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IN THE SUPREME COURT OF THE STATE OF DELAWARE

UNOCAL CORPORATION, a Delaware corporation, Defendant Below-Appellant, v. MESA PETROLEUM CO., a Delaware corporation, MESA ASSET CO., a Delaware corporation, MESA EASTERN, INC., a Delaware corporation and MESA PARTNERS II, a Texas partnership, Plaintiffs Below-Appellees.	)	No. 152, 1985

ANSWERING BRIEF OF PLAINTIFFS BELOW-APPELLEES

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INTRODUCTION

Unocal asserted below and argues here that its directors do not owe fiduciary duties to its largest stockholder as long as that stockholder seeks to make an unwanted tender offer. Unocal contends that it has no duty to treat Mesa Partners II (the "Partnership") fairly because it has determined that its tender offer is inadequate. Unocal maintains that it can disregard the fact that the Partnership has made an investment of over $1,000,000,000 in its stock. In the words of Unocal's Chairman, Mesa Partners II has become a "non stockholder" and may be treated accordingly.

Nothing in our law offers the slightest support for such a pernicious doctrine. Unocal seeks no less than the power to destroy the stock interest of the Partnership, if necessary, to force it to end its offer. By its rhetoric and epithets, Unocal obscures the simple fact that the Partnership is legally entitled to make an offer for Unocal stock. However inadequate or hostile Unocal may deem the Partnership offer to be, at $54 it is substantially above Unocal's pre-offer trading range of $27 to $40 per share,* and without it Unocal admittedly would not have made its own $72 offer which was made in order to defeat the Partnership's offer.

If this Court were to adopt the revolutionary rule of law sought by Unocal, there would be no more tender offers initiated by stockholders because no one could take the risk of the destruction of his property rights as a stockholder as the price for making an offer. Shareholders would thus be deprived of the benefits afforded by such

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*Nolen Aff., Ex. A at 18.

offers and our economy would be deprived of this important means for change in management and ownership.

Of equal importance, however, would be the removal of one of the cornerstones of our law, the duty to treat all shareholders fairly, including ones management does not agree with or whose ideas and proposals management does not like. Such tyranny, for it is nothing less, is the antithesis of the fundamental tenets of American jurisprudence and of the underlying principles upon which shareholder democracy is based.

SUMMARY OF ARGUMENT

1. Denied. The Amended Debt Tender, including the exclusion of the Partnership and its transferees therefrom, is on the record of this case an improper defense to Mesa's offer, which is not inadequate, nor coercive, nor two-tiered.

2. Denied. Unocal's board was required to show that the Amended Debt Tender was fair to Mesa; it did not even make the effort below and its effort here fails.

3. Denied. Mesa has demonstrated that it will suffer extreme irreparable harm if the Amended Debt Tender is permitted to proceed.

4. The Unocal board failed to exercise due care in approving and commencing the Amended Debt Tender, and injunctive relief should have been granted on this ground as well.

STATEMENT OF FACTS

This appeal arises out of the defensive measures taken by Unocal and its directors in response to the investment by Mesa Partners II in Unocal and its subsequent determination to seek by tender offer control of, and ultimately the entire equity interest in, Unocal.* Those reactive measures have been three times enjoined by the court below as illegal or inequitable. This appeal concerns the third of those orders. The preliminary injunction was entered by the court below after full review of a record belatedly expanded by defendants to seek to meet the suggestions contained in this Court's May 2 order, and enjoins defendants from making an illegal discriminatory self tender to all Unocal stockholders other than Mesa and its transferees.** Because the salient facts are fully set forth in the briefs below, we anticipate that the Court will draw heavily on those briefs for a fuller appreciation of the factual background of this appeal.

On April 8, 1985, Mesa commenced a tender offer (the "Mesa Offer") for 64 million shares, or 51%, of the common stock of Unocal at $54 cash net per share and announced its intention to propose the acquisition of the remaining equity interest in Unocal in exchange for securities having an aggregate market value of $54 per share. The Mesa Offer represents a substantial premium over the historical market price of Unocal stock (Op. at 3), and the price offered represents Mesa's view of the value of Unocal as a going concern.

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*The partners in Mesa Partners II are Mesa Asset Co. (a wholly-owned indirect subsidiary of Mesa Petroleum Co.), Cy-47, Inc. and Jack-47, Inc., none of which are controlled by T. Boone Pickens, Jr. Unocal's suggestion to the contrary (Unocal Opening Brief on Appeal ("UB") 3) is without record support and is incorrect as a matter of fact regardless of the record.

**For brevity plaintiffs below will be referred to herein as Mesa or the Partnership unless the context otherwise requires.

(Tassin Dep., Appendix to Answering Brief ("App.") B 2-3)).* It is not, as defendants suggest, coercive, front-end loaded or two-tiered. Instead the values offered on the front and back ends are identical.

On April 13, 1985, the Unocal board met to consider the Mesa Offer. The directors were not given any agenda or written documents prior to the meeting. (Op. at 4). At the meeting the board was given no written materials, but was shown a few slides by one of Unocal's investment bankers. (Ch. OB 9). The evidence below established that the directors did not understand the slides or their import (Ch. OB 10-11), and the court below found that the investment bankers' presentation was designed to apprise the board of the methodology used rather than facts or numbers bearing on the adequacy of the Mesa Offer. (Op. at 5).

During that presentation neither Mr. Sachs nor Mr. Hobbs, representing the investment bankers, advised the board of their conclusions as to the value of various components of Unocal (Op. at 5) or how the company might be valued as a whole based on various methods of valuation. (Ch. OB 11-15). No information was given to the board as to the value of Unocal as a going concern. (Brinegar Dep. 37). Neither the directors nor Mr. Hobbs understood the comparisons

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*Citations to depositions in the record below will be indicated by the name of the deponent and the appropriate page reference. Citations to the briefs submitted below on plaintiffs' motion for a preliminary injunction will be indicated by "Ch. OB", "Ch. AB" and "Ch. RB," indicating plaintiffs' opening brief, defendants' answering brief and plaintiffs' reply brief respectively. Citations to affidavits submitted below will be indicated by "[name of affiant] Aff." followed by the appropriate paragraph or exhibit number. References to the May 13, 1985 opinion below will be indicated by "Op." followed by the appropriate page number.

which Mr. Sachs presented to the board. (Ch. OB 10-11; Hobbs Dep. 54). Rather, the board was merely advised by Mr. Sachs that the liquidation value of Unocal was in excess of $60 per share. (Op. at 5). Nonetheless, based on that presentation, the directors concluded that the Mesa Offer was inadequate.

At the April 13 meeting it was proposed that Unocal make a self tender in exchange for Unocal debt securities worth between $70 and $75 per share, conditioned on consummation of the Mesa Offer. Despite the fact that the investment bankers had supposedly been working for six weeks (UB 4), no action was taken on the self-tender at the April 13 meeting because the idea "was not sufficiently well developed." (Op. at 7). Only two hours of the meeting were devoted to a discussion of the proposed Debt Tender. (Brinegar Dep. 72).

On April 15, the board reconvened to reconsider the self-tender proposal and the investment bankers' contract. Again the board was given no written materials either before or during the meeting. Despite the fact that the directors were considering the biggest debt offering ever (Hobbs Dep. 73), the meeting lasted only two hours and the investment bankers attended for only five minutes. (Sachs Dep. 116). Nonetheless, defendants determined at that meeting to commence a self-tender, contingent on the consummation of the Mesa Offer, for the remaining 87.2 million Unocal shares at $72 per share in debt securities. That offer (the "Debt Tender"), was made to all stockholders of Unocal except one -- Mesa Partners II.

As more fully discussed in the briefs below, the Unocal board completely lacked information sufficient to enable it to conclude that $72 per share represented the value of Unocal stock (Ch. OB 15-22; Ch. RB 25-28) or that the debt securities authorized would have the value ascribed to them by the board (Ch. OB 32-38; Ch. RB 28-29). Instead the $72 figure was settled on by the executive committee, and only that figure was considered by the board on April 15. (Eamer Aff., Ex. A at 16-17; Brinegar Dep. 86-87). The investment bankers never opined that the per share value of Unocal stock was $72 or that $72 was fair to all stockholders, and they gave no opinion as to the actual value of the debt securities. Instead they only opined that $72 was fair to the favored class who were to get it. The board admitted in the Offer to Purchase that if the Debt Tender was consummated the value of shares not purchased would be "significantly adversely affected." (Nolen Aff., Ex. A at 10).

Furthermore, the board delegated entirely to management the responsibility of establishing the terms and restrictions to be established in the indenture governing the debt securities.* There was no discussion by the board of specific restrictions. (Ch. OB 22, 80-82; Ch. RB 23-25). Indeed, as Mr. Hartley (Unocal's Chairman) said, there was nothing other than the "general statement, if my memory serves me right,

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*The board's resolution read as follows:

> RESOLVED FURTHER, That the proper officers of the Company be and they hereby are authorized and directed to execute and deliver on behalf of the Company ... an indenture ... setting forth such covenants restricting the future actions of the Company and its subsidiaries as such officers may deem appropriate for the protection of the holders of such securities and containing such other terms, conditions, and provisions as such officers may deem necessary or appropriate....

Eamer Aff., Ex. A at 18-19.

that these notes would be put out with all of the necessary covenants and restrictions, et cetera, et cetera." (Hartley Dep. 103-104; <u>see also</u> Campbell Dep. 101; Brinegar Dep. 146-148). No reason has been advanced by defendants for this delegation of authority to limit Unocal's future business by the imposition of restrictive covenants. Given the nature of the restrictive covenants to which management agreed, which severely limit the business of Unocal (so much so that they have since had to be twice amended) (Ch. OB 22-27; Ch. RB 23-25), the delegation was plainly improper.

The purpose of the Debt Tender was to defeat the Mesa Offer or, failing that, to transfer value from the Partnership to Unocal's other stockholders. Thus the board stated that it "recognize[d] that the offer of the Securities pursuant to the [Debt Tender] might inhibit Mesa Bidders' ability to obtain financing for the Mesa Offer by preventing or hindering the use of Company assets and earnings to finance the Mesa Offer and could cause Mesa Bidders to terminate the Mesa Offer." (Nolen Aff., Ex. A at 7).* Supposedly, the board was concerned about the value of the second step of the Mesa Offer. However, there could be no legitimate concern as to the value of the securities in that second step since the Partnership offered, in a letter to each of Unocal's directors, to have the value of the securities to be offered in the second step determined by an investment banker chosen jointly by Unocal and the Partnership. (Fourth Tassin Aff. ¶11).

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*Defendants say (UB 26) that the effect of consummation of the Amended Debt Tender will be to <u>help</u> Mesa, not to <u>harm</u> it. In the face of Unocal's public pronouncements this is incredible.

There was also no credible evidence below that the board designed the Debt Tender to protect Unocal from supposed depredations by Mesa, or that the board was concerned that Mesa might be interested in "greenmail" or other selective treatment. Instead, it was only after this Court raised that issue, and after Unocal had formulated and lost on its position in the court below at the temporary restraining order stage, that such testimony appeared in the form of virtually identical, "cookie cutter" affidavits. (See Ch. RB 13-17). These ideas, belatedly introduced, were pure afterthoughts, and the evidence below demonstrated no reasonable basis upon which the Unocal directors could reasonably have harbored them.*

On April 22, the investment bankers recommended to the board that it partially waive the Mesa purchase condition of the original Debt Tender and that Unocal exchange debt for 50 million shares of its common stock whether or not Mesa purchased shares pursuant to the Mesa Offer. (Second Tassin

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*This is clear from the record below. First, the otherwise exhaustive minutes of the board's meetings, drafted by counsel, reveal no hint that the board had any concern that Mesa was seeking selective treatment. Second, had the directors chosen to look beyond newspaper reports (carefully collected by Unocal's counsel after the May 2 order), they would have seen that there was no historical basis for any such concern. (Fourth Tassin Aff. ¶¶3-5). Third, they did not need to look beyond the opinion of the Court of Chancery in Edelman v. Phillips Petroleum Co., Del. Ch., C.A. No. 7899, Walsh, V.C. (Feb. 12, 1985), interlocutory appeal refused, Del. Supr., No. 55, 1985, Moore, J. (Feb. 16, 1985), to see that in that recent transaction Mesa chose to forego significant profits in its quest to push for a recapitalization beneficial to all stockholders, not just itself. Fourth, the public statements of Mesa themselves condemned greenmail, not promoted it. (Fourth Tassin Aff. ¶5). And fifth, Mesa disclaimed any intention to seek such selective treatment from Unocal itself.

Aff., Ex. A). Again the Unocal board met for only two hours, again there were no written materials presented to the board, and the investment bankers were asked to attend for only a "couple of minutes." (Ch. OB 28-30). As had the original Debt Tender, the Amended Debt Tender purported to exclude Mesa from participating in the offer. (Op. at 9-10).

Although we thought it had been laid to rest long ago, Unocal now contends again that Mesa has "admitted" that its offer is "inadequate," that its price is "concededly inadequate" and that evidence "created by Mesa" demonstrates this. (UB 3-4, 7, 24). Indeed Unocal seems compelled to rely upon these phantom "admissions" to support every one of its arguments. We will say it again: Mesa believes that its offer is adequate and that it is a valuable offer for the Unocal stockholders deserving of their consideration.

Unocal's efforts to construct phantom admissions are, we think, an affront to the dignity of the Court. The deposition testimony established that the Mesa Offer reflects Mesa's view of the value of Unocal as a going concern. (Tassin Dep., App. B 2-3). The $54 price, unlike the $72 price, is supported by reference to acquisition prices of other comparable companies considered by Unocal's investment bankers themselves. (Third Tassin Aff. ¶7; Sorte Aff. ¶17). The documents constituting the record on this issue include analyses of the assets of Unocal by Mesa and by third parties, but Mesa has expressed no opinion as to the value of Unocal's stock in any of those documents. (Third Tassin Aff. ¶4; Fourth Tassin Aff. ¶12, see also Sachs Dep. 95). Certainly such an opinion cannot be inferred by the inclusion for comparative purposes of analyses of others, such as John S. Herold, Inc. and Donaldson, Lufkin & Jenrette. Indeed, in his affidavits Mr. Tassin has gone to great lengths to explain to the Court and to the defendants the inherent limitations, such as the failure to take deferred and future taxes into account, in the broad brush analyses that Unocal again tries to palm off as Mesa's, or Mr. Pickens', view. (See Third Tassin Aff. ¶¶4-6; Fourth Tassin Aff. ¶12). We are confident that the Court, if not defendants, will find the misrepresentations again made by defendants in the face of a contrary record to reveal the bankruptcy of their factual, and thereby their legal, position.

ARGUMENT

I. THE COURT BELOW CORRECTLY HELD THAT THE DIRECTORS' ADOPTION OF THE DISCRIMINATORY AMENDED DEBT TENDER IS NOT PROTECTED BY THE BUSINESS JUDGMENT RULE AND THAT THE DIRECTOR DEFENDANTS DID NOT SATISFY THEIR BURDEN OF PROVING THAT THE AMENDED DEBT TENDER IS FAIR TO ALL UNOCAL STOCKHOLDERS.

A. Standard and Scope of Review.

The Court of Chancery has broad discretion in granting or denying a preliminary injunction. Data General Corp. v. Digital Computer Controls, Inc., Del. Supr., 297 A.2d 437, 439 (1972). This Court may therefore reverse only if it finds that the Vice Chancellor has abused her discretion. Daniel D. Rappa, Inc. v. Hanson, Del. Supr., 209 A.2d 163, 166 (1965); Gimbel v. Signal Cos., Inc., Del. Supr., 316 A.2d 619, 620 (1974).

Moreover, the Vice Chancellor's finding of unlawful discrimination is a mixed question of law and fact. Accordingly that finding must be accepted unless "clearly wrong." Levitt

v. Bouvier, Del. Supr., 287 A.2d 671, 673 (1972); Smith v. Van Gorkom, Del. Supr., 488 A.2d 858, 871 (1985). The "clearly wrong" standard is expressly applicable where, as here, the evidence consists of depositions and other written documents. Application of Delaware Racing Association, Del. Supr., 213 A.2d 203, 207 (1965).*

B. The Debt Tender Inequitably And Unfairly Discriminates Against The Partnership In Violation Of The Directors' Fiduciary Duties To Mesa.

The Court below correctly held that the business judgment rule is inapplicable to the present case for two independent reasons. First, because the Debt Tender discriminates among Unocal stockholders, making financial benefits available to all stockholders but one, the directors must prove the fairness of the discriminatory transaction they propose. (Op. at 16-19). Second, the directors cannot invoke the business judgment rule because they are financially interested in the Debt Tender. (Op. at 19). Because the actions of the directors are not entitled to the presumption of propriety afforded by the business judgment rule, and the directors did not even attempt to prove the fairness of their actions to all stockholders, the Court below properly enjoined the directors

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*The Delaware standard is in accord with that recently announced by the United States Supreme Court in Anderson v. City of Bessemer, 53 U.S.L.W. 4314 (U.S. Mar. 19, 1985). There the Court held that the "clearly erroneous" standard does not allow reversal of a trier of fact simply because the reviewing court would have decided the case differently, even where the findings rest on documentary evidence. 53 U.S.L.W. at 4317. As the Court stated: "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous." Id. To avoid unnecessary duplication of judicial effort the Court found that trial findings should be "the main event" rather than "a tryout on the road." Id.

from implementing the illegal and inequitable Debt Tender.

The Court below succinctly summarized defendants' position as espousing "a rule suspending the directors' fiduciary duty to treat shareholders fairly as to any shareholder perceived to be a threat to the company" and "departing from the established principles of fiduciary duty governing directors' treatment of their shareholders." (Op. at 18-19).* The Court stated that the "decisions of our courts consistently have not only recognized but have been founded upon the precept" that directors owe fiduciary duties to all shareholders (Op. at 18), with the foremost of those duties being the duty to treat all stockholders fairly. See, e.g., Condec Corp. v. Lunkenheimer Co., Del. Ch., 230 A.2d 769, 775 (1967); Baron v. Allied Artists Pictures Corp., Del. Ch., 337 A.2d 653, 658 (1975); Pathe

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*In response to a question from the Trial Court, defendants' counsel expressed the concept advocated by defendants as a "springing fiduciary duty":

> THE COURT: Well, then, would it be fair to say, to parallel the question that I asked Mr. Richards, that what you are in effect saying is that when you have a stockholder who becomes a raider and who is determined to be not in the best interests of the company, then the board no longer owes any fiduciary duties to that stockholder?
>
> MR. SPARKS: It's sort of a springing fiduciary duty concept, your Honor. Once that person ceased to be a predator and became a passive investor, then there would be fiduciary duties owed to him.
>
> * * *
>
> But, yes, when he's a predator for that period of time, in effect, their fiduciary obligations owed to all other stockholders are suspended as to that person....

(Transcript of May 8 Hearing at 86-87). See also UB 10 ("In these circumstances, Unocal's directors do not owe a duty of fairness to Mesa").

Industries v. Cadence Industries Corp., Del. Ch., C.A. No. 5755, Marvel, C., slip op. at 3 (Apr. 11, 1979) (App. B 42). There being neither precedent nor justification for doing so, the Court refused to allow the defendant directors to disregard their fiduciary duties and enjoined the Debt Tender because it flagrantly abrogates those duties.

It is this recognition of the fiduciary duty of directors to treat all shareholders fairly which serves as the basis for the decision of the Court of Chancery in Fisher v. Moltz, Del. Ch., C.A. No. 6068, Hartnett, V.C. (Dec. 28, 1979), reprinted in 5 Del. J. Corp. L. 530 (1980), reargument denied, Del. Ch., C.A. No. 6068, Hartnett, V.C. (Feb. 21, 1980). In Fisher, the only decision of a Delaware Court involving a discriminatory tender offer, the Court held that a defendant seeking to justify such an offer bears the burden of proving "that there is a valid corporate purpose for limiting the offer and that in so doing it has not unduly favored one group over another," 5 Del. J. Corp. L. at 532, in the sense that the tender offer is "fair to all the stockholders." Fisher, slip op. at 1 (Feb. 21, 1980); Mesa Petroleum Co. v. Unocal Corp., Del. Ch., C.A. No. 7997, Berger, V.C., slip op. at 6 (Apr. 29, 1985).

Defendants' attempt to rid themselves of their duty to deal fairly with all Unocal stockholders is based on their erroneous application of the Vice Chancellor's holding to the numerous cases applying the business judgment rule to defensive maneuvers. (UB 11-12). Defendants argue that the Vice Chancellor's holding establishes a rule that "all defensive efforts are, by definition, 'unfair' to the raider" (UB 12) because they "are designed to defeat his bid for control" (UB 11). In fact, the Court below held only that directors bear the burden of proving the fairness of a defensive tactic that does not affect all shares equally on a pro rata basis. Each of the cases cited by defendants (UB 11-12) involved defensive tactics that affected the aliquot interests of all stockholders identically. By contrast, the Debt Tender offers immediate financial benefits to holders of 87% of the Unocal stock but excludes the holder of 13%. This discrimination among stockholders, in their capacities as stockholders,* led the Court below properly to require defendants to prove the fairness of their actions. A different result would apply had defendants chosen to employ a defensive tactic that affects all shares equally.

Moreover, contrary to defendants' assertions, the Delaware cases involving repurchases of dissident stockholders' shares neither abrogate the fiduciary duty of directors to deal with all stockholders fairly nor justify the discriminatory tender offer at issue here. Thus, Martin v. American Potash & Chemical Corp., Del. Supr., 92 A.2d 295, 302 (1952), supports the power to purchase stock selectively, but expressly acknowledges the concomitant duty to treat all shareholders fairly. In its key findings

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*Defendants ignore the distinction between the effect of a defensive maneuver on a hostile suitor in his capacity as a suitor and the effect on the hostile suitor in his capacity as a stockholder. Although each of the defensive measures employed in the cases cited at page 15 of the Court's opinion is detrimental to the suitor's takeover attempt, the action affects him no differently as a stockholder of the target company than the other stockholders.

the Court held that a selective repurchase of stock is not absolutely prohibited "provided of course that the transaction is clear of any fraud or unfairness" and that the purchase "will not work unjustly or inequitably." 92 A.2d 301-02, quoting British and American Trustee and Finance Corporation v. Couper [1894] A.C. 399.

In Cheff v. Mathes, Del. Supr., 199 A.2d 548, 554 (1964), no claim was raised that the repurchase of the dissident's stock was inequitable to other shareholders because not extended to them. Rather, in Cheff the dissident shareholder had consented to the transaction and obtained an agreed price for his shares. Here, the Partnership has not consented and gets nothing.

The differences between Cheff and the present case go farther, however. In Cheff all the other shareholders received the benefit of the removal of the dissident. Here, that is not true; instead, the other shareholders get unfair and unduly favorable treatment, $72 for a share selling at $46, and at Mesa's expense. In Cheff, the directors did not participate in the sale; here they do. In Cheff, there was a dramatically different equitable effect in buying from one shareholder at a price slightly over market, as opposed to here where Unocal is buying from 70,599 shareholders at 56% over market at the expense of one shareholder.*

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*Bennett v. Propp, Del. Supr., 187 A.2d 405 (1962), is similarly inapposite. In Bennett, the company purchased shares on the open market, so all shareholders had the opportunity to be treated the same.

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Defendants claim that the Court below established a "rule of law that requires that one seeking a personal advantage must consent to defensive actions taken against him." (UB 21). That is a gross mischaracterization of the lower Court's holding. The Vice Chancellor held only that if a stockholder is to be discriminated against contrary to his will by unequal treatment of his shares, those proposing the discrimination must prove its fairness. Defensive maneuvers that treat all shares alike will continue to be judged by the business judgment rule, without consideration of consent, because there is no discrimination there.*

Finally, in Kors v. Carey, Del. Ch., 158 A.2d 136 (1960), a dissident's stock, constituting 16% of the stock outstanding, was repurchased at a premium of only 10%. The Court recognized:

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Even so, the Court sounded a warning, applicable here as well:

> We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved.

187 A.2d at 409. Kaplan v. Goldsamt, Del. Ch., 380 A.2d 556 (1977), is likewise dissimilar to this situation. First, shareholder approval was obtained. Thus, as in American Potash, everyone in effect had consented. Second, only 6% of the stock was bought back, a far cry from the diluting effect of repurchasing a minimum of 29% and up to 49% of the stock with the crippling effect of the self-imposed debt restrictions and covenants.

*Thus, cases such as Hall v. Trans-Lux Daylight Picture Screen Corp., Del. Ch., 171 A. 226 (1934), Edelman v. Phillips Petroleum Co., Del. Ch., C.A. No. 7099, Walsh, V.C. (Feb. 12, 1985), and Moran v. Household International, Inc., Del. Ch., C.A. No. 7730, Walsh, V.C. (Jan. 29, 1985), are not inconsistent with the holding of the Court below. None of those cases involve actions that do not affect all shares equally. Accordingly, those cases are properly governed by the business judgment rule.

> [D]irectors, while bound to deal with stockholders as a class with scrupulous honesty, may in the exercise of their honest business judgment adopt a valid method of eliminating what appears to them a clear threat to the future of their business by any lawful means.

158 A.2d at 141 (emphasis added). Based on the above-quoted sentence, Kors is said to have established that disfavored stockholders are "in a separate category from other stockholders" (UB 18) and that "concepts [of fairness] do not apply once a stockholder has taken a position adverse to the interests of the corporation and its stockholders." (Ch. AB at 26-27 n*, 38). Instead, as the Vice Chancellor correctly stated (Op. at 18), the above passage from Kors stands for the proposition that, while directors may treat stockholders differently, they must do so "consistent[ly] with the directors' fiduciary duties." Indeed, immediately following the statement relied upon so heavily by plaintiffs, the Court in Kors quoted with approval the requirement enunciated in American Potash that any disparate treatment of stockholders be free of any "unfairness." 158 A.2d at 141. There is simply no basis for defendants' claim that Kors eliminates the fiduciary duty of fairness owed by directors to an unpopular stockholder.

Thus, defendants' argument essentially is that this Court should turn its back on the cardinal principles of Delaware law of fairness and equity. Defendants contend that as long as directors act in good faith they may take any "reasonable" action, defining reasonable as no more than is necessary to achieve some proper corporate purpose. If the end is justified, they argue, and the means are reasonably calculated to achieve the ends, then the means are not subject to judicial scrutiny no matter how unfair or inequitable they might be. As held by the court below, that has never been the law of Delaware and should not be now. See, e.g., Schnell v. Chris-Craft Industries, Inc., Del. Supr., 285 A.2d 437, 439 (1971) ("inequitable action does not become permissible simply because it is legally possible").

To adopt defendants' position is to invite unbridled inequity in directors' treatment of stockholders. Once directors deem a stockholder to be "hostile" to the corporation (UB 17) and thereby in a "separate category from other stockholders" (UB 18), directors would not be restrained from other discriminatory acts. The fundamental principle of Delaware law that all shareholders are to be treated equally would be destroyed. That result is unnecessary, however. Contrary to defendants' claim that denying directors the ability to treat stockholders unfairly will deprive directors of "the ability to respond reasonably" to unwanted takeover attempts, a multitude of defensive tactics remains available to directors which affect all shares equally.

C. The Directors Cannot Invoke The Business Judgment Rule Because They Stand On Both Sides Of The Debt Tender And Expect To Derive Personal Financial Benefit From It That Is Not Available To All Unocal Stockholders.

The Court below correctly held that the self-interest of the directors is an independent ground for requiring them to prove the fairness of the Debt Tender to all Unocal stockholders. (Op. at 19). It is well-settled in Delaware law that directors who stand on both sides of a transaction, or expect to gain personal profits that are not shared by all shareholders equally, are not entitled to the benefits of the business judgment rule with respect to the transaction in question. Instead, they bear the burden of proving its entire fairness. Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984). See also Pogostin v. Rice, Del. Supr., 480 A.2d 619, 624 (1984); Lerman v. Diagnostic Data, Inc., Del. Ch., 421 A.2d 906 (1980).

Although each of the directors has expressed his intention to tender his Unocal shares into the Debt Tender which he approved, defendants claim that the financial interests of the director defendants in the Debt Tender is "de minimus" (UB 9). The directors personally stand to gain between $1.46 and $7.28 million, depending upon how many shares the public tenders, merely as a result of their having excluded Mesa from the Debt Tender. (Fourth Tassin Aff. ¶9 and Ex. B). Moreover, the total consideration they could receive exceeds $70 million -- hardly de minimus. Nor is it "dogmatic" or "technical" (Ch. AB 43) to contend that the directors' financial interest in the Debt Tender, which is not available to all Unocal stockholders, requires the directors to prove the fairness of the Debt Tender.

In short, the directors chose to participate in the Debt Tender and to enjoy the financial benefits available thereunder.* They cannot claim that it was neces-

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*Indeed, the directors have served their personal financial interests by means other than their adoption of the Debt Tender. On April 29, 1985, the date that the

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sary for them to tender for the Debt Tender to succeed. In light of the huge premium over market being offered, there can be no doubt that the Debt Tender will be over-subscribed. Moreover, had they refused to tender, more benefits would have been available to the favored non-Mesa stockholders and, if they believe their own arguments, they would suffer no disadvantage by not tendering. The fact that all of the directors have opted to accept the terms offered in the Debt Tender speaks volumes to the attractiveness of those terms to those able to accept them and the corresponding unfairness to those excluded. Thus, the court below correctly held that because of their personal interests in the Debt Tender, the directors have the burden of proving its fairness.

D. The Court Below Correctly Held That Defendants Have Failed To Prove That The Amended Debt Tender Is Fair To All Unocal Stockholders.

Perhaps the most graphic evidence of defendants' inability to prove that the Debt Tender is fair to all Unocal stockholders is their failure to even attempt to do so. See Op. at 20 ("Unocal has made no effort to establish the fairness of the exchange offer as it applies to Mesa"). Defendants are not alone, however, in their unwillingness to address the fairness of the Debt Tender.

[Footnote continued from previous page]

court below temporarily restrained the Debt Tender, the Compensation Committee of the Unocal board accelerated options held by the five inside directors and determined that the stock appreciation rights coupled with those options could be paid entirely in cash. The resultant benefit to the directors was $974,848.00. (See Ch. OB 40-41, 68).

Neither of the investment banking firms retained by Unocal was willing to opine that the Debt Tender was fair to <u>all</u> Unocal stockholders.

Defendants' new-found "proof" that the Debt Tender is fair to Mesa consists entirely of the following "analysis": "the record is clear that $72 fairly states the underlying asset value of a share of Unocal stock. Moreover because Mesa ultimately intends to own all of Unocal, it would, as a 100% owner, be able to realize those values." (UB 23). Thus, for the Debt Tender to be considered fair to Mesa: (1) the Mesa Offer must succeed and Mesa must achieve 100% ownership; (2) despite the obstacles created by the restrictive covenants contained in the trust indenture, Mesa must be able to liquidate the assets of Unocal; (3) that liquidation must yield at least $72 per share; and (4) the time value of money must be ignored. Any analysis built on this "slippery slope" of blind assumptions falls far short of satisfying defendants' burden.

Defendants' fairness argument is largely premised on their repeated claim that Mesa "admits" that the value of Unocal stock is at least $72 per share and that Mesa's $54 offer therefore is inadequate. (UB 23-24). These assertions are false and defendants know it. Mesa believes $54 per share to be the value of Unocal as a going concern. (Tassin Dep., App. B 2-3). Moreover, the $54 price is comparable to the terms of the acquisitions of two integrated oil companies (Gulf and Getty) which are substantially similar to Unocal in size and nature of assets. (Sorte Aff. ¶17).

Defendants' attempt to ascribe to Mesa values generated by Donaldson, Lufkin & Jenrette ("DLJ") and John S. Herold, Inc., ("Herold") is similarly misleading. (UB 4, 21, 23).* Neither of those values nor the Mesa analysis makes provision for existing deferred income taxes ($1.333 billion, or $7.68 per Unocal share as of December 31, 1984) or future income taxes on operations. (Third Tassin Aff. ¶6, Fourth Tassin Aff. ¶12). Moreover, Herold's value is inappropriate for ascertaining realistic liquidation values, (Sorte Aff. ¶¶18-22),** and DLJ's methodology is used by no one else in the industry. (Third Tassin Aff. ¶6). In short, these values were used by Mesa for comparison purposes only and are recognized by persons in the oil industry as having inherent limitations and limited scope. (Fourth Tassin Aff. ¶12).

Defendants also rely on "the views of Unocal's two investment bankers, who independently concluded that $72 is within the range of values that may fairly be assigned to Unocal's stock." (UB 23). Those views, however, are based upon the value of Unocal in an "orderly liquidation." As this Court held just six days ago, "[i]n Delaware a company is valued as a going concern, not on what can be obtained by its liquidation." Rosenblatt v. Getty Oil

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*Unocal misquotes and distorts Mr. Pickens' testimony on Herold's values. (UB 23-24). Mr. Pickens recognizes Herold's values for "comparative purposes" only (Pickens Dep., App. B 1), not as being authoritative. (Third Tassin Aff. ¶4).

**The liquidation value contained in Drexel Burnham's unreleased report relies on Herold's value, and is thus subject to the same defects.

Co., Del. Supr., C.A. No. 352, 1983, slip op. at 29, Moore, J. (May 9, 1985) (App. B 5). Moreover, Unocal's advisors' views as to liquidation value are not supported by any estimate of how long such a liquidation would take (Ballhaus Dep. 131). Likewise, they ignore the fact that Unocal has announced no intention to liquidate, and that the liquidation of a company the size and complexity of Unocal has never occurred. (Sorte Aff. ¶¶18-22).* Thus, defendants' distortions of the record regarding the valuation of Unocal and the adequacy of the Mesa Offer fall far short of establishing the fairness of the Debt Tender.

The unfairness of the Debt Tender is perhaps best seen, however, by considering its implications. If allowed to do so, boards of directors will make successive discriminatory tender offers until they have succeeded in paying out virtually all of the equity of the corporation. The excluded stockholder will be left only with an insurmountable debt burden and the hope that after liquidation (if the restrictions made necessary by the various debt instruments allow him to liquidate) and satisfaction of the claims of the multitude of creditors, he can realize the fair value of his investment. This Court should not afford directors who feel threatened the ability to wreak such destruction of the corporate enterprise and the rights of stockholders.

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*Indeed, contrary to defendants' claim that their advisors' views evidence the fairness of the Debt Tender to Mesa, defendants have admitted that after completion of the Debt Tender the market price of Unocal stock will decline. (Nolen Aff., Ex. A at 3).

Mesa has invested over $1,000,000,000 in Unocal, and no reasonable beliefs or good faith perceptions can justify what in effect is a partial confiscation of that investment. There are other defensive tactics available to defendants, many of which have been blessed by the courts, that do not inflict upon the unwanted stockholder the immediate injury that is the intended effect of the Debt Tender. This particular device, founded upon concepts of inequity and unfairness, finds no place in Delaware law.

II. THE ORDER ENTERED BY THE COURT BELOW IS SUPPORTED BY THE FAILURE OF DEFENDANTS TO EXERCISE DUE CARE.

The Court below made factual findings concerning the absence of due care on the part of the Unocal board in reacting to the Mesa Offer which, together with the other facts of record below, were more than sufficient to warrant the entry of preliminary injunctive relief against the Amended Debt Tender.

As this Court only recently held, directors owe their stockholders an unyielding duty of due care. Smith v. Van Gorkom, Del. Supr., 488 A.2d 858 (1985). They must inform themselves of "all material information reasonably available" before they act. Aronson v. Lewis, Del. Supr., 473 A.2d 805, 812 (1984). Merely bringing good faith to the consideration of a particular question is not enough. Instead, judgment must be informed, and must be "brought to bear with specificity on the transactions" under review. Kaplan v. Centex Corp., Del. Ch., 284 A.2d 119, 124 (1971);

Smith v. Van Gorkom, 488 A.2d at 872; Aronson v. Lewis, 473 A.2d at 812. These defendants fell far short of that standard.

The evidence submitted below demonstrates the complete lack of any exercise of due care on the part of the Unocal board. Instead, the directors acted on the basis of incomplete and selective oral advice, delegated the most fundamental decisions to management and the investment bankers and undertook neither efforts to understand what they were approving nor efforts to ensure that what they decided to approve was in fact carried out. The board was given no documentation on the important matters it was being asked to consider either before, during or between its meetings. (Op. at 20).

The board's failure to obtain and consider appropriate information pervaded its entire consideration and adoption of the Debt Tender and the resulting recapitalization of Unocal. The undisputed evidence shows that the directors were given no documents to explain either the extent or the nature of the restrictive covenants they imposed on Unocal (Op. at 8), and they simply delegated fundamental decisions governing and restricting Unocal's ability to continue as a going concern.*

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*Dividends were restricted (Sorte Aff. ¶32), future debt limited (Sorte Aff. ¶33), sales of assets limited (Sorte Aff. ¶34) proceeds from sales of assets are now required to redeem outstanding debt (Sorte Aff. ¶35) and so forth. See Ch. OB 22-27. These unnecessary and commercially unreasonable restrictions, combined with the economic effect of $6.264 billion in debt, will dramatically alter Unocal unless enjoined.

Because the directors made no effort to inform themselves as to the scope of the restrictions, their decision to delegate this task cannot be considered to have been an informed decision, within the business judgment of the board. For whatever reason, and none has been advanced by the defendants, these extraordinary issues were simply left to subordinates. Unlike in Rosenblatt v. Getty Oil Co., here there was no purpose for the delegation. Moreover, unlike in Rosenblatt, the decisions were left to parties who under any construction of the record could not be considered independent or unbiased. The fee arrangements between Unocal and the investment bankers provide for the investment bankers to receive millions of dollars more in compensation if Unocal remains independent than if Unocal is acquired at any price.* A management intent on preserving its jobs can hardly be said to lack interest. Thus this task was delegated to persons who cannot under any reading of the record below be considered independent or unbiased. It is therefore not surprising that the restrictive covenants are so drafted as to inhibit Mesa's Offer.

Further, the board made no effort whatsoever to double-check the restrictions which were in fact put in place by the persons to whom it had delegated that duty. Cf. Smith v. Van Gorkom, 488 A.2d at 883, n.25; Rosenblatt v. Getty Oil Co., slip op. at 32. Nor were the directors

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*See Nolen Aff., Ex. A, p. 9. The investment bankers receive $25 million if Unocal stays independent for a year, and a maximum of $22 million if it does not.

any better informed in making the critical valuation determinations that they were required to make. (See Ch. OB 18-22, 32-38; Ch. RB 25-29). Thus it cannot be said that the advice received by the board from the investment bankers was meaningful or that the board's inquiry passed the test of due care. Cf. Rosenblatt v. Getty Oil Co., slip op. at 22.

III. THE COURT BELOW CORRECTLY FOUND THAT PLAINTIFFS ESTABLISHED THE THREAT OF IRREPARABLE INJURY.

Defendants mischaracterize both the decision and the record below by stating that the finding of irreparable injury was premised "entirely" on the conclusion that the substantial debt, with its severely restrictive covenants, will make it more difficult for Mesa to succeed in its takeover efforts. (UB 25). This attack simply ignores the Court's finding that:

> In apparent recognition of the realities of an exchange offer such as this one involving more than 70,000 shareholders, Unocal does not quarrel with this Court's earlier conclusion that rescission will not be a viable remedy.

(Op. at 23; emphasis added).

The conceded inability to rescind or unscramble the discriminatory Amended Debt Tender, which constitutes the "biggest offering of debt securities perhaps ever" (Hobbs Dep. 73), is sufficient of itself to establish irreparable harm. Courts have frequently recognized that it is impossible to "unscramble the eggs." Ronson Corp. v. Liquifin Aktiengesellschaft, 483 F.2d 846, 851 (3d Cir. 1973); Joseph v. Shell Oil Co., Del. Ch., 482 A.2d 335, 344 (1984). The harm here is all the more irreparable given the complicated nature of the Amended Debt Tender. Once the Amended Debt Tender is consummated and the restrictive convenants imposed, it could never be unraveled and the present status quo could never be regained. See Gimbel v. Signal Cos., Del. Ch., 316 A.2d 599, 603, aff'd, Del. Supr., 316 A.2d 619 (1974).

Moreover, the Amended Debt Tender interferes with the Partnership's legal right to have its shares treated equally with all other shares of Unocal. This of itself establishes irreparable harm. Plaza Securities Co. v. Datapoint Corp., Del. Ch., C.A. No. 7932, Brown, C. (Mar. 5, 1985), aff'd, Del. Supr., No. 79, 1985, Horsey, J. (Mar. 8, 1985).*

Similarly, irreparable injury is established by the "unlawful alteration of the company's assets which was also designed to fend off a Mesa takeover." (Op. at 24). Plaintiffs are here threatened with the loss of a unique opportunity not compensable in money damages. Mesa Petroleum Co. v. Unocal Corp., Del. Ch., C.A. No. 7997, Berger, V.C. (Apr. 29, 1985). This, too, establishes irreparable harm. In holding that a stock issuance designed to defeat

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*Once the Amended Debt Tender is consummated, plaintiffs will have been deprived of any opportunity to acquire Unocal without suffering the impact of defendants' unlawful acts and will see their investment of over $1 billion irreparably injured. Where a damage claim is enormous in terms of dollars, it may well be a meaningless remedy. Gimbel v. Signal Cos., 316 A.2d at 604; Thomas v. Kempner, Del. Ch., C.A. No. 4138, Marvel, C. (Mar. 22, 1973). The director defendants, who would be presumably liable, cannot respond to an award of money damages in this action given the magnitude of damage. In addition, if Mesa were to acquire 100% of a greatly damaged Unocal, it is hard to see how it could make itself whole by a payment to itself out of corporate funds.

an impending takeover attempt irreparably harmed the party seeking control, Judge Debevoise of the District Court for the District of New Jersey recently stated:

> I also conclude that Weeks has established irreparable injury if Series C Preferred Stock is issued. It holds a substantial block of Asarco common stock and evidently plans to acquire in excess of 20 percent of the total common shares outstanding. If it does so, its vote will be illegally diluted by virtue of the new preferred. Weeks' opportunity to make a tender offer will be limited by an unlawful device and correspondingly the opportunity of other shareholders to receive a tender offer will be impaired. All this constitutes irreparable injury.

Asarco, Inc. v. MRH Holmes A Court, Civil No. 85-1123, slip op. at 35 (D.N.J. May 1, 1985) (App. B 48); Applied Digital Data Systems, Inc. v. Milgo Electronic Corp., 425 F. Supp. 1145, 1162 (S.D.N.Y. 1977).

In sum, the record in this case establishes, and the court below correctly found, the existence of a threat of irreparable injury.*

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*Defendants' continued reliance on Judge Tashima's conclusion in the California federal securities law action is misplaced. (UB 27-28). Judge Tashima was not "faced with the same arguments of irreparable injury" (UB 27) presented here. As was recognized by Judge Tashima, Unocal Corp. v. T. Boone Pickens, No. CV-85-2179-AWT, slip op. at 5 (C.D. Cal. May 1, 1985), and by Unocal's counsel (Unocal's April 30 Application for Certification, Ex. C at 12) in that action, Mesa made no attempt to submit affidavits or other evidence in support of the claimed irreparable harm, relying instead on a per se claim of the legality under the Williams Act.

CONCLUSION

For all of the reasons advanced herein the Appellees respectfully request that the decision of the Court below be affirmed.

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