -- that, in Higgins' words, they have "a right to participate in the economic life of [the] company" (Higgins VII 83-84). The cases are flatly inconsistent with plaintiffs' contention that shareholders have a "right" to a tender offer.

* * *

Plaintiffs cannot distinguish the controlling business judgment cases. Their rhetoric about shareholder "rights" to a tender offer cannot hide their inability to articulate any principled distinction which would permit the courts to override the business judgment of directors who adopt the Rights Plan and yet defer to the business judgment of directors who approve sales of "crown jewel" assets, the issuance of "springing" warrants, the parking of stock in friendly hands, the purchase of subsidiaries to create regulatory blocks and other devices which deny shareholders access to tender offers.*

The logic of plaintiffs' position is that a board of directors <u>should</u> not have a role in determining the ultimate fate of the company entrusted to their direction. The essence of plaintiffs' position was captured by the testimony of Professor Jensen that, "absolutely," it would "better serve" shareholders to let arbitrageurs decide the fate of an offer, rather than the company's directors (Jensen IV 225). Although

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* Professor Jensen conceded that there is no academic research that would validate his opinion that the Rights Plan is more "extreme" than those other defensive devices (Jensen IV 199-201).

Jensen, like plaintiffs, paid lip-service to the directors' role, one simply cannot reconcile their position with the repeated holdings of the Delaware courts that a board of directors may, and must, act to protect shareholders from takeovers that are not in the interest of the shareholders as a whole, whatever the arbitrageurs may want (DPM 61-69).

The severe qualifications plaintiffs seek to impose upon the Delaware business judgment rule are without precedent. Plaintiffs ask this Court to work a fundamental reformulation of the law based upon their expert's policy judgment that directors have no rightful place in determining when, and at what price, a company should be sold.

The policy judgment that plaintiffs ask this Court to make is precisely that which the United States Court of Appeals for the Ninth Circuit refused to make in its recent opinion in Jewel Companies, Inc. v. Pay Less Drug Stores Northwest, Inc., 741 F.2d 1555 (9th Cir. 1984) (applying California law), which seems almost to have been written with Professor Jensen in mind. Reversing the District Court, which had invalidated a merger agreement provision precluding the board from seeking a higher price pending a shareholder vote, the Court of Appeals declared:

> . . . [T]he district court's policy premise, that the sole aim of corporate law in these matters is to promote active competition among corporate conglomerates interested in acquiring new targets is a highly controversial point of view and by no means represents the consensus of courts and commentators that have considered the question. No authority has previously suggested that the market for corporate acquisitions is unbounded by traditional principles of contract

> and corporate law. It is not the function of the courts to fashion so novel a rule or to resolve the policy disputes that have divided the economic experts. That task, if it is to be performed at all, is best left to the California legislature.
>
> — Id. at 1568 (emphasis added).*

This reasoning is a complete answer to plaintiffs' reliance upon the views of Professor Jensen and to the various policy arguments which permeate their briefs. As the Jewel case indicates, plaintiffs are pleading their "case" in the wrong forum.

B. The Rights Plan is Fair to Household Shareholders.

Plaintiffs argue, under a variety of legal rubrics, that the Household Rights Plan must be invalidated because it allegedly immunizes the directors from challenge by means of a tender offer or proxy fight

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* The controversial nature of the underlying policy issues plaintiffs have raised in this litigation was amply demonstrated by plaintiffs' own experts (see, e.g., Abbott IV 47-48 (whether two-tier and partial offers are coercive is the subject of very current and intensive debate in the mergers and acquisitions community); Jensen IV 211 (two-tier pricing is an area of extensive current controversy); Jensen V 62-63 (theory that takeover activity promotes economic "efficiency" is subject to dispute); Bradley V 129-33 (SEC and Congress are both studying fairness of two-tier offers); Moran II 57 (a spectrum of views exists as to proper roles of management and shareholders); see also, e.g., PX 191 at H401 et seq. (article entitled "Will Money Managers Wreck the Economy" reflects varying views as to whether takeover activity tends to force corporate managements to focus unduly upon short-term values).

The ongoing debate concerning these issues is also reflected in several other publications subsequent to the trial herein (see Exh. J, M and N at 7-18).

(e.g., PTB 24-28, 43-50). Plaintiffs argue that these alleged effects made the directors "interested" in the adoption of the Plan, that defendants were therefore obliged to prove that the Plan is fair and reasonable and that they failed to carry this burden (PTB 43-49).

These contentions, however, represent but another attempt to restrict or bypass the business judgment rule. Defendants do not bear the burden of proving fairness. In any case, the Plan is fair to Household's shareholders, and plaintiffs' "reasoning" to a contrary conclusion is unsound.

1. The Rights Plan does not prevent a hostile tender offer. Plaintiffs repeatedly contend that adoption of the Rights Plan has made Household tender-offer-proof (e.g., PTB 48; see also id., pp. 7-15). However, they offered no evidence that any actual offer had been prevented or deterred. Instead, their contention rests on a web of unsubstantiated -- and unsupportable -- assumptions.

Thus, one necessary premise of plaintiffs' argument is their assumption that potential acquirors who see money to be made in acquiring Household will "pass silently by" (Tr. I 34) and give up the gains they perceive from acquiring Household. No witness was called to validate this assumption. It is unsupportable: as plaintiffs' own expert Abbott testified, Household is a "unique entity"; "an opportunity only comes by once to buy this particular collection [of assets]" (Abbott III 174).

Yet another unsubstantiated assumption was that the Household directors will act irresponsibly and fail to redeem the Rights even when a full and fair bid is made. This was expressly conceded by Abbott, whose analysis of an any-and-all offer at $45 — a price which he assumed was "full and fair" — was premised on the assumption of non-redemption by the Board (Abbott IV 15, 21). Yet, on cross-examination, Abbott had to concede that he had never heard of a board of directors blocking a transaction which its investment banker had opined was made at a full and fair price (Abbott IV 18). This Court cannot presume that Household's Board will be the first, as plaintiffs' case tacitly assumes. See <u>Huffington</u> v. <u>Enstar Corp.</u>, <u>supra</u>.

Yet another assumption underlying the testimony of plaintiffs' experts is that the only possible method for effecting a takeover against the opposition of the Household Board was the hypothetical one outlined by Lipton at the August meeting (see PX 203 at 9). They assumed that if Lipton was wrong — which he was not -- they had proved their case. Defendants demonstrated, however, that a prospective acquiror could make a successful acquisition, notwithstanding initial opposition by the Board, by bringing <u>pressure</u> to bear upon the directors to force them to redeem the Rights -- whether they wanted to or not (Higgins VII 60 <u>et</u> <u>seq.</u>). In this fundamental respect, Household remains no different from any other company. Just as an acquiror will want to pressure another company not to implement a <u>post</u>-offer defense, it will want to pressure Household to withdraw its pre-offer defense. Just as arbitrageurs now have to appraise whether a post-offer defense will succeed, they will have to appraise, among other factors, whether the Rights will be redeemed (Greenberg IV 83-84, 88-89).

Higgins' testimony shows, for example, that a prospective acquiror could make an attractive proposal to the target company (a "bear hug") and go public with it, thereby pressuring the Board to redeem the Rights (Higgins VII 62-63). He could threaten the Board with a less attractive transaction (Higgins VII 67-68). The prospective acquiror could also make a tender offer at an attractive price; the tender of a high percentage of the shares would evidence shareholder support for the offer and thereby put enormous pressure on directors, who might well decide to redeem the Rights rather than risk losing a proxy fight for re-election (Higgins VII 65-66). A prospective acquiror could also actually mount a proxy contest or consent solicitation in connection with the offer if the implicit threat of one did not produce results (Higgins VII 72-73).*

* Plaintiffs' claim (PTB 14 n.*) that the Rights Agreement would preclude such a consent solicitation is unsound. Mere tenders to a bidder would not make the Rights non-redeemable, as plaintiffs contend; a contract, arrangement or understanding does not come into being until a tender offer has been accepted, and all the conditions to the offer satisfied, so that the parties are bound. E.g., Lowenschuss v. Kane, 520 F.2d 255, 265 (2d Cir. 1975). Consequently, an offeror could preserve its ability to conduct a consent solicitation without triggering the Rights simply by including an appropriate condition in the offer.

Nor is a consent solicitation an "impractical and unworkable alternative" (PTB 14). To the contrary, the record shows that Huffington used a proxy contest at Enstar to force the sale of the company (Abbott IV 35-36; Troubh VII 243-44, 253), that Jacobs used a consent solicitation as part of his strategy to acquire Pabst (Troubh VIII 28-29), and that Howard Keck used a consent solicitation to put Superior Oil "on the block" (Higgins VII 71; DX 18). Moreover, sophisticated bidders are capable of keeping "eight balls in the air at one time" (cf. PTB 15): for example, Martin Marietta ran a proxy contest in conjunction with its PAC-MAN tender offer for Bendix while Bendix's offer for Martin Marietta was also in progress. See Martin Marietta Corp. v. Bendix Corp., Del. Ch., C.A. No. 6942, Brown, C. (Sept. 19, 1982), at 8-9, 14 (Exh. E).

Contrary to plaintiffs' unspoken assumption that takeovers are essentially static transactions -- either purely hostile or purely friendly -- in the real world the tender offer is a dynamic device. As Higgins explained, target companies that may begin by resisting are exposed to market and shareholder pressures by the tactics which the bidder devises, and the circumstances which the bid creates, such that a transaction which starts off hostile often comes to a negotiated conclusion. In the real world, people who see money to be made by acquiring the "particular collection of assets" which is Household will devise such tactics, and its Board of Directors will not be immune to their effects (Abbott III 174; Higgins VII 60-73, 81-83, 166-67).

Defendants elicited detailed evidence of real-world transactions to back up these conclusions. The evidence shows, for example, that Lenox began by resisting Brown-Forman's bid, announced a "poison pill" dividend, but wound up negotiating a friendly deal at a higher price -- in a transaction in which the arbitrageurs fully participated, notwithstanding the "poison pill" (Abbott IV 34-35; Higgins VII 70-71, 78-79). Likewise Gulf Oil, which Higgins served as investment banker, succumbed to pressure generated by a tender offer and the implied threat of a proxy contest (even though it had just prevailed in one such contest) by agreeing to a sale of the company despite the board's earlier refusal to do so (Higgins VII 75-76).* The expectation of a similar dynamic process no doubt explains why Household's stock, and that of the other

* Moreover, even Greenberg -- plaintiffs' self-confessed cynic about directors' integrity -- conceded that the Superior Oil board was brought to the bargaining table (albeit "kicking and screaming") by the mere announcement of a proxy contest challenging a "poison pill" preferred stock dividend it had authorized (Greenberg IV 79).

companies which have adopted the Plan, have not performed as if the companies were takeover-proof (Greenberg IV 98-99; DX 27; Exh. L).*

Plaintiffs offered no testimony as to why these dynamic forces would not operate on the Household directors, even if one assumes that they initially adopted a "bunker" attitude towards an offer. Incredibly, their academic experts treated these possibilities as irrelevant.**

But these were not the only baseless assumptions in plaintiffs' "proof." Even if one assumes that the Board would seek to thwart exactly the kind of fair, high-minimum, any-and-all bid which it says it would support -- and withstand all pressures to redeem -- it is simply illogical to assume further, as plaintiffs' experts uniformly did, that shareholders would defeat the $45, any-and-all offer by holding out for a bonanza in the second step.***

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* And it is apparent from First Boston's recent research report on Owens-Illinois (DX 26) that market professionals are, as Higgins testified (Higgins VII 53), already developing ways "to circumvent this rights plan."

** Jensen conceded that any such possibility was a "separate issue" outside the ambit of his testimony (Jensen V 37; see also Jensen V 41). Plaintiffs' other experts failed to address the issue at all. Thus Higgins' detailed testimony as to how these pressures would operate on the Household Board stands uncontradicted.

*** Thus, plaintiffs' experts simply <u>assumed</u> that any small shareholder (<u>i.e.</u>, one with less than 5% of the stock) could not possibly affect the outcome of the offer so that the <u>only</u> determinant of the tender decision would be the extra $100 per share available in a second-step merger because of the "flip-over" provision of the Rights Plan (see, <u>e.g.</u>, Jensen IV 180-81, 184; PX 335). On the basis of these <u>assumptions</u>, plaintiffs reached the unsurprising conclusion that, since a higher price is obviously more desirable than a lower price, a shareholder would refrain from tendering since "there is no other rational decision" (Jensen IV 184). Jensen conceded that his "analysis" was not based upon any study as to how shareholders actually behave in the real world (Jensen V 49).

Manifestly, shareholders living in the real world cannot afford to act on such facile assumptions. Plaintiffs' trial witnesses could not really accept them either. Abbott had to concede that, since "a bird in the hand is worth two in the bush," shareholders will tend to act so as to get the premium price which becomes available only if the offer succeeds -- i.e., they will tender into the offer rather than gamble on the remote possibility of a super-premium in a second-step (Abbott IV 27-30). Even Professor Jensen conceded that, "absolutely," a shareholder will be powerfully motivated to tender at $45 rather than own a $30 stock (Jensen V 55-56).*

Plaintiffs engage in sleight-of-hand in contending that the hypothesized $45-per-share offer for Household could not succeed because a high-minimum-condition offer is perceived as "weak" (PTB 10-13). Concededly it is the conventional wisdom that, where nothing about the target accounts for a high minimum condition, Wall Street professionals would justifiably reason that such a condition reflected some financial or other hidden impediment to the offeror's ability to proceed (Wilcox IX 67-68). But as Wilcox went on to explain, in testimony carefully

* Rational shareholders will understand that the "super premium" would be available only in the unlikely event that: (a) the offeror had irrevocably committed itself to effectuate a second step; (b) the 95% minimum condition was met in the first step by tenders from other shareholders; and (c) the board elected not to redeem the Rights despite such an outpouring of shareholder support for the offer. As Higgins testified, shareholders make economic decisions based on the real-world probabilities of achieving returns on their investments and, accordingly, they will tender to receive the 50% premium that is available only if the offer succeeds rather than risk everything on a speculative back-end bonanza (Higgins VII 58-59).

ignored by plaintiffs, were such an offer made for Household the financial community would understand that it was the Rights Plan, and not the offeror's situation, that justified the condition (Wilcox IX 68-69).* Similarly, Higgins -- whose testimony on the subject plaintiffs repeatedly distort (PTB 9, 10, 11) -- stated that the Rights Plan was a new development in "an area that is dynamic," and testifed that Salomon Brothers might indeed advise a hypothetical bidder for a company which had adopted it "to make a tender offer with a very high minimum conditioned on getting not only the stock but the rights . . ." (Higgins VII 187).

In short, the record clearly supports the conclusion expressed by Higgins that the Rights Plan will <u>not</u> prevent a non-negotiated change of control at Household:

> In no way will it [the Rights Plan] prevent a change of control that is not blessed by the Household board.
>
> *   *   *
>
> As any student of the merger and acquisition marketplace, a serious student, I think, has to appreciate, there has been an evolving potpourri of mechanisms that have been introduced into the marketplace to give additional advantages to either the buyer or the seller. This rights plan I think is ingenious, clever, terrific, but I don't think it is the bulletproof, you know, showstopper that is going to prevent Household or anybody else who implements it from preventing a change of control of their company that's not approved by the board of directors.
>
> — Higgins VII 51.

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* In other testimony which plaintiffs also ignore, their own expert, Abbott, said essentially the same thing (Abbott III 88-89). Moreover, the record clearly established that it is not uncommon for a tender offer to attract 90-95% of the shares (Wilcox IX 69-70; Higgins VII 120; Fahey Dep. 37-38; DX 31). Indeed, 96% was tendered into D-K-M's offer for Criton (DX 31 at 1).

McMahon and Fahey of Goldman Sachs agreed (McMahon IX 202-208; PX 203 at 9-10). Plaintiffs were unable to come up with any witness of equivalent stature and experience to testify otherwise.*

In tacit retreat from the $45-per-share hypothetical on which their case was based at trial, plaintiffs now argue at length that the Plan makes Household "takeover-proof," and therefore makes the directors "interested," because it prevents two-tier, front-end loaded transactions in which a large quantity of stock is left unpurchased in the tender offer (e.g., PTB 7-9). But they reach this conclusion largely by ignoring or distorting Higgins' testimony. Thus -- contrary to the statements in their brief (p. 8) -- Higgins refused to testify that no "rational"

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* Plaintiffs presented the testimony of four expert witnesses. One of them, Abbott, started off by testifying as if he were speaking for Morgan Stanley, a leading investment banking firm, only to concede on cross-examination that he was speaking only for himself (compare Abbott III 89 with Abbott IV 45). He conceded that Superior Oil was a Morgan Stanley client when it authorized the "poison pill" preferred, which Troubh testified without contradiction was a stronger deterrent than the Rights Plan (Abbott III 140-41; Troubh VIII 13-14; DX 18).

The second, Greenberg, chief executive officer of Bear Stearns, is an arbitrageur with a vested, ideological opposition to all defensive activities by directors -- which he describes as "burning down the plantation" and "giving the company away just to keep themselves in power, or have their friends keep them in power" (Greenberg IV 83; see also id. 67). He is a self-confessed cynic about directorial integrity (e.g., Greenberg IV 71, 90) whose testimony was predicated upon assumptions which run directly contrary to the presumption of good faith embodied in Delaware law (DPM 57-61).

The third, Professor Jensen, candidly conceded that he has no relevant practical experience (Jensen V 39, 58) and, indeed, proclaimed proudly that he does not spend his time "poring over the entrails" of what actually happens in the real world (Jensen IV 236). The intervenor's expert, Professor Bradley, likewise did not claim to have any practical experience in the field of mergers and acquisitions and, on balance, his testimony supported defendants' position by demonstrating that defensive tactics can serve shareholder interests by defeating one offer and thereby paving the way for a higher one down the road (Bradley V 93-95; PX 339).

offeror would make such a bid, despite repeated attempts by Moran's counsel to get that testimony (see Higgins VII 138, 140-41, 157-58). As Higgins testified:

> Q. Given their rights plan in the situation of the front-end loaded offer, no rational offeror would actually commence such an offer if he knew the board would not go along with it; isn't that correct? Isn't that what you have been testifying?
>
> A. No, I did not, sir. . . .
>
> — Higgins VII 157 (emphasis added).

Higgins then refused to agree that a two-tier tender offer for Household is impossible (Higgins VII 157-58).

Higgins elsewhere explained in detail that a "rational" offeror could well conclude that there was money to be made even by owning less than 100% of Household; that, since the Rights would be freely-trading securities, an acquiror who wished to get to 100% ownership could purchase them or do an exchange offer for them; and that, in the interim, the shareholders would get "the benefit of being treated pari passu, exactly equal, with the 51 or 60 percent that is owned by the guy who now controls Household" (Higgins VII 162-64, 192-95, 219-22).*

Concededly, two-tier, front-end-loaded offers are deterred by the Plan. But directors do not acquire an "interest" by deterring one

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* Plaintiffs' assertion that Higgins called such an offer "totally theoretical" (PTB 17) is another distortion of his testimony, since, as he clearly explained, "it is totally theoretical that anybody is going to launch any offer about anybody" (Higgins VII 196).

particular form of tender offer which the overwhelming weight of the evidence establishes is made for the precise purpose of forcing shareholders to tender and depriving them of any economic choice. See pp. 11-13, supra. These offers not only permit, but require a firm defensive response by directors -- as Abbott, at least, was candid enough to concede (Abbott III 171, 173).

But, plaintiffs argue, two-tier or bust-up offers can be good or bad depending on the circumstances. Yet what they fail to tell the Court is that every "good" two-tier offer cited by them -- notably those at Conoco, Marathon Oil, and Enstar -- was a friendly, negotiated deal with a substantial, well-financed bidder, in which the target's board could negotiate to maximize shareholder values (PTB 7, 8; Higgins VII 141-42; Troubh VII 253-54; Tower X 74-79; PX 345 at 1-11; 350 at 1-7). Neither at trial nor in their briefs do they offer a single example of a "good" two-tier or bust-up transaction which was completed over the opposition of the target company's board. However, it is undisputed that the Rights Plan leaves absolutely unimpaired the Household Board's power to agree to a "good" two-tier offer, just as the directors of Conoco, Marathon and Enstar enjoyed.

And the existence of the Rights also tends to assure that the shareholders of Household will not be victimized by "bad" partial or two-tier transactions, as were the shareholders of Pabst and Becton-Dickinson which Troubh testified about (Troubh VIII 16-23, 28-30; DX 12 at H1357-59). The existence of the Rights tends to assure that the threat of such "bad" transactions will not force the Household directors to resort to greenmail and issuance of a huge block of stock into friendly hands, as Troubh and his fellow Warner directors felt obliged to do (Troubh VIII 23-28), or to adopt at the eleventh hour another of the defenses which defeats a bid by harming the company.

Directors with real-world fiduciary obligations cannot sit idly by, as plaintiffs' academic experts would have it, while some "invisible hand" protects their shareholders' inalienable "right" to a tender offer. No case holds that Delaware directors acquire an "interest," such that they must prove the "fairness" of their actions, simply because they take steps not otherwise unlawful to oppose takeover activity which the directors believe not to be in the shareholders' best interest. Directly to the contrary are, among many others, the Pogostin and Pogo decisions, which correctly recognize that these are matters of business judgment (DPM 61, 66-67). Plaintiffs' argument also contradicts the Delaware Supreme Court's recent holding in Aronson, supra, that a disabling "interest" arises only where directors "appear on both sides of a transaction [or] expect to derive any personal financial benefit from it in the sense of self-dealing. . ." (473 A.2d at 812).

Plaintiffs' reliance in this regard on Norlin Corp. v. Rooney, Pace, Inc., [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,564 (2d Cir. June 27, 1984), is wide of the mark. There, in a holding carefully limited to the facts before it, see id. at 98,871, the court invalidated stock issuances to a subsidiary and an ESOP by which the target company's directors got control over 49% of the company's voting power. These transactions had caused the New York Stock Exchange to de-list Norlin. The court held that the share issuance to the subsidiary was illegal under New York and Panamanian statutes similar to DGCL § 160(c), id. at 98,865-67, and affirmed the trial court's finding that the ESOP had been "created solely as a tool of management self-perpetuation," id. at 98,868.

Defendants will agree that directors' acquisition of 49% voting control for purposes of self-perpetuation gives them an interest. But what Norlin's extreme -- indeed, unique -- facts have to do with the present case plaintiffs do not explain, although they cite the case on seven pages of their brief.* What is relevant here is that the Norlin court, consistent with the Jewel decision, supra, expressly noted that:

> Although we are cognizant that takeover fights, potentially involving billions of dollars, profoundly affect our society and economy, it is not for us [i.e., courts] to make the policy choices that will determine whether this

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* Here, of course, the New York Stock Exchange has accepted the Rights for listing (DX 23). It should also be noted that Norlin was not decided under Delaware law and, indeed, relied in part on the dissenting opinion in Johnson v. Trueblood, [1984 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,564, at 98,865-67.

Plaintiffs' reliance upon Good v. Texaco Inc., Del. Ch., C.A. No. 7501, Brown, C. (May 14, 1984) (Exh. C), is also misplaced. The only holding in Good -- which denied a motion to dismiss a derivative complaint for failure to make demand -- was that demand was excused based on the complaint's allegations of futility. The complaint alleged that, because the grantee of stock had agreed to vote his shares in accordance with the directors' recommendations, the directors had put themselves in a position where they could facilitate their own re-election. In the case at bar, in contrast, the Rights give the directors no votes and the voting rights of the Household shareholders have not been changed in any way.

style of corporate warfare will escalate or diminish. Our holding here is not intended to reflect a more general view of the contests being played out on this and other corporate battlefields.

— Id. at 98,871 (emphasis added).

2. The Rights Plan does not prevent or impede a proxy contest. Plaintiffs' assertion that the Rights Plan must be invalidated because of its alleged impact on possible proxy contests is one of the most curious parts of their case. It goes unmentioned in any of their complaints. Neither the Moran plaintiffs' complaint, nor the intervenor's, nor Moran's proposed amended complaint contains any challenge to the Rights Plan on proxy contest grounds.

Moreover, plaintiffs' counsel offered not one witness to testify that the Household Rights Plan impedes or inhibits a proxy contest. They were apparently unable to persuade any of the experienced proxy contest professionals to testify, and subject themselves to cross-examination, on that proposition. Even after Wilcox of Georgeson, in response to a question by the Court, squarely testified that the Rights Plan would not inhibit a shareholder from being able to wage a successful proxy fight (Wilcox IX 53), plaintiffs offered no rebuttal evidence. Not even Moran himself was able to testify that the Rights Plan would prevent him, or anybody else, from waging and winning a proxy contest at Household. And Moran supported the Household bylaw amendments adopted on August 14 which limit the call of a special shareholders' meeting, nomination of directors, presentation of business at shareholders' meetings, and the use of written consents (PX 203 at 6).

In fact, the record is crystal clear that the Rights Plan does not restrict the ability of Household's shareholders to conduct a proxy contest. The Rights Plan does not affect the voting rights of holders of Household's voting securities: the Rights have no voting rights at all on any issue at any time (Clark VI 84; PX 204).

Plaintiffs assert however -- without benefit of pleading or proof -- that the Plan imposes severe impediments upon proxy contestants because the Rights are triggered when some person or group acting in concert acquires beneficial ownership of 20% or more of the shares. But this is a transparent attempt to put a voting rights "gloss" on their basic, tender-offer-oriented objections to the Rights Plan. Compare Colonial Securities Corp. v. Allen, Del. Ch., C.A. No. 6778, Longobardi, V.C. (Apr. 18, 1983) (Exh. B), at 7-8.

What plaintiffs are really saying is that an acquiror should be able to purchase more shares, directly or in concert with others, without triggering the Rights. But the "creeping" purchase of a potentially controlling block of stock without treating all shareholders fairly and equally is precisely one of the evils that the Plan is designed to deter.* The purposes of the Plan would be totally undermined if holders of 20% or more of the shares could put together a group of

* Not only does the uncontradicted evidence show that 20% is a well recognized threshold for measuring control (Tower X 70-71; Dammeyer X 13-15), but the appropriateness of such a measure is also recognized by judicial authority (see, e.g., Dan River, Inc. v. Unitex Ltd., 624 F.2d 1216, 1225 (4th Cir. 1980), cert. denied, 449 U.S. 1101 (1981) (20% "accumulation of stock in a publicly held corporation frequently is regarded as control of a corporation")).

shareholders committed by agreement to concerted action with respect to a block of stock large enough to be deemed effective control of Household. See Financial General Bankshares, Inc. v. Lance, [1978 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,403 (D.D.C. 1978).*

In any event, the record establishes the Rights Plan does not impair the ability of shareholders to vote and run a proxy fight and that comparable provisions in other defensive plans have had no adverse impact on proxy contest activity. Thus if, as plaintiffs contend without benefit of proof, the "group" definition in the Rights Plan impedes such activity, the same effect should have been visible at the companies which earlier adopted the so-called "poison pill" preferred stock plan. For, whatever the differences between the Rights Plan and the "poison pill" preferred, they are identical in this respect: like the non-redeemability of the Household Rights, the "put" feature of the Enstar and Superior preferred stocks was also triggered by formation of a "group" (although the ownership percentages at which the "put" was triggered were higher than in the Plan) (DX 37 at 9, 10, 12; DX 16 at 7). Yet

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* Plaintiffs profess not to understand why the 20% triggering event includes the formation of a beneficial ownership "group" as well as an outright purchase. But any other approach would leave a gaping loophole in the Plan. In the absence of such a "group" concept, persons could acquire a joint investment far larger than would otherwise "trigger" the Rights simply by making sure that each individual holding fell below the threshold.

Nor is there any mystery about where the "group" concept comes from: the "beneficial ownership" and "group" provisions of the Plan are "lifted" virtually in haec verba from the federal regulations under Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, which are also intended to prevent evasion of a numerical threshold by dispersing ownership or the incidents of ownership among a number of individuals. See H.R. Rep. No. 1711, 90th Cong. 2d Sess., reprinted in 1968 U.S. Code Cong. & Adm. News 2811, 2818, 2820.

the record is clear that there were proxy fights, and successful proxy fights, at both companies.*

The Enstar experience in particular confirms Wilcox's opinion, based on Georgeson's study of all verifiable proxy contests in the last three years, that there is no correlation between the number of shares held by a dissident and his chances for success in a proxy contest -- except at ownership levels so high that there is no true contest. The overwhelming percentage of successful contests were waged by insurgents with less, and usually much less, than 20% of the stock. Wilcox IX 35-39, 101; DX 39. See also Wilcox IX 33 (Heyman victory in GAF proxy contest holding less than 5% of the stock), 34-35 (Day victory in Superior Oil proxy contest holding only 3%); Higgins VII 170.**

Wilcox testified without contradiction that the key variable in proxy contest success is the merit of an insurgent's issues, not the size of his holdings (Wilcox IX 25-27; see also Higgins VII 170). In-

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* At Enstar, Mr. Huffington was able to mount and win a proxy contest for control of the board of directors, although he owned only about 9 1/2% of the outstanding stock, and did not form a group with other shareholders (Troubh VII 244, VIII 15-16). And the record likewise shows that, at Superior, the mere initiation of a consent contest by Mr. Keck, after the board had authorized the preferred stock, induced the directors not to issue it but rather to put the company up for sale (Higgins VII 71; DX 18).

** Wilcox also made clear that a statistically meaningful study could not be done limited only to companies whose corporate characteristics were very similar to Household (Wilcox IX 102) -- responding to an earlier comment by the Court (id. 46-47). Plaintiffs offered no such study, nor evidence that one could be done.

deed, even very large holdings are no guarantee of success, as Greenberg testified (IV 102-03) (defeat of Pabst dissident Irwin Jacobs holding 16-17%), and as Wilcox also illustrated from his experience, again without contradiction (Wilcox IX 34) (defeat of Ronson dissidents holding 36%).

Plaintiffs are reduced to grasping at straws. They argue that the Rights Plan supposedly inhibits proxy fights because a group holding 20% or more of the stock cannot be formed to share expenses. But even Moran conceded that an individual or a group of Household shareholders with an investment just short of this threshold — worth, at current market, approximately $400 million -- would have the wherewithal to finance a proxy contest (Moran II 94-96; Clark VI 87). And plaintiffs offered no evidence to rebut Wilcox's testimony that, since the costs of proxy contests are relatively modest in light of the matters at stake, he "could not imagine" that a dissident would have to form a 20% group in order to fund a proxy fight (Wilcox IX 31-32, 54).*

The frivolousness of plaintiffs' proxy contest assertions becomes all the clearer if one compares the alleged proxy contest impact

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* As Wilcox also pointed out without contradiction, dissidents usually obtain reimbursement from the corporation if they win their contest and sometimes obtain reimbursement even if they lose (Wilcox IX 32-33).

Plaintiffs are splitting hairs in suggesting that a dissident would be impeded in conducting a proxy contest by the inability in certain circumstances to file a Schedule 13D statement. Nothing in the Rights Plan prevents shareholders who support the dissident from publicly endorsing his cause, or prevents the dissident from announcing the names of shareholders who adhere to his views. Unless there is an "agreement" to act in concert, there is no "group." See Corenco Corp. v. Schiavone & Sons, Inc., 488 F.2d 207, 217-18 (2d Cir. 1973).

of the Rights Plan to the impact of the other defensive measures on which there was testimony at trial. For example, in the Carter Hawley/Limited and Gearhart/Smith situations, the target companies' managements got the power to control the vote of substantial blocks of stock when they issued shares to defend against unwanted offers (Abbott III 110-112, 133). At Disney and Warner, potential dissidents were bought out at a premium, thus increasing the voting power of shares aligned with management (Abbott III 123-24; Troubh VIII 23-27). Once again, it is clear that the Rights Plan is well "within the pale."

If the relevant comparison is between the Rights Plan and the facts in Schnell v. Chris-Craft Industries, Inc., Del. Supr., 285 A.2d 437 (1971), and Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906 (1980), it is equally clear that the Rights Plan is not "beyond the pale."* The Rights Plan is not remotely comparable to the actions taken by the boards of directors in those cases. The effect of what the boards did there was to preclude a contest altogether, regardless of the merits of the issues to be raised in the contest and the availability of funds to finance it. The conduct of the respective boards was found to have been "inequitable" because it was taken for the purpose and with the effect of preventing a proxy contestant from pursuing his contest. Moreover, in those cases, there was an actual proxy insurgent before the Court whose lawyers were prepared to sign a complaint, and who was

* These decisions are fully discussed in Defendants' Pre-Trial Memorandum (at 71-72).

himself prepared to testify under oath, that he could not proceed without judicial relief. That is not the record here.

3. The Rights Plan serves shareholder interests. As shown above, the business judgment rule protects the Household Board of Directors' approval of the Rights Plan from being "second guessed" by plaintiffs in this action. Defendants do not have to prove that the Rights Plan is fair to Household and its shareholders. But even were the business judgment rule inapplicable, the evidence shows that the Rights Plan is fair to Household shareholders and serves their best interests.

Household shareholders benefit from the Rights Plan:

First: by making it likely that a potential acquiror will seek to negotiate the terms of a proposed takeover with the Household Board of Directors, the Plan gives shareholders a realistic opportunity to get the best price in a takeover. It permits the Board to act as "bargaining agent" for the shareholders as a whole, thereby solving the "prisoner's dilemma" that prevents shareholders from advancing their collective interests in the face of a takeover bid.

Second: by deterring inherently coercive front-end loaded, two-tier tender offers, the Plan serves to protect Household shareholders from being forced to surrender their investments in Household for an inadequate price.

Third: the Plan assures Household shareholders that they will have a substantial equity interest in Household's continuing business should an acquiror of Household determine to merge out the remaining shares.

Fourth: the Plan creates the possibility that the Household shareholders at a future date may have the opportunity to profit by purchasing — or selling the right to purchase -- Household preferred stock at a price below its market value, which the Household directors reasonably determined may eventually exceed the $100 exercise price of the Rights (Whitehead VI 70; Clark VI 76; DX 46).

The Plan achieves these benefits without preventing changes of control, by proxy contest, tender offer or otherwise, and without adversely affecting Household's business, earnings or financial condition. The balance of benefits and burdens, therefore, clearly leads to the conclusion that the Plan is "fair."

Plaintiffs' contentions that the Plan would harm shareholders if the Rights became non-redeemable (e.g., PTB 15-17) simply ignore the fact that the Rights would then be freely-trading securities, available for sale by the shareholders and for purchase by anyone who saw money to be made by buying them (Higgins VII 189, 219-22; Clark VI 217-18). Shareholders would profit in such transactions.

Moreover, the scenario which plaintiffs visualize is not clear. On the one hand, if the Rights become non-redeemable because an unfair and coercive offer has been made, and 20% of the stock purchased thereunder, the Rights will perform their intended function of assuring that shareholders do not get "squeezed out" of their investment, and that in all events they will receive consideration which reflects the Board's judgment of the long-term values inherent in Household stock. If, on the other hand, plaintiffs are assuming that the Rights will become non-redeemable because of a 20% purchase by a passive investor, they are, in Mr. Clark's apt words, "bringing up a hypothetical that I suggest doesn't even fit on the scale of probability" (Clark VI 216).*

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* Plaintiffs suggest no reason why any person or group would purchase 20% or more of the stock for non-control purposes and thereby trigger the Rights. And they offered no evidence that, even before the Rights

(footnote continued)

C. The Rights Plan Does Not Violate Any Statutory or Common Law Right of the Plaintiffs

There is no merit to plaintiffs' arguments that the Rights Plan supposedly violates DGCL §§ 159 and 202(b), is illegal under the Telvest decision and usurps fundamental shareholder "rights."

1. The Rights Plan does not restrict the free alienability of stock. Plaintiffs' argument (PTB 21) that the "Rights Plan impermissibly interferes with stockholder rights to alienate their shares as guaranteed by the common law and implemented by Sections 159 and 202(b) of the DGCL" is baseless. Nothing in the Rights Plan restricts the alienability of Household shares.

Section 159 provides, in pertinent part, that the "shares of stock in every corporation shall be deemed personal property and transferable as provided in Article 8" of the Uniform Commercial Code. It is intended to override certain common law rules that treated stock as "evidence of property" rather than as "property in the normal sense." E. Folk, The Delaware General Corporation Law: A Commentary and Analysis

(footnote continued)

Plan, a 20% purchase with no change-of-control intention had ever occurred at any company. Contrary to plaintiffs' suggestion (PTB 17), Higgins did not testify that he had heard of instances of a person acquiring 20% or more of a company of Household's size for a non-control purpose (Higgins VII 222-23). Plaintiffs were reduced to supposing that the Bank of England might make such a purchase (Whitehead VI 57). Clark testified, without contradiction by any witness, that "I doubt very much that somebody is going to put up $400 million and choose to be passive." He also indicated that he was not aware of any interest on the part of the Bank of England in buying 20% of Household (Clark VI 87).

148-49 (1972).* Plaintiffs do not and cannot cite any authority to support the construction of § 159 that they urge.

They fare no better under § 202(b), which sets forth the requisites for a valid "restriction on the transfer or registration of transfer of a security of a corporation. . . ." Section 202 describes the kinds of restrictions on transfer that are permissible, i.e., rights of first refusal, buy and sell agreements, consent restrictions, prohibitions on transfer to designated persons (if not "manifestly unreasonable"), and other "lawful" restrictions. The purpose of § 202 is to "substantively validat[e] . . . a wide variety of stock transfer restrictions" in a manner consistent with the Uniform Commercial Code provisions respecting the negotiation of investment securities. E. Folk, supra, at 197.

As used in § 202, the phrase "restrictions on the transfer of securities" refers to restrictions on the transfer of title to the securities and the attendant rights that the securities represent. Nothing in the Rights Plan even purports to impose any such restriction. Adoption of the Rights Plan has had no effect whatever on the negotiability of Household shares: a willing seller can today sell, and a willing

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* These rules related to such questions as whether stock could be converted or attached or seized by execution, levy or other legal process, and had nothing to do with the authority of a board of directors to take actions which may deter or discourage tender offers for shares of the corporation which it serves. See E. Folk, supra, at 148-50.

buyer can today buy, shares of Household just as he could prior to adoption of the Plan.*

The authority that plaintiffs offer on their § 202 argument is inapposite. In Joseph E. Seagram & Sons, Inc. v. Conoco, Inc., 519 F. Supp. 506 (D. Del. 1981), on which they principally rely, the bylaw in question expressly provided that certain transfers of shares would "be void and shall be ineffective as against the corporation . . .," and therefore concededly imposed a "restriction on transfer" within the meaning of § 202. Id. at 508. The only question addressed by the court was the narrow one of whether the restriction applied to shares issued prior to, but represented by certificates issued after, adoption of the bylaw. The court held that the restriction was not binding on those shares, a ruling which is totally irrelevant here.**

In essence, plaintiffs are arguing that corporate action which may deter the purchase of shares by a buyer who wants to squeeze out the other Household shareholders is tantamount to a flat restriction on

* The absence of any adverse impact on the negotiability of Household shares is evidenced by the fact that the volume of trading in Household stock has continued at substantial levels at all times since adoption of the Plan (PX 326), and at price levels above those prevailing before its adoption (DX 27; Exh. L).

** The decision in San Francisco Real Estate Investment Trust v. Real Estate Investment Trust, 701 F.2d 1000 (1st Cir. 1983), is likewise inapposite. The First Circuit determined that a bylaw purporting to prohibit any person from acquiring more than 9.8% of the shares of a real estate investment trust, and providing that shares held in excess of the 9.8% limit would not be entitled to voting rights or dividends, could not be enforced because the plaintiff had shown a probability of success on the merits of its claim that the bylaw violated the Declaration of Trust.

transfer. Plaintiffs' argument is not only unsupported by authority but is contrary to the numerous precedents recognizing the legitimacy of defensive measures taken by target companies to defend against takeovers. Those measures, if successful, likewise have the effect of decreasing the universe of interested buyers of the target company's shares, and thus arguably "restrict" the alienability of those shares. Yet there is no question but that such measures are valid (see IV A, supra).

Moreover, plaintiffs' argument leads to absurd results. If accepted, it would call into question the legality of numerous corporate actions of undoubted validity that have the effect of deterring potential buyers of shares. Indeed, it would follow that even fair price amendments (which plaintiff Moran has endorsed) would be invalid under § 202(b) since the supermajority voting requirements they impose could discourage tender offers for, or other acquisitions of shares held by, persons who voted against the amendment and therefore could not be bound by a "restriction" of the sort encompassed by § 202(b).

Plaintiffs' § 159 and § 202 contentions are simply an attempt to find a statutory foothold for their policy views about tender offers. As legal arguments, they are without merit. Compare Colonial Securities Corp. v. Allen, supra, at 10.

2. No shareholder vote was required for adoption of the Rights Plan. Plaintiffs appear to argue (PTB 37; ITB 31) that directors cannot take steps which "restrict" alienation indirectly, by deterring two-tier offers, when a like result could have been accomplished by means of a

shareholder-approved fair price amendment. But this argument ignores the doctrine of independent legal significance, which teaches that "[t]he mere fact that the result of actions taken under one section [of the General Corporation Law] may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section." Orzeck v. Englehart, Del. Supr., 195 A.2d 375, 377 (1963); accord, Rothschild International Corp. v. Liggett Group, Inc., Del. Supr., 474 A.2d 133 (1984); Field v. Allyn, Del. Ch., 457 A.2d 1089, 1098, aff'd, Del. Supr., 467 A.2d 1274 (1983).

Thus, contrary to plaintiffs' argument, the fact that the Household Board could have chosen to propose a fair price amendment does not mean that the Board could not exercise its statutory authority to issue the Rights without a shareholder vote. This choice was a matter of the directors' business judgment. See American International Rent A Car, Inc. v. Cross, supra.*

3. The Rights Plan does not violate the Telvest decision. Plaintiffs' argument (PTB 28-36) that the Rights are a "sham security," and that the Rights Plan therefore runs afoul of Chancellor Brown's ruling

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* Moreover, the evidence showed that, when the directors considered a fair price amendment shortly before the 1984 shareholders' meeting, they were assured by Georgeson that the measure would receive shareholder approval. The decision not to propose it reflected uncertainty about whether there was sufficient time before the meeting to win over institutional shareholders. Clark V 167-171; Wilcox IX 97; PX 41.

in Telvest, Inc. v. Olson, Del. Ch., C.A. No. 5798, Brown, V.C. (March 8, 1979) (Exh. H), ignores both the rationale of that case and the facts concerning the Rights Plan.

Telvest has no application here, whatever its precedential weight on its own facts.* The question addressed in Telvest was whether a board could seek to thwart a perceived takeover threat from an existing 20 percent shareholder by issuing a "preferred" stock dividend that enjoyed supermajority voting rights with respect to a business combination between the corporation and a holder of 20 percent or more of its common stock and thereby impaired the voting rights of the common stock.

Chancellor Brown enjoined issuance of the "preferred" stock. First, he found that the "preferred" stock was identical to the common stock in every respect but voting rights, and therefore could not be deemed a true preferred stock for purposes of the "blank stock" provisions of the target company's certificate of incorporation and DGCL § 151. Second, the Court reasoned that under the General Corporation Law, a board of directors lacks the power to alter existing voting rights of the shareholders. And, third, the Court found that the stock issuance was "inequitable" within the meaning of Schnell v. Chris-Craft Industries, Inc., supra.

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* The precedential value of Telvest is questionable. Chancellor Brown himself has stated that, while he remains "of the opinion that that decision was a proper one on its facts," it "is an unreported decision on an emergency injunction application" that was, by necessity, prepared "hastily." National Education Corp. v. Bell & Howell Co., supra, at 5, 9. In addition, in 1983 the General Assembly legislatively overruled one of the statutory grounds for the Telvest holding. See DGCL § 151(g).

Telvest, then, stands for the proposition that a board cannot employ blank stock powers to create a preferred stock that is indistinguishable from common stock except for a special voting feature designed to alter voting rights to the disadvantage of an existing substantial shareholder. It was to describe that instrument that the Chancellor used the phrase "sham security."

Chancellor Brown's later opinion in National Education Corp. v. Bell & Howell Co., supra, sheds further light on his concept of a "sham security." That case concerned the legality of an issuance of preferred stock with special voting and redemption rights. Unlike the "preferred" stock at issue in Telvest, however, the Bell & Howell preferred also enjoyed certain fixed dividend, liquidation and other rights not enjoyed by the common stock (see pages 57-58 of Exhibit C in the Appendix to PTB).

Chancellor Brown refused to enjoin issuance of the Bell & Howell preferred stock, finding that the plaintiff had failed to demonstrate probable success on the merits. The Chancellor expressly confirmed that Telvest turned on the facts that the "preferred" stock at issue there "was nothing more than an attempt by a board of directors, by resolution, to change the existing voting rights of the common shareholders without their consent so as to make a hostile acquisition of the corporation more difficult to achieve," and, moreover, was an "action taken in direct response to an ongoing hostile take-over attempt." Slip op. at 9-10.* The Chancellor thus made clear that Telvest did not condemn the issuance of every security designed to protect shareholders against unfair takeovers.

There are significant differences between the facts here and those in Telvest. Unlike the Telvest "preferred" stock, the Household Rights have economic substance. The new series of Household preferred stock created pursuant to the Plan is a "true" preferred stock in the sense that it enjoys certain minimum dividend and liquidation rights that are superior to those of Household's common stock (DPM 36n.**). Unlike the Telvest "preferred," the Rights do not alter existing voting rights. Moreover, the Rights are precisely what they purport to be: instruments that, upon satisfaction of their terms and conditions, entitle the holder to purchase at the stated exercise price shares of the new Household preferred stock or shares of the surviving entity in a merger between Household and another party. They have been accepted for listing by the New York Stock Exchange and have therefore satisfied that exchange's stringent listing standards (DX 23; Troubh VIII 35-40).**

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* This latter observation directly contradicts plaintiffs' assertions that the business judgment rule protects only "response[s] to an ongoing hostile take-over attempt" (see IV A, supra).

** The fact that the Rights are currently "out of the money" in no way implies that they are sham securities inasmuch as the $100 price represents what the directors reasonably believe the long-term value of the preferred stock to be (Dammeyer X 26-29; Clark VI 76; DX 46). Plaintiffs offered no evidence that this judgment of value is unreasonable and did not even cross-examine Dammeyer on the valuation study he did from which the $100 figure is derived. It is well known that corporations commonly issue rights, warrants, convertible securities and the like that are "out of the money" at the time of issuance and which remain so for some time.

(footnote continued)

4. <u>The Rights Plan does not deprive the Household shareholders of any "fundamental right."</u> The common thread running through all of plaintiffs' arguments is the notion that the Rights Plan unlawfully abridges some alleged "fundamental right" of Household shareholders to a hostile tender offer. This notion has no evidentiary or legal basis.

The evidence shows that the Rights Plan will <u>not</u> prevent the shareholders of Household from transferring control of the company in a tender offer (see IV B, <u>supra</u>). The evidence shows that the other defensive measures which the witnesses described were "much more dramatic . . . to the company [and] to the value of the remaining securities than what has been done or contemplated here" (Higgins VIII 80). Only by relying on the assumptions of Jensen and plaintiffs' other experts, or on Greenberg's cynicism about directors, could one conclude otherwise.

But beyond the lack of an evidentiary basis, plaintiffs' argument must fail because it has no legal substance. Plaintiffs have not cited any statute or case that creates or recognizes any such "right." Professor Jensen was reduced to uncharacteristic doubt and uncertainty

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(footnote continued)

Nor is there any merit to plaintiffs' argument that the "flip-over" provisions of the Rights Agreement render the Rights "sham," because they are allegedly so onerous as to totally prevent mergers. This argument twists the word "sham" into unrecognizable form. It also ignores the fact that the "flip-over" feature has the very "non-sham" effect of protecting shareholders against being "squeezed out" of Household at an unfair or inadequate price and ensuring that they will have a substantial continuing equity interest in a combined company.

when he was asked where the "right" comes from; after a vague reference to "something involving constitutional law," he went on for several pages but never did answer the question (Jensen V 41-45). And, in their post-trial brief, plaintiffs have abandoned the principal argument advanced in their pre-trial brief, and in their counsel's opening statement at trial, to the effect that the "right" can be derived from the federal scheme regulating tender offers. See PPM 56-60; Tr. I 29, 34-37, 49, 57. As defendants earlier demonstrated (DPM 76-79), that argument is totally without merit.

In the final analysis, plaintiffs' argument rests on their policy views. Even as to these, the expert witnesses were in sharp disagreement.* But plaintiffs have failed to articulate any basis for converting into positive law the policy preferences of their particular school of thought.

Unlike plaintiffs, defendants do not ask this Court to determine questions of policy. Rather, defendants ask this Court to apply the business judgment rule to a trial record which clearly established that the Household directors are entitled to its protection.

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* Thus, on the one hand, there is the view of Professor Jensen discussed at length above. On the other hand, there is the view of Jay Higgins that:

> I don't think shareholders have an inalienable right to participate in tender offers. They have a right to participate in the economic life of . . . [the] company.
>
> — Higgins VII 83-84.

CONCLUSION

For the foregoing reasons, as well as those set forth in Defendants' Pre-Trial Memorandum, defendants and counterclaim-plaintiff Household are entitled to the entry of judgment in their favor.

Respectfully submitted,

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November 21, 1984

CERTIFICATE OF SERVICE

I hereby certify that on November 21, 1984, two copies of the within Defendants' Post-Trial Brief were hand delivered to the following attorneys of record in the foregoing action at the addresses indicated:

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