

IN THE SUPREME COURT OF THE STATE OF DELAWARE

REVLON, INC., a Delaware
corporation, MICHEL C. BERGERAC,
SIMON ALDERWERELD, SANDER P.
ALEXANDER, JAY I. BENNETT,
IRVING J. BOTTNER, JACOB BURNS,
LEWIS L. GLUCKSMAN, JOHN LOUDON,
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EZRA K. ZILKHA, FORSTMANN
LITTLE & CO., a New York limited
partnership, and FORSTMANN
LITTLE & CO. SUBORDINATED DEBT
AND EQUITY MANAGEMENT BUYOUT
PARTNERSHIP-II, a New York
limited partnership,

Defendants Below-
Appellants,

v.

MACANDREWS & FORBES HOLDINGS,
INC., a Delaware corporation,

Plaintiff Below-
Appellee.

No. 353 & 354, 1985

THE FORSTMANN LITTLE APPELLANTS' REPLY BRIEF

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ARGUMENT

Most of what Pantry Pride says in its opening brief has been treated in our opening brief. We will not burden the Court with a reiteration of that material, but will concentrate on what we believe to be some of the fundamental facts and principles controlling this case. Most fundamental is the fact that FLC's participation has resulted in hundreds of millions of premium dollars for Revlon's shareholders, and that the bidding process which produced these amounts would never have taken place without the inducements which the Court of Chancery has invalidated.

The Bidding Process

Pantry Pride's claim that this "is a case of a bidder who was never permitted to bid" (Appellee's Brief at 27) is absurd. Pantry Pride was given every opportunity -- even after the October 3 merger agreement was signed -- to present Revlon with a meaningful bid but chose only to make an insignificant increase over FLC's offer. Indeed, Pantry Pride's contention that it had no opportunity to bid is conclusively refuted by the minutes of the October 12 board meeting, which recite that Revlon's counsel told Pantry Pride's counsel on October 11 that

"...he would be pleased to convey any Pantry Pride proposal to the Company and its investment banker or that Mr. Drapkin could do so directly or that his client could do so directly, if they pleased. Nothing further has been heard from Mr. Drapkin since that time. Mr. Drapkin had then called Mr. Rohatyn of Lazard Freres, and Mr. Loomis had returned Mr. Drapkin's calls to Mr. Rohatyn. However, Mr. Drapkin was not available for

Mr. Loomis' call and had not returned that call by the meeting."

Minutes of October 12 at 30 (A 909).

While Pantry Pride suggests that the asset option somehow inhibited substantial additional bidding for Revlon, this is absolutely contrary to the record. Revlon refused to grant the asset option on October 3, when there was the prospect of substantial additional bidding from either Pantry Pride or others; the option was granted only when it was evident that no such bidding was forthcoming, and then only to achieve millions of additional premium dollars for shareholders. If a board cannot, in the exercise of its business judgment, grant an option or other inducement to obtain this result, low bids will more likely be successful and corporate stockholders disadvantaged.*

Pantry Pride appears ultimately to be premising its position on the thought that because it had said that it was willing to insignificantly better any FLC bid, no inducements

* Nor could Revlon have "shopped" FLC's proposal prior to the October 12 meeting, since FLC simply would not have made a proposal under those circumstances. There has never been a requirement in tender offer contests that target companies "shop" bids made by white knights to the original bidder before a definitive agreement is reached. The test, rather, is whether the board, in the exercise of its business judgment, reasonably believed that the course of action chosen was the preferable one for shareholders. Here, the Revlon board was not only a most knowledgeable one, but was advised both by its investment bankers and counsel to accept the FLC proposal.

could ever be granted to FLC to increase the bidding after the bidding process had run its course. The fallacy in this premise is fundamental: bidders like FLC would never participate nor increase their bids if this were the law, and initial bidders would have the field to themselves. If there had been no asset option, and no deal with FLC, bidding would have been over, and the maximum price to shareholders would have been \$56.25, a price which might even have been substantially less if FLC had withdrawn and Pantry Pride had been left as the sole contestant.* All Pantry Pride had offered to do was to follow and marginally increase FLC's bidding, but there would have been no bid to follow or increase in the absence of the asset option. It is hard to see how any rational board would have acted differently than Revlon's board did in these circumstances.**

* It is time to finally put to rest Pantry Pride's idea that its \$56.25 should be considered to be greater than FLC's \$57.25 because of the minor time differences which may have been involved. It is not certain, in any case, that there would have been any time differences, since Pantry Pride, after two months of trying, still did not have the necessary financing. But this factor notwithstanding, both Lazard Freres and Goldman Sachs testified that they believed the FLC offer to be the higher one. Rohatyn Affidavit ¶15 (A 936); Minutes of October 12 at 21 (A 900); Herbst Affidavit ¶9 (A 1037).

** Cases such as Thomas v. Kempner, Del. Ch. C.A. No. 4138 (March 22, 1973) (Appellee's Compendium of Unreported Opinions and Other Authorities, Exh. D) and Pennsylvania Co. v. Wilmington Trust Co., Del. Ch., 186 A.2d 751 (1962), have no application here. In both of those cases a higher offer for the same assets was made before the corporation or trust executed an agreement at a lower price. Here, the asset option was granted to induce a higher offer for the whole company.

The decision faced by the Revlon board on October 12 was a clear one: bidding had stopped at \$56.25, despite all efforts to produce a higher offer, and the evidence is undisputed that FLC was willing to raise its price only if the asset option were granted. The Revlon board weighed the risk of being left with Pantry Pride's \$56.25 offer (and the possibility of that offer being lowered) in the event that FLC dropped out of the bidding,* against a firm, fully-financed \$57.25 offer from FLC conditioned on a "no-shop" provision. To suggest that Revlon was required to risk losing FLC's \$57.25 offer by going back to Pantry Pride, when it knew that Pantry Pride intended to engage only in piggy-back bidding, and when Pantry Pride still lacked the financing even for its \$56.25 bid,** defies logic and sound business sense, and is simply not the law.

* The likelihood that FLC would walk away from the transaction was recognized by both Revlon and Lazard. Minutes of October 12 at 26, 33-34 (A 905, 912-13); Rifkind Affidavit ¶49 (A 777); Glucksman Deposition at 153-55 (A 1489-91),) There were sufficient "outs" under its agreement, including particularly a "litigation" out, to permit it to do so. October 3 Merger Agreement ¶10.2(h) (A 463).

** When asked by Lazard on October 9 to detail its financing, Pantry Pride responded on October 11 that it was still \$350,000,000 -- over \$10.00 per share -- short. The fact, as is set forth in Pantry Pride's brief, that it was able to obtain the necessary commitments only on October 18 (Appellee's Brief at 28-29), six days after the October 12 board meeting, has no relevance to what was before the board on October 12. The board also knew on October 12 that FLC's financing was complete and firm, and that FLC required no additional funds.

The Asset Option Price

Pantry Pride continues to complain about the exercise price of the asset option, although the board's function was to evaluate the fairness of the deal as a totality, and not of any particular component of it. Insofar as the option price itself is concerned, Pantry Pride omits to note that in Thompson v. Enstar Corp., Del.Ch., C.A. Nos. 7641, 7643, Hartnett V.C. (Aug. 16, 1984) (Appendix of Unreported Cases to the Forstmann Little Appellants' Opening Brief, Exh. C), infeasible voting control over Enstar's "single most valuable asset" had been ceded to a bidder near the start of the takeover process for no consideration other than the signing of the agreement, even though voting control over the asset was what the bidder "craved the most." Id. at 11.

In any event, the option price in the present case was well within the parameters of value ordinarily produced by arm's-length negotiations such as those undertaken here. It was precisely within the range of values estimated by FLC's investment bankers, Goldman Sachs, and by Pantry Pride itself and its investment banker, Morgan Stanley.* Moreover, Lazard's higher estimates were premised on a liquidation analysis of Revlon, which assumed that over a substantial period of time the individual businesses of Revlon would be sold to a number of different buyers, each of which would purchase a particular

* Forstmann Affidavit Exhibits A, B (A 1023, 1029); Herbst Affidavit ¶ 5 (2035).

business--a process which inevitably results in higher prices than an immediate sale.*

Most significantly, Pantry Pride itself had offered to sell these assets to FLC for \$557,000,000 when it proposed a division of the Company, and FLC had refused this offer. This is telling evidence both that Pantry Pride does not believe the option price to be out of range, and that FLC does not consider this price to be an extraordinary bargain to it. Indeed, the difference between the \$557 million price and the option price of \$525 million is approximately 5%, hardly sufficient to present a real deterrent to a meaningful bid. In sum, the negotiated option price, like the transaction as a whole, falls squarely within the province of the board's business judgment.

The Validity of the Asset Option

By citing to Unocal,** Pantry Pride would have the Court treat this transaction as a type of management-imposed defensive tactic, such as a poison pill or golden parachute, designed to entrench its position. But this transaction is not a "defensive" tactic, and Revlon management is not retaining either control or any promise of continued employment. The

* While Pantry Pride places great store on Lazard's liquidation value estimates for these assets, it ignores completely Lazard's opinion that the transaction in its entirety was fair to Revlon and its shareholders, and its affirmative recommendation to the board that the FLC transaction was the most desirable course of action for the Company. Minutes of October 12 at 24, 34 (A 903, 913).

** "If [the] defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." Appellee's Brief at 26 citing Unocal Corp v. Mesa Petroleum Co., Del.Supr., 493 A.2d 946 (1985).

Revlon severance agreements were entered into long before FLC came on the scene, and would be binding on any acquiror, including Pantry Pride. Indeed, Pantry Pride agreed to pay Revlon's chairman the sums due him under his "parachute" and also agreed to enter into a new contract with him that would "further increase [his] life style." Bergerac Deposition at 121 (A 1411).

What is involved here is an acquisition of Revlon by a third party, FLC, in a transaction providing huge benefits to shareholders. It bears emphasis, in this regard, that this transaction is not a "management sponsored buyout." Appellee's Brief at 10. FLC is an independent company with huge capital resources that is in the business of acquiring corporations and controlling them, and entered into the transaction to further its own business objectives. The transaction ultimately arrived at was the product of extensive and difficult arm's-length negotiation. We do not have here a question of "threats" and management "responses," as in Unocal or Household.^{*} This is, rather, a third party transaction which resulted in furthering the bidding process to the substantial pecuniary advantage of all Revlon's shareholders.^{**}

^{*} Moran v. Household International, Inc., Del.Ch. 490 A.2d 1059 (1985) (appeal pending).

^{**} Even if the transaction is viewed according to the considerations articulated by this Court in Unocal, it is proper in all respects. The Court there held that directors, in responding to a takeover bid, could consider "constituencies"

(Footnote continued on following page)

The Cancellation Fee

We note, finally, that there is not a word in Pantry Pride's brief attempting to justify the injunction against the cancellation fee, in the apparent recognition that there can be no such justification. As we said in our opening brief, no findings were made either of a probability of success on the merits or of the lack of an adequate remedy at law, and without such findings we respectfully submit that the injunction cannot possibly stand.

(Footnote continued from previous page)

other than shareholders, including "creditors" and could also consider such factors as the "risk of nonconsummation" of the bid. Unocal, 439 A.2d at 955. Under these standards, the directors could not only consider Revlon's noteholders, as well as its stockholders, but could also consider Pantry Pride's failure, after two months, to obtain the necessary financing.

The board was also entitled to consider the nature of Pantry Pride's piggy-back bidding--a tactic which would freeze the bidding process without providing any additional money to shareholders unless inducements were granted, since no competitor would otherwise have any incentive to raise its bid.

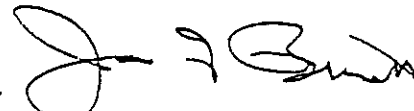
CONCLUSION

For the reasons set forth in our original brief and this reply, we respectfully urge this Court to reverse the preliminary injunction granted below.

Respectfully submitted,

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CERTIFICATE OF SERVICE

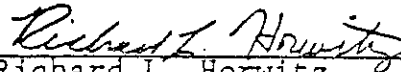
I hereby certify that on this 29th day of October 1985,
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