City Capital Assocs. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988)
Household & Interco: Michael Schwartz Interview

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MR. ROWE: We are here with Mike Schwartz. Maybe you can start by explaining the background of your many years at Wachtell Lipton as a premier takeover litigator. #00:00:47#

MR: SCHWARTZ: Well, I'll skip all the flattery, but I came to Wachtell Lipton as an associate in 1973 and became a partner in 1977. And I spent thirty-one years, I guess, altogether at Wachtell Lipton litigating a lot of very interesting cases. I must say none more interesting, I think, than the one that you're probably going to talk to me most about, and that's the Household case. #00:01:12#

MR. ROWE: That Household case that some people call Moran and like all these cases, it seems to travel under a couple of different names. So, Household in some ways is unique in that it involved not so much a look at a specific transaction or competing transactions that the court was being asked to review, but a whole new device in the takeover context. #00:01:40#

MR: SCHWARTZ: That is correct.

MR. ROWE: And it was also the subject of a full trial, I think nine days, and most of the other—

MR: SCHWARTZ: Which I would have said longer, but if that's what the record shows...

MR. ROWE: Well, I'm not a hundred percent sure, but I guess...it probably felt like a couple hundred.

MR: SCHWARTZ: A lot longer. #00:01:58#

MR. ROWE: And it resulted in a complete change in how M&A was practiced.

MR: SCHWARTZ: Correct.

MR. ROWE: And I'm talking too much. Why don't I ask you to say what you recall about the background of the development of the rights plan and how you got into defending it. #00:02:18#

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MR: SCHWARTZ: I was not personally involved at all in the development of the rights plan. I learned about it over the summer, I guess it would have been of 1984, when I heard that there were a bunch of depositions being taken of directors of Household about a new device that had been developed by Marty Lipton and by Andy Brownstein and others in our corporate group. And I learned that promptly after the rights plan had been adopted by Household, one of Household's directors John Moran, had brought suit, as you say, in the absence of any particular transaction, seeking a declaration from the Delaware courts that the plan was invalid and

illegal, unconstitutional, fattening, every bad thing it could possibly be. And a team of litigators was put together here to handle that case; it was headed by my late and much-lamented partner, George Katz. And I was on the case, Bill Sterling, Eric Roth, Warren Stern, a bunch of others. #00:03:36#

It was obviously from the get-go an extremely consequential case, not only in terms of Delaware law and the takeover environment but for Wachtell Lipton. This was the pill, the poison pill, as it was promptly named I think by the fellows over at Skadden, who were our adversaries in the matter; it was an enormously controversial development and was much derided. The very name, poison pill, implies a sort of a sneering, contemptuous dismissal of this thing as being beyond the pale. #00:04:12#

And there was a sense, I think, legitimately, that maybe somehow or other, Wachtell Lipton had just gone too far and this was going to be invalidated. And to say that that would have put egg on our face would be an understatement. I mean it was, I think I remember seeing an interview that Marty did some years ago in which he thought this was, from his perspective, a bet the firm issue. I don't think he was wrong. I think if one tries to imagine an alternative universe in which the pill had been held illegal by the Delaware courts,

one wonders exactly what the future of Wachtell Lipton would have been. #00:04:54#

So, it was a hugely important case, and we treated it as such.

We were very glad, obviously to be litigating in the Delaware courts. The Delaware courts where I, although I'm a New York lawyer, and obviously our office is in New York, I am sure I spent more of my thirty-odd years at Wachtell Lipton litigating in the Delaware courts than in any other court system in the country. And I don't say this lightly; they are, I think, the premier court system in the country for corporate litigation. #00:05:23#

So, we knew we had a fair, dispassionate, objective environment in which to try the case.

As I said a few moments ago, of all the cases I had tried, and I tried, I was fortunate enough to be involved in a ton of really interesting litigation over my years at Wachtell Lipton; in some ways, this was the most interesting, both substantively and because of the stakes that were involved. #00:05:50#

MR. ROWE: And you've referred to this, but there were a series of unusual litigation decisions, both by Skadden and by our firm. And I think one place to start is with Skadden; I assume it was Skadden's decision to bring a case

where there was not a bid on the table, and the poison pill wasn't being used to block a bid, it was just out there as an abstract principle. How do you feel that affected the course of the litigation? #00:06:24#

MR: SCHWARTZ: That's a very good question. I think Skadden brought suit – it was almost as if they had something ready – they brought suit within a matter of days after the Household Board adopted the, I'll call it the pill because that's the conventional term for it. Though, my recollection is that throughout the litigation, we used its proper name, which is the shareholder rights plan. #00:06:44#

Skadden was, I would have to say, institutionally determined to kill this thing. And they might well have been better advised to wait for another context to litigate in a situation where there was actually somebody's money on the table, and the pill was being used to prevent the money from getting to the shareholders. They did not choose to go at it that way. In their view, and this is the way they tried the case, this device, let's call it, was sinful. It was illegal under Delaware law, and not authorized by the Delaware corporate statute; it infringed the rights of shareholders, it arrogated power to the board of directors. It was, as I said before, all things bad, including fattening. #00:07:30#

I, look, the fellows at Skadden that litigated it are very able lawyers. They are very good friends of mine. Mike Mitchell, Stu Shapiro, Rod Ward, and some of the younger people. I have to say I think they made a lot of judgments, which if I were making them, at least in hindsight, I would not agree with. And maybe the first one of those is the timing of the case. Because it came before the court in a sort of an abstract mode, and in fact, if you read both the Chancery Court opinion and the affirmance by the Delaware Supreme Court, both of those opinions say that plaintiffs' fears will have to await another day, and it will all sort out when an actual transaction is on the table, and we see how the Household board actually administers the pill. #00:08:19#

There was a flavor about the two decisions, at both the trial level and the appellate level, of essentially saying you fellows are in court too early. But they were just champing at the bit to declare this – to have this thing declared illegal. My guess is that there was, I think you have mentioned to me that was an interview of Rod Ward, who was the principal Delaware office partner of Skadden involved in the trial, who thought the case ought to be submitted on a very simple basis that the Delaware statutes authorize the issuance of this preferred stock, and the associated rights, or not;

that's not the way they went at it. They went at it, World War III. #00:09:02#

MR. ROWE: And this was a period of time when, in a way that may have been forgotten by now, Wachtell Lipton and Skadden Arps, in effect, represented, or tried to present themselves as representing two opposed camps on Wall Street and in corporate America. And maybe you can speak to that— #00:09:21#

MR: SCHWARTZ: Well, I can. I mean it was very interesting. First of all, I once described this trial as something like the Scopes trial of corporate governance. I mean it was like these two competing views of the universe were at each other's throats. Though that may be a slightly harsh image, but you know what I'm saying. Yes, I mean Skadden was known to be much more than we on sort of both sides of the street. They were representing companies that were the target of takeover activity, and that became a very important part of our trial strategy – and I will come back to that. #00:09:58#

But they were also very freely representing companies that were attempting to make acquisitions by means of hostile takeovers.

Wachtell Lipton, on the other hand, was almost exclusively on the defense side, representing targets. I don't want to say exclusively because there were situations

involving very big transactions where we represented, when Loew's Corporation acquired CNA, later on when AT&T acquired NCR, we were on the acquiror side. But at the time of this trial, you're quite right; we were perceived to be on the defensive side. #00:10:36#

The interesting thing – or one of the interesting things about the trial was that we made – let me back up a step. I said that Skadden was like declaring this thing illegal in all manner of ways. They tried the case – because there was no transaction on the table as you said, this was not a contest about a particular offer. Skadden, we as litigators, I think both on our side and on their side had a lot to do with the outcome of the case. I should say, before I get into the trial itself, that obviously, Wachtell Lipton was giving opinions, including to Household and to a couple of other companies that had adopted the pill. By the way, at this point, only a handful of companies had done so. The unease about this thing was palpable. #00:11:30#

But Marty and other of our corporate partners were opining to the boards of these companies that the pill was legal under Delaware law. I don't think it's unfair to say that what he was essentially saying was when the day comes, my litigators will establish that it's legal; they'll win. Because there was no case upholding it, it had never been

litigated, and while there were certainly analogies, nobody knew for sure how it was going to come out. #00:11:57#

So, this, without wanting to be immodest, this was really a case where litigation strategy had a huge amount to do with what happened at the end. And Skadden and we approached the trial in totally different ways. They basically presented a case exclusively through the testimony of expert witnesses and very heavily weighted in the direction of academic expert witnesses. Their principal trial witnesses were Michael Jensen, a very well-known professor, and Michael Bradley, somewhat less well-known, but also a very highly thought of corporate finance professor. And those were the two principal people they presented. #00:12:38#

They also presented Alan Greenberg, Ace Greenberg, as he was known, who was the head of Bear Stearns, and a banker from Morgan Stanley named Clark Abbott. But there's no question that the essential guts of their case was the academic testimony that this device was illegal, and not only illegal, but worked a fundamental structural change in the nature of the corporation such that if it were to happen at all, it could only happen by a stockholder vote, and it was beyond the power of a board of directors to implement. #00:13:13#

We, on the other hand, approached this like a trial, not like a theoretical matter; we told a story. I mean, on Skadden's account, I don't know, Lipton and his corporate, [#00:13:25#] a number of corporate partners, kind of dropped down this thing, and it kind of came out of nowhere, and it was patently illegal, and the Delaware courts should so declare. We tried a case which was a story, and the story was there's a takeover environment, as a context, in which this device was developed. The takeover environment was a very, very rough, and ready business. I mean, in those years, it wasn't many years before that, that the takeover game involved things like what we used to call Saturday night specials, where tender offers would be announced late on a Friday, and under the SEC rules, they could be closed within ten days. So, the Saturday night special was also the name of a cheap gun that was used by hoodlums, so that's where the name came from. #00:14:16#

And target companies were under enormous pressure and with very few defensive resources at their command. And we made the point by testimony from very experienced, practical-world people that something like the pill was not only perfectly consistent with what was actually going on in the world but was actually a lot milder and a lot less disruptive

and a lot less destructive than what companies were doing to defend against takeovers. #00:14:49#

So, they had professor this and professor that; we didn't have any PhDs from the witness chair. We had Jay Higgins, who was the head of M&A at Salomon Brothers – I think he was actually an amateur boxer as a young man – he was a street fighter, and a very – you could just tell, the guy knew what he was talking about because he had actually been in the ring and fought. We had Ray Troubh, who was a former partner at Lazard Freres, and who then went on to make a career as an outside director of a lot of different companies, and who had, again, also been actually in the ring where takeover activity had affected – he had actually been, for example, a director of Pabst, a company I had represented the year before in a huge takeover contest with Irwin Jacobs. We had Gordon McMahon, who was a Goldman Sachs partner. We had John Wilcox, who ran the proxy mechanism at—

MR. ROWE: Georgeson? #00:15:45#

MR: SCHWARTZ: Georgeson, right. And then, we put on a bunch of our directors, Household directors. Notably, Don Clark. I have to say, on the record here, Don Clark was the client from heaven. He was a brave man; he was a smart man, he was a loyal man. He was really only the – he was the chairman of only the second company, big company, to have adopted the

pill, and he knew he was taking a risk. But he was just a great client and also a very good witness. #00:16:13#

Anyway, we told this story about these surprise takeovers, these so-called two-tier takeovers where a company would offer for fifty-one percent of the shares, and it would try to coerce stockholders to tender into that fifty-one percent offer by being either vague or even punitive about what the forty-nine percent that was left after the offer closed would receive for their shares. And the story we told was this. Initially, when the takeover craze began in the late seventies, companies were really at a loss; they didn't know what to do. But pretty rapidly, and Higgins was very articulate about this, pretty rapidly companies developed all sorts of ways of defending against takeovers. But many of them were quite radical.

For example, when Bendix went after Martin Marietta, Bendix bought Martin Marietta, but Martin Marietta made what was called a Pac-Man tender offer for Bendix. And wound up with a crazy corporate structure with debt equity ratios that made no sense. And the company was a sort of mess when the process was over. You had Marshall Field Company, went out and bought companies it wouldn't otherwise have bought to create an antitrust obstacle against the acquiror. So, it made an

uneconomic decision to spend a lot of shareholder money essentially to fend off a takeover. #00:17:46#

Carter Hawley; another company engaged in a self-tender which, again, changed the whole stock structure of the company in an effort to defeat a takeover. Unocal, I mean the case which wound up in the Supreme Court just before our case, in the Supreme Court, of Delaware, that is, made an exchange offer for its own shares but it excluded from the exchange offer Boone Pickens' company, Mesa. I mean okay. The point we made in our evidence, and we argued it then in the Supreme Court of Delaware was, these defensive tactics were effective. But they had an enormous impact on the company going forward. They involved the expenditure of a lot of money. They changed the capital structure of a company radically. In the Unocal case, they discriminated against a very substantial stockholder. That was the environment in which the poison pill was developed. #00:18:47#

And our argument was that, and if you look at the world as it was and not as Professor Jensen and Professor Bradley sort of imagined it to be, it was a dog eat dog situation, and the poison pill had two huge advantages over these things that I have just described. Number one, you adopted it in advance of any takeover activity. You didn't wait until the takeover proponent was at the door and you had

to sort of act in a big hurry with all the uncertainty which attends a highly-emotional situation, like one in which your company is going to be potentially taken over. So, it's what we called a pre-planned defensive measure. And secondly, it didn't involve spending any money, changing your corporate structure, buying companies you didn't really want to buy, or selling assets you didn't really want to sell. It involved, essentially, issuing a piece of paper and then, let's see what happens. #00:19:49#

We told that story through Higgins, through Troubh, through John Wilcox, and I have to say, like I think most good trials, the real art of a trial is telling a story and making the decision-maker like your story. We told, I think, a very good story. Skadden, with all due respect to my good friends, Mitchell and Shapiro and the rest of them, kind of came in with this very abstract argument; you just can't do this. And I don't think, therefore, that it is a coincidence that we won. I just think it was – we were telling a story, and it was a true story, and it was a compelling story. #00:20:33#

Anyway, that's some of my reflections on the trial.

MR. ROWE: And it could almost have been a closing argument.

MR: SCHWARTZ: Well, maybe it was.

MR. ROWE: There were so many different strands to the case and to the legal and factual arguments. There's partially the theme that I think you just articulated, which one could say there is this problem out there of coercive tender offers, tender offers that harm companies and constituencies because this was before Revlon, and you could still talk about constituencies – not that you can't outside the context of a Revlon situation, but I was struck in looking at the papers that we very much sounded the theme that these takeovers are bad for companies and they're bad for the constituencies in addition to stockholders. #00:21:34#

But we also took the position that the pill would not actually stop all hostile tender offers. And that became a subject of expert testimony, and maybe you can speak to that.

MR: SCHWARTZ: Absolutely. Our position was, and I think the record clearly showed this in a way that I'll explain, that the pill would not stop takeover activity or inhibit takeover activity. That was kind of Skadden's argument. I remember they used the phrase, an acquiror looking at Household will silently pass it by, just by virtue of the issuance of the pill. #00:22:12#

And the underlying assumption of the argument was that the pill was going to be something that the directors would never redeem as they were lawfully entitled to do, no

matter what an offer was made or no matter what price an offer was made at or whatever the economics of the transaction would be. I mean the one real-world witness they put on was this fellow, Ace Greenberg, then the head of Bear Stearns. And he, I would have to say, I think may well have lost the case for them. He was – he was, I'm sorry to speak – he's now deceased, and I don't mean to speak ill of the dead, but he was, how shall I say this? Crazy. I mean, this is the...this is the...the shareholders have the right to do this, and you're trying to burn down the plantation to protect the jobs of your friends! He was practically screaming from the witness stand. #00:23:06#

So, the premise of their case so far as the pill was concerned was the directors would use it and just freeze all activity. And we said, no, that's not true. They're still directors. They still have fiduciary obligations, including, under the right circumstances, to sell the company. What the pill did, we argued, was it gave the directors negotiating leverage, gave them a serious threat to an acquiror who might act unfairly or try to make an acquisition at an unfair price, and it sort of leveled the playing field. #00:23:43#

The evidence, which we put in, necessarily, was a little bit abstract about that except here's what happened. In the aftermath of our winning in the trial court, which was a

very important thing, but everybody understood the real issue is what's going to happen in the Delaware Supreme Court. In the interim between the trial court's decision in January of eighty-five, and the submission of the case to the Delaware Supreme Court I think was in September of that year, a whole bunch of takeover activity happened, including at companies which had adopted pills, okay? So, Phillips Petroleum was the subject of a big takeover attempt. Who else? Rorer, Johnson Controls – these companies, which had the pill, were the targets of takeovers. So, we, in our appeal brief, I'm not quite sure this was exactly legit because you're not supposed to add to the record in an appeal brief, but you know, we did. But we just put in a bunch of evidence in effect in the appeal brief, saying the abstract arguments of Professor So-and-so, and Professor So-and-so, have been shown to be without merit even as this appeal is pending. #00:24:55#

And by the time we get to Interco a few years later, which is, I guess, a case we'll talk about a little bit, the record was simply overwhelming. The takeover activity did not cease at companies which had adopted the pill. And that there was all kinds of evidence to the contrary; takeover activity continues, and at higher values than had happened before the pill was adopted by these companies. #00:25:20#

So, the arguments that we advanced to trial were as you say, not just that this is legitimate [#00:25:29#/unintelligible] but that it would not prevent takeover activity and what it would prevent, or at least obviate the need for, was the use of these defensive techniques, which even if they worked, left the company worse off materially, in many cases, than the company had been before the takeover attempt. #00:25:48#

So, if you're focusing on harm to the shareholders, our argument was we put out a piece of paper that doesn't hurt anybody. These other companies engaged in activities that were harmful to shareholders. Another point that's worth mentioning. You made the point about Skadden and Wachtell being sort of different places on the street. We made a big point in our trial evidence of highlighting defensive tactics which had been taken by companies represented by Skadden. In other words, the very conduct which we were saying the pill made unnecessary was the responsibility of our adversary in the trial. And they found it, as we expected they would, impossible to respond. I mean, what were they going to say? That they were guilty of corporate misconduct and encouraging directors to breach their fiduciary duty? So that if you read their appeal brief, they say, well, that's all about something else; this case is just about the pill. But the argument made

no sense. There was no principled way to distinguish what they had been advising their clients to do – in the cases I just mentioned; Martin Marietta – I'm looking at a list I made so I wouldn't forget, Marshall Field – these were all Skadden clients. #00:27:07#

So, in the real world, we were saying, takeover activity will continue if you assume, unlike Ace Greenberg, that directors act in good faith, they are not going to stand on the pill when the pill no longer serves the shareholder interests and the interests of other constituencies. #00:27:24#

MR. ROWE: And another major focus of the expert testimony and of the argument as to whether or not the pill would be preclusive, to use a word that came into vogue a few years later, has to do with the proxy fight, or out, as I think we – your papers and arguments would have referred to it as. Can you speak about the proxy out? #00:27:50#

MR: SCHWARTZ: Yes, that's a very important part of the case. I'm glad you asked me about it. The pill provided, among other things that, well, I don't know – can I assume that the audience there knows how the pill basically works?

MR. ROWE: I'm not sure I do. #00:28:05#

MR: SCHWARTZ: Well, I'm being cautious myself, but look, the basic idea was that upon the happening, that the

corporation issued a right, which is a piece of paper – by the way, these rights that we issued were accepted for listing by the New York Stock Exchange, a point we made in opposition to Skadden's notion that this was a—

MR. ROWE: A sham security—

MR: SCHWARTZ: A sham security and an original sin. And the terms of the right were that if a so-called triggering event happened, that preferred shares would be issued on the right, and those preferred shares, in turn, if the company was later acquired through a merger, would flip over into a right to buy stock of the acquiring company at a below-market price. So, that the jeopardy to the acquiror was dilution of his equity in the event that he tried to buy a hundred percent of a target company. #00:29:00#

One of the triggering events, to get back to your question about a proxy fight, was the formation of a group, which is an SEC concept, SEC term, including for the purpose of waging a proxy fight. And if the group collectively controlled twenty-percent or more of the shares, the shares of the company – the target company, that is, that was a triggering event, and the right would become a right to get this preferred stock. #00:29:29#

Voting rights are a very sacred part of Delaware law, as they should be. The directors, after all, at the end

of the day, are elected by the shareholders and are the shareholders – at their shareholders' election, they serve and not otherwise. #00:29:47#

So, the argument was made – well, I want to mention something – I'll come back to it. The argument was made that whatever the rights and wrongs of a tender offer are concerned, to the extent the pill made it a triggering event, and somebody waged a proxy fight, you were impinging on the voting rights of shareholders, and voting rights are sacred. #00:30:10#

An odd thing about the case was that neither in its complaint nor in its evidence, did Skadden actually push this voting rights contention. The complaint didn't mention voting rights, and they didn't put on a witness, as we did – we put on a guy from Georgeson and Company, a big proxy soliciting firm; they didn't. I always thought, frankly, that they missed the boat there. I mean that – of course, the answer may be they tried to get a proxy expert, and nobody would – nobody would accept the job. I don't know that that's plausible, but who knows? In any event, although they had what seemed to me to be a much stronger argument on the proxy issue than on the tender offer issue, they never presented a witness to make that argument. However, they did certainly argue the point. And all I am saying is, here again; I think you see where

trial strategy you know, could well have made a big difference to the outcome if they decided to make this a case about voting rights and not about tender offers. #00:31:14#

But that wasn't their state of mind. Their state of mind was the shareholders have a right to get a tender offer; tender offers are good for the economy. This I might say was a philosophical position being pushed very heavily, not only by Professor So-and-so and So-and-so, but by the SEC in these years, and the SEC's chief economist, a guy named Greg Jarrell, who by the way, also went on to become an academic in the aftermath of serving at the SEC, had authored a study at the SEC about how terrific tender offers were, and so on. So, their mindset was on tender offers. #00:31:48#

MR. ROWE: Let me just interrupt you there because the SEC did file an amicus here, and what effect did that have on the case? #00:31:56#

MR: SCHWARTZ: Well, it was actually, it was great for us. You would have – they filed an amicus brief in support of Skadden, in support of the opposition to the pill in the Delaware Supreme Court. But, what happened was, the SEC, as your audience may know, is made up of five members. And the SEC has to vote about whether to file an amicus brief. It was a very unusual thing for the SEC to file a brief in a state

court in a case involving no issue of federal law, with one small exception I'll mention in a minute. #00:32:28#

But nonetheless, it turned out that the SEC's vote to file the brief was a three to two vote. In other words, they were split right down the middle. And two of the guys – well, maybe, I don't know if they're guys, but two of the people on the commission were on our side of the thing. So, we turned this against Skadden on appeal. Our basic argument was to the Delaware Supreme Court, look, this is authorized by Delaware statute, and the only real issue is, did the directors exercise a good faith business judgment to issue the pill? Good faith, informed business judgment. #00:33:09#

The fact that the SEC itself divided in half, essentially, on this point, made our point. This was a matter of debate. Some people think it's a good idea; some people think it's a bad idea. That's exactly the situation in which the business judgment rule is meant to operate, and specifically, is a situation in which the business judgment rule immunizes a board decision from judicial second-guessing. #00:33:34#

So, a great theme of our appeal brief was, in a polite but cautionary way to the Supreme Court of Delaware, you fellows ought to stay out of this thing. This is a matter of contention and dispute. Some people are all in favor of

takeovers, like Professor So-and-so, and So-and-so, and some people think it's a bad idea. That's why God invented boards of directors. And the SEC brief, in a peculiar way, I think, strongly supported our position on that. And of course, that was the position the Delaware Supreme Court adopted. #00:34:08#

MR. ROWE: When the Delaware Supreme Court said, in their opinion, that ultimately the decision whether to actually deploy the rights as opposed to initially adopt them and even distribute them in their – I'm not quite sure what the right word is to use – but their unexploded form, that the ultimate decision whether to actually cause economic damage to the bidder, if you will, was a second decision that the board would have to make under the circumstances of a particular bid. Was that something that we – or you – expected the Supreme Court to do? Unocal, or the brief that you filed in the Supreme Court if my dating is correct, my chronology, was about a week before Unocal came down— #00:35:01#

MR: SCHWARTZ: Correct.

MR. ROWE: So, Unocal wasn't specifically argued in the brief.

MR: SCHWARTZ: Correct.

MR. ROWE: Was it a surprise? Or in any way did it – how to put it – diminish from the crushing nature of your victory that it was hedged with this Unocal caveat? #00:35:20#

MR: SCHWARTZ: I don't think so. I mean to the contrary. Look, our point was – go back to what I said a few minutes ago. There's this environment out there, this economic environment, this takeover environment. In that real world, not in Professor So-and-so's world, there are all kinds of things that boards of directors do to defend against takeovers. The issuance of – or the adoption of the pill, and its to use your phrase, in its unexploded form, doesn't do anything. It's just a piece of paper. And we always recognized that the critical business judgment moment would be reached when, in the context of an actual offer, the board decided whether or not to redeem the pill. I'm remembering, I don't think we've used the word redeem so far in this conversation. So, let me just take a moment and explain. These rights were issued to shareholders, as I said, they were listed on the Exchange, and so on. But they contained a redemption feature, which meant that for a very nominal – I can't remember – a couple of mills per right, or something like that, the board could redeem them. And it was the redemption decision which – it's not exactly – you used the word explode, I mean, the issue was would the board redeem them or not? #00:36:40#

And our argument was, obviously, at that moment, the board will be making a judgment whether or not the offer and under all the circumstances that prevailed, was in the interest of the company or not. In the interest of the shareholders and the other constituencies or not. #00:36:56#

So, no, it was clear to us from the get-go that that's really the right context in which to analyze this thing. And as I said, we stressed that this was a desirable measure because it was pre-planning. It meant that if somebody came on the scene, you didn't then have to scramble to find some way of giving yourself, you, a director, bargaining power. You had the bargaining power, and if the acquiror, or potential acquiror, met your terms, you could redeem the pill, and the transaction would go forward. #00:37:29#

So, let me just go to Unocal, though, I mean Unocal, obviously, was not briefed by us because it hadn't been decided at the time that our brief was put in. But Unocal, obviously, was a very helpful decision. That's the decision in which the Delaware Supreme Court held that the Unocal Corporation, defending against an unwanted takeover attempt, a two-tier bust-up takeover attempt by Boone Pickens, could do an exchange offer for its own shares and not buy Boone Pickens' shares. #00:38:02#

That was, to me, a perfect example of the kind of – I don't want to use the word radical, but potentially self-destructive defensive activity that I just listed a whole bunch of examples of a few minutes ago. I mean, here, the company is going to spend a lot of money and change its capital structure and so on to defeat a takeover offer. Our feeling was, well, hell, if they can do that sort of thing, issuing a piece of paper with a right to redeem the piece of paper in favor of a fair offer, should be a walk in the park. And I don't want to overstate our optimism as we approached the Delaware Supreme Court decision, but Unocal was certainly an enormously helpful decision. And had it been decided before we file our brief, you can bet we would have briefed it. #00:38:55#

MR. ROWE: Unocal did introduce a concept that is somewhat different from the business judgment rule, however, which goes to a court essentially applying something closer to an objectively reasonable standard to the board's conduct. So, by putting that at the end of their opinion, did you feel that they were in any way changing the approval, the sort of just clear sailing sort of approval that the Court of Chancery had given? #00:39:31#

MR: SCHWARTZ: I see what you're saying.

MR. ROWE: I mean it's interesting that the Court of Chancery in Unocal had enjoined—

MR: SCHWARTZ: Vice-Chancellor Berger, yes.

MR. ROWE: Yes. And the Supreme Court of Delaware reversed that decision. No, look, I think the key point, and this became a major theme, not only in our appeal brief but in the Supreme Court's opinion affirming the poison pill - the theme was the pill doesn't harm the company. The pill doesn't do anything; it's just a piece of paper. And essentially, the Supreme Court, in sort of a nice way, was saying to Moran and the plaintiffs in the Household case, you guys are you know, got your knickers in a twist here; let's wait and see what happens. Nothing has really changed in this company. And as I say, we were able to document that even their argument that stockholder – or acquisition activity will not occur, and you will never know it didn't happen because people would just silently pass the company by, was disproved by what happened in the interim between the Delaware Chancery Court decision and the Supreme Court decision. #00:40:46#

No, we were very comfortable with Unocal. Unocal was a case which we thought portended a win for us in the Delaware Supreme Court. I mean you never know, of course. I mean there was another set of circumstances to have in mind as well. Once we won in the Chancery Court, the decision of the Chancery

Court was in January of eighty-five. In the aftermath of that, something like three dozen companies adopted the pill. Before that, only a handful had done so. So, a little bit we had like established a beachhead and the breakout, so to speak, began thereafter. And by the time the case got to the Delaware Supreme Court, the pill was already you know, a more accepted, less strange-seeming aspect of corporate America. I mean the companies which had adopted it were like not just fringe companies – Phillips Petroleum, Johnson Controls, RCA; I'm just looking at a list – Pennzoil, Revlon; so, major American companies had now acted in reliance on the Delaware Chancery Court decision that this was valid. #00:42:01#

So, I was quite optimistic we were going to win, but you never know.

MR. ROWE: To go back to the trial itself, one of the things, maybe a minor one, but in light of my sort of joking reference to how difficult the mechanics of the pill can be to understand, how much effort had to be spent both making sure that our own directors, and for that matter, the court, which was unfamiliar with the mechanics of the pill, understood to the extent that any human can, the mechanics? #00:42:49#

MR: SCHWARTZ: Paul, that is an excellent question because here again, I think the trial strategy of my friends

on the other side can be questioned at least in hindsight. I think I mentioned at the very beginning of our conversation, the first I heard of this thing, there were a bunch of depositions being taken, I understood, over the course of the summer before our trial, and directors were having a hard time at these depositions. Because the pill is complicated. I mean I think the operative document is 50 pages long, and it's got all kinds of you know, it's a complicated legal document, and the concept was a novel one. Not entirely novel, but pretty novel. I'll tell you why not entirely novel in a minute. #00:43:36#

I don't want to say how I would have tried their case, but it might have been more effective if instead of Professor So-and-so and Professor So-and-so, they had really gone after the directors of Household that they really didn't know what they were doing. Because the premise of the business judgment rule is not only that directors have to act in good faith, but they have to act on an informed basis. #00:43:58#

Now, at the time the case was tried, the Supreme Court of Delaware had not yet decided Smith v. Van Gorkom. Ironically, that case was decided on the very same day that the Chancery Court ruled in our case. However, and Smith v. Van Gorkom, again, for the benefit of the audience, is a case which held directors of a company called Trans Union

personally liable for agreeing to a takeover at a premium price on the basis that they had been grossly negligent. #00:44:29#

I mean, we put on four directors, and they put on Moran. But my guess is that if they had made a fuss and insisted that all the directors come and testify, they could have, potentially – I mean, we might have prepared our directors and defendant against it, but you always run the risk, obviously, in a situation like that, that a lay witness questioned on a legal subject is not going to know his way around thoroughly – or her way around and could make a bad impression. That's not the case they tried. #00:45:06#

I think it would be fair to say that even if the approach that I'm just describing had been taken, we would still have prevailed. The Delaware Supreme Court specifically addressed this issue as did the Chancery judge – the Vice-Chancellor, and held that, I think correctly, that the directors essentially relied upon competent counsel, that's us, Wachtell Lipton, and investment bankers and other experts, and sufficiently understood what they were doing to pass muster under the business— #00:45:40#

MR. ROWE: Well...he said they understood the purpose of it and the effect—

MR: SCHWARTZ: The actual...well, but there was another nice touch. This happened in the interim between the Chancery decision and the Supreme Court decision. The Chancery Court, of course, ruled it was legal. Moran, the director who had precipitated the litigation, then revived the issue at another meeting of the Board of Household. And said, you guys should really think about this again. I think I've gotten my chronology right. So, by the time we got to the Supreme Court and the directors did not change their mind, by the time we got to the Supreme Court, the board had essentially considered the issue twice, including – and we also made the point they had been questioned intensively about it and challenged about their support of it by Skadden's lawyers in the discovery process. #00:46:37#

In other words, by the time the case got to the Delaware Supreme Court, these directors unquestionably knew what they had done, and it would have been implausible to argue that the directors were uninformed, even about the mechanics. Still and all, I wonder how the case would have come out if instead of swinging for the fences, Skadden had, in a very you know, narrow way, said this is not a business judgment case because the directors don't really understand this thing. #00:47:09#

MR. ROWE: And mentioning director Moran is an interesting point because it is an unusual situation to have as the plaintiff in a case like this, a director of the very company that's taken the action that's being challenged.

MR: SCHWARTZ: Right.

MR. ROWE: Did that wind up helping or hurting or not really having much effect on the course of the litigation? #00:47:35#

MR: SCHWARTZ: That's a good question. Moran, first of all, is a very good guy; a nice man, a very smart man. I might add that much later, in a totally different context, he became a Wachtell Lipton client for a while. And I was personally very fond of him. But Moran was a director of Household because a company that he controlled was acquired by Household for – what was it called? Wallace Murray, for a preferred stock, and he wound up being Household's largest stockholder. He was a principal in a firm Called Dyson, Kissner, Moran, and they were sort of an investment company. They had interests in lots of different companies. And they profited by buying and selling companies. #00:48:28#

It turned out that, and we put this into evidence, that Moran had actually proposed to Don Clark, the Chairman of Household, that he and Clark lead a so-called management LBO of Household, and as Don testified at trial, John said to him

we could make a bundle of money, which Moran estimated at four-hundred-and-fifteen million dollars, by buying the company, selling off the finance business, and as Moran apparently had said to Don, we'd own the rest of it for free. #00:49:02#

I cannot believe that that evidence was helpful to Skadden's case. And so, I would have to say that the decision to use Moran as a plaintiff probably hurt them. My guess is because there was also like a shareholder plaintiff who was, you know, someone who owned five-hundred shares, that if Skadden had been determined to challenge this thing, they might have been better off you know, as it were, finding a plaintiff than using Moran. #00:49:38#

I say this, and I want to reiterate, John Moran is a good guy and we got along fine, although he was cross-examined at trial by George Katz, my late partner. And George did a great job and took him apart, including eliciting these facts about Moran's proposal to Don Clark that they both make a barrel of money by buying the company and breaking it up. #00:50:04#

MR. ROWE: This is always a hard question I think for people, for especially litigators, maybe, to answer, but at the end of the trial, but before the decision, what was

your personal view as to the odds of winning and losing? #00:50:22#

MR: SCHWARTZ: Well, I'm not sure I can clearly recall my state of mind—

MR. ROWE: You knew you'd win.

MR: SCHWARTZ: -- I'm whatever age I am, and my memory isn't so great. I knew, I could tell you this, I knew we had put on a terrific show. And that we had told the judge the truth. A, there's a big problem out there of self-interested takeover activity, which is harmful to companies, not only in the sense that an offer may be made at an inadequate price but in the larger context, that Marty was – Marty Lipton was always at pains to express, that the currency of this kind of takeover activity had the sort of global effect of having companies focus on short-term operating results, not take a longer-term view of their economic and business prospects. It precipitated, as I said before, defensive activity when the tender offer did emerge of a nature that as often as not was destructive of the company's value. Nonetheless, I should say, consistently upheld by the courts as within the business judgment of the directors. #00:51:42#

So, I am sure you know, we had put on a good show. I have to say it fell to my personal responsibility, to cross-

examine the people I had referred to as Professor So-and-so. I did the cross-examination of the experts. If I can use one inside baseball moment: for reasons I cannot remember - and I have actually asked some of my partners, they don't remember - these cross-examinations were done without there having been first a deposition of the expert. It was the old-fashioned kind of trial situation. Skadden put on an expert. The defendant can cross-examine. And I'd just stand up and start asking questions. #00:52:27#

For a young litigation partner, it was a heart-stopping responsibility given the stakes that were involved. But, on the other hand, these guys essentially gave themselves away without – they were basically academics. I remember, for example, Jensen, I asked him, Professor Jensen, did you ever, you know, actually represent some company that was faced with a takeover — he says, no! This was his answer. I don't spend my time, he says, I'm quoting him, poring over the entrails of actual transactions. I mean, I was ready to sit down right then and there. I must say, honestly, I don't remember Bradley's testimony as well, but Jensen, who, again, was an honest man, but he was, you know, he was a theoretician. Then, there was Ace Greenberg, who, as I say, I would have to say he imploded on the witness stand. I think even Skadden must have been embarrassed. I think the Chancellor's opinion describes

his testimony as forceful, or some such word, but believe me, it was a lot more than forceful. #00:53:29#

And then, the last guy they put on was this fellow Clark Abbott, from Morgan Stanley. And he was an honest man, and he basically agreed, you know, takeover activity – tender offers, especially these two-tier offers, are coercive. He actually testified shareholders have no choice, everybody tenders. The consequence was that when Skadden came to file its appeal brief, Clark Abbott vanished. He was not mentioned once in an eighty-five-page brief. I should say he was very much mentioned in our brief. #00:54:04#

I guess I thought we'd win, okay. I mean think we were really telling a, as I said, a story and a good story, but you know, when the Supreme Court of Delaware acted nine months later – and this is a day I'll never forget, it was November, I want to say nineteenth, whatever it was, it was the same day that the jury returned a ten-billion-dollar verdict against Texaco in a case in which Texaco had acquired Getty Oil Company and, arguably, according to the Pennzoil people, tortiously interfered with Pennzoil's prior agreement to buy Getty Oil. My senior partner, Marty Lipton, had been a trial witness in that Pennzoil-Texaco trial, and I don't think he'd be insulted if I'd say he did not get rave reviews for his trial testimony. #00:55:05#

As it happens, the morning the Delaware Supreme Court came down with its decision, Marty and I were at a board meeting together; it was a board meeting of Allied Signal. I guess we represented [Signal] and Skadden represented [Allied], and we were all at this board meeting together. And I remember Marty – so, we heard that the jury had come in against Texaco for ten billion dollars, and then we heard that the Delaware Supreme Court had affirmed Household. And Marty said to me, can you imagine, he said, if, on the same morning, this ten billion dollar verdict had happened and we had lost Household? I mean it was a fraught situation. There's no doubt about that. #00:55:47#

So, that one, even then, even though we had Unocal on our side and the rest of it, it was not a sure thing. Interestingly at that board meeting of Allied Signal, Joe Flom was also present, because he represented, I think it was the meeting at which Allied and Signal merged. And he represented Allied, and we represented Signal. So, Joe came over to Marty and me and shook our hands; congratulations, you guys won the Household case. And he said, and now, he says, I'm going to issue some pills that will make your toes curl. And they did. Of course, thereafter, I mean— #00:56:21#

MR. ROWE: Everyone did.

MR: SCHWARTZ: You know, yesterday's news was that this pill was illegal, immoral, and fattening. Now, as far as they were concerned, it was a legitimate part of the arsenal, and they would deploy it as well as we.

MR. ROWE: Well, in that sense, I think what you're saying is, from their perspective it was a win-win situation. To go back to the experts for a moment. Did you get a sense when you were cross-examining them, you know, when you're in the courtroom, and the judge is right there – did he – I think the trial was nine trial days; did you have a sense as to what he was thinking from his questions or his, even his affect? Or was it pretty much unclear what the court was concerned about? #00:57:12#

MR: SCHWARTZ: I don't think you could read him. Judge Walsh is a very fine judge, later on the Delaware Supreme Court. I think he was relatively new to the bench, actually, when the Household case was tried, I think. But he was a poker face and he – I mean, I said at the very beginning when the case was brought, we were happy that it was a case to be litigated in the Delaware Chancery Court, which is a model court for these kinds of corporate disputes. And I think the Chancellor played it by the book. #00:57:45#

As I said at the outset of our conversation, the sort of abstract quality of the evidence that the plaintiffs

principally relied upon, I have to think, you know – let me go back a step. You know, in some sense, a trial is a trial, okay? And whether it's a judge or a jury or whatever, I do think you ought to tell a story. And Skadden didn't have a story to tell, basically, they simply had this philosophic and academic argument; this thing is illegal. I mean, there was a technical legal argument, I should perhaps mention. And that is, there's a statute in Delaware which authorizes the issuance of rights, which is what the pill involved, the issuance of rights. And they had a technical legal argument that the rights had to be issued to accomplish a financing purpose. And they did make a big argument to that effect. That like any other security of a company, it's an economic instrument, and it has to have a financing purpose. And this was, they called it, a sham security, because it didn't have a financing purpose. #00:58:53#

And we argued the statute doesn't say anything about financing purpose, that's your gloss on the statute. Directors, for example, who engage in a self-tender, as some of the defendant – the other companies that I described had done, relied on a statute which said, in general terms, a company can deal in its own shares, I think it’s 160 of the Delaware Code. But it doesn't say anything about doing it for

defensive purposes or financing purposes or whatever; it just says you can do it. #00:59:22#

So, they had this technical argument, but it was submerged in this philosophic argument that they made that you just – somehow, this must be illegal because we know it's economic suicide to put this kind of power in the hands of a board of directors. Again, I have to think that a Delaware chancellor, who is after all, at the end of the day, a Delaware lawyer, would be put off by that style of argument. I always wondered whether, on the other side of the case, who made the decision how to present this case. And you told me that Rod Ward was interviewed, and he was the Delaware guy, and he was probably overruled on how to present the case. I think that's the substance of some of his interview as you described it to me, Paul. And I think maybe they would have been better off listening to their Delaware lawyer. I mean, you – this – a rifle shot might have been better than a cannonball, to try to upset this thing. #01:00:27#

MR. ROWE: I think one thing you may be alluding to is the efficient market hypothesis and people who were active in both economics and the way economics theories were affecting Wall Street and, for that matter, the way other countries have approached takeover defense. I suspect, and I wonder if you got this feeling, that they just felt their

intellectual position was so strong that management, boards, incumbent directors, albeit independent ones, should not have the right to get between stockholders, who have the right to alienate their shares by selling them, and a willing buyer. And that that argument was strong and compelling, and that the Delaware statute concerning mergers, of course, which does give the board an essential role; it doesn't say anything about boards having a role in tender offers. To me, that was the intellectual background they were proceeding from. #01:01:36#

MR: SCHWARTZ: Look, and you're perfectly right. And hindsight is 20/20, and as I – I hope I made clear, I'm not really saying, but I think they mis-tried it exactly, I'm saying, in hindsight, I can see where this very academic approach was not effective in the courtroom in which they were litigating. And therefore, when your question of a moment ago was how did Vice-Chancellor Walsh react, I think this stuff would have sounded grating to his ear. And when Professor Jensen said I don't pore over the entrails of actual... I just have to think that the decision-maker would not have been impressed by that sort of thing. #01:02:18#

MR. ROWE: It's like a doctor saying I don't see living patients.

MR: SCHWARTZ: That's kind of the feel of it; that's exactly—that's very well put. Look, there was a huge, and I think to some extent there still is, a huge school of thought that tender offers are first of all, very beneficial. They always, by definition, happen at a price above market. That they encourage economic efficiency because if companies are threatened with takeovers, management will be incentivized to you know, maximize results, and make their stock very expensive and, therefore, make them not likely to be a target of a takeover. I mean, we, here at Wachtell Lipton, have a totally different view, including of the academic truth or falsity of those assertions. But there is no doubt that there is a strong, was then; still is, a strong academic and theoretical view that takeover activity should not be inhibited. I mean, at the time that we're talking about, there were articles written suggesting that boards had an affirmative obligation, so to speak, to be passive in the face of a takeover and do nothing. I don't think that was ever the view of the Delaware courts, and I don't think it is good policy, but you were totally right; there's a legitimate view, which I think Skadden was essentially the mouthpiece for in this case, that this activity, far from being detrimental and dangerous and destructive, is all to the good and should be facilitated. #01:03:58#

MR. ROWE: To switch gears for a moment, the oral argument at the appeal, do you recall that?

MR: SCHWARTZ: I do.

MR. ROWE: What was your impression of how it was argued? #01:04:08#

MR: SCHWARTZ: Well, first, there's a wonderful little anecdote. When, as I have mentioned, one of the Skadden lawyers who tried the case against me, was a fellow named Stuart Shapiro, a good lawyer, and a good friend. Stuart is the son of Irving Shapiro, who was a, for many years, the chairman of DuPont, a major Delaware company, not only in the sense of incorporated in Delaware but physically based in Delaware. And when the Chancery Court ruled as it did, Stuart told George, George Katz, and me one day that the appeal was going to be argued for Moran, for the plaintiff, by Irving Shapiro. #01:04:49#

Irving was a lawyer by training, but he hadn't been in a courtroom, I don't think, in fifty years, or whatever it was; for a long time, anyway. And clearly, their hope was that having the Chairman of DuPont, this major Delaware presence, would have some kind of extra influence with the Supreme Court of Delaware. I remember George said, gee, that's funny, he said to Stuart; our case is going to be argued by Bella Katz. And Stuart said who's Bella Katz? Well, your father is arguing

the case for you; we're going to have my mother argue it for us. #01:05:22#

Anyway, we didn't have Bella Katz argue it; we had Charlie Richards argue it for us. We did feel that a Delaware lawyer rather than a New York – even though we had, obviously carried the laboring oar at the trial; we did think that as a matter of etiquette before the Delaware Supreme Court that a Delaware lawyer should argue it. #01:05:44#

I must say I don't have a very clear recollection, except – I guess we argued it I think down in Dover or Georgetown or somewhere, I mean some very remote, rural location where the Delaware Supreme Court sat on that occasion. And it was like this bucolic country town and here are all these limousines with all these fancy lawyers with their briefcases and the rest of it – the whole thing was slightly Alice in Wonderland, as far as I was concerned. #01:06:12#

Charlie Richards had argued the losing side in Unocal; he had represented Mesa. And I think he was still a little miffed that somehow or other Mesa – that Unocal had kind of gotten away with discriminating against his client in their exchange offer. But he was a very able lawyer; a big, tall guy who had made a very good impression. And for that matter, Irving Shapiro, who I don't think had been in a

courtroom for you know, forever, it was a very good argument. I will say that I – I mean, obviously in preparation for our conversation this morning, I have reread the briefing. And the same thing is true in the briefing as I was describing with respect to the trial. We had this brief, which I enjoyed rereading. And sometimes you read a brief thirty years later and say, oh, how could I have possibly argued that stuff? This one was fun to reread because we told a story. #01:07:14#

And the bottom line of the story was, there is all this activity happening, as in the case of the SEC, half the world thinks it should be encouraged and facilitated, and half the world doesn't. You guys ought to basically defer to the judgment of the directors on this. That's why the business judgment rule was created. #01:07:39#

And their brief, and we used all these examples of self-destructive conduct by boards in response to an unwanted takeover and so on, and said, as I have said to you now a couple of times this morning; the pill doesn't do anything. The stock price, we could demonstrate by then, the stock price of companies which had bought into the pill did not decline, and takeover activity continued at these companies and so on. That was our brief. #01:08:05#

Their brief was in this sort of airless room of "you know, you can't do this." It's fundamental – there has to be a

stockholder vote and so on. And so, I think, Charlie had the better side of the argument, and we won. #01:08:23#

MR. ROWE: I think we will move on to the Interco case.

MR: SCHWARTZ: Okay.

MR. ROWE: And if Household was the birth of the pill, in the Interco case it had a serious heart attack.

MR: SCHWARTZ: That's true.

MR. ROWE: And it's a fascinating opinion – do you want to give a little background about what the competing transactions were before we get to the pill? #01:08:55#

MR: SCHWARTZ: Yeah. Interco was the old International Shoe Company. It was a St. Louis-based conglomerate which owned a whole lot of different businesses and was therefore vulnerable to a form of activity, which we focused on at Household, and which was derogatorily described by, I guess by us, by Wachtell Lipton, as a two-tier bust-up takeover—

MR. ROWE: It's junk bond …

MR: SCHWARTZ: Junk bond … Right. Frankly, the kind of thing which John Moran had proposed to Don Clark that the management of Household do. And these two young entrepreneurs, the Rales brothers, came along; they were Drexel Burnham clients, they were financed by junk bonds, and they proposed

to take over Interco against the judgment of the Interco board. #01:09:50#

By the way, the Interco board was one of the boards which had adopted the pill in the interim between the Chancery Court decision and the Supreme Court decision in Household. And so, the Raleses made a tender offer, or announced a tender offer. And management advised by us and by, I'm not remembering who the bankers were, I think it was Goldman, but I'm not sure, determined that the offer was financially inadequate, and therefore, as the pill permitted, determined not to redeem the pill to facilitate the offer. #01:10:27#

And the Raleses brought suit, trying to get the pill – try to force us to redeem the pill by injunction.

The Interco board did not simply – well, let me back up a step there. There came to be a sort of takeover defense called "just say no." Where a board would fail to redeem the pill, and basically, do nothing else. But more commonly, a board faced with a tender offer would fail to redeem the pill but would also engage in a competing financial transaction of some sort. And so, the Interco board did. It announced that it would do a recapitalization, it would sell off certain assets and borrow some money, and that would finance a rather complicated transaction, the net of which the board believed

was financially more valuable to the stockholders of Interco than the Raleses' offer. #01:11:30#

The Raleses, on a couple of occasions, increased their offer price. I think it started at seventy; then it was seventy-two, seventy-four. But at the end of the – at the point in which it came into litigation, the Interco board believed, based on the financial advice they had received, that the recapitalization was worth more than the Rales brothers, and in, first of all, just in dollar terms. But beyond that, we relied on the fact that the recapitalization involved the Interco shareholders continuing to have an equity interest in the business on an ongoing basis. So, from the perspective of the Interco board, the upside, so to speak, implicit in the future prospects of the company, would belong to the shareholders and not to the Rales brothers. #01:12:19#

So, the Raleses were in Delaware Chancery; we were in Delaware Chancery again before a different Chancellor, Chancellor Allen. And they argued that the board was here confronted with exactly the situation that the Household court had talked about. There's an actual offer, it's a substantial offer, it's in their judgment, at least as valuable or maybe more valuable than the recapitalization, and the board, therefore, cannot fail to redeem the pill. That would be a

breach of fiduciary duty, would not be protected by the business judgment rule. #01:12:55#

And we litigated the issue before Chancellor Allen. And, this was a dramatic moment. Chancellor Allen agreed with them. He decided that the pill had to be redeemed. That, in his phrase, the end stage of the takeover process had been reached. That while reasonable men could differ about exactly what our transaction, our recap transaction was worth; nobody claimed it was worth you know, a hundred times what the offer was. The margin between the two was relatively modest. And at that point, the Interco board was under an obligation to let the shareholders decide between our recapitalization and the Rales' tender offer. And so, he announced that he was going to enter an injunction compelling the Interco board to redeem the pill. #01:13:49#

Those were dark days. There then ensued—

MR. ROWE: Let me, if I may.

MR: SCHWARTZ: Yes.

MR. ROWE: Because to just to set the scene, again, for our audience. It had been three years since Household.

MR: SCHWARTZ: Yes.

MR. ROWE: And the reason why this came as a shock or an unpleasant surprise was that in that period, no

Chancellor or Vice-Chancellor or judge elsewhere had ordered redemption of a pill—

MR: SCHWARTZ: Correct.

MR. ROWE: -- despite the fact that as you said, that four hundred or a thousand companies had adopted pills, and there had been an enormous amount of takeover activity in that three years. So, what made this dramatic wasn't only the result, but that it was the first time, at least in Delaware, when a judge had said I have found that case that the Household Supreme Court imagined might come one day when, in fact, someone's – a board's Unocal duties requires the redemption of a pill. #01:14:58#

MR: SCHWARTZ: Yes. I mean, there may—I'm just recollecting, there may have been some other judge somewhere else who had reached that decision already, but not in Delaware. And I have to say, Chancellor Allen, who later became our partner here at Wachtell Lipton, was a preeminent jurist. And I think everybody would agree; he was one of the great chancellors of the Court of Chancery. And so, it wasn't just any old – even any old Delaware judge, this was Bill Allen, a first-rate judge saying, in his judgment, the end stage had been reached, and the board could no longer fail to redeem the pill. So, it was a very dramatic moment indeed. It was just a coincidence, I suppose, that I happened to be at

the Household trial and now, I'm the guy that's arguing for Interco in this situation; but there I was. #01:15:52#

And I have to say; it was a very interesting – we had a series of arguments – ordinarily, when a judge decides a case, he then says the parties should submit an order. And it's kind of ministerial, more or less, I don't want to overstate that, but the case is over, I want a piece of paper which implements what I had said is my ruling. That didn't happen here. And there ensued several oral arguments, which were among the most challenging of my career, in which my job was to say okay, we accept your decision, but you should not enter an injunction against us pending appeal. And, moreover, you should enter an injunction against them doing anything pending appeal. #01:16:40#

MR. ROWE: Because otherwise, they could have closed their—

MR: SCHWARTZ: Yeah, they'd close their offer.

MR. ROWE: And the appeal would have been nugatory.

MR: SCHWARTZ: Exactly. So, my adversary there was also a Skadden lawyer, a guy named Bob Zimet, a good guy. And at the end of the day, I prevailed. I persuaded Chancellor Allen that not only should we not be enjoined, that is to say affirmatively compelled, but he should be enjoined. And Zimet couldn't believe it. He said, I won the case; it turns out

you're not enjoined, and I am. But that's what happened. In preparation for this morning's session, I reread the transcripts of those arguments, and I have to shake my head and – I mean, I think we were right, but the way I just quoted Zimet, they are not quoting exactly, but that was the idea. It was like pulling a very big rabbit out of a very small hat, okay. #01:17:30#

Anyway, the judge did, therefore, prevent the Raleses from closing on their offer while we went to the Supreme Court of Delaware. And we filed – and I have a copy here – we filed a brief—

MR. ROWE: Let me interrupt—

MR: SCHWARTZ: Yes.

MR. ROWE: -- one more time because one of the more almost baroque moments was the other conference which dealt with certification to the Supreme Court because the Supreme Court doesn't have to take an appeal even from a preliminary injunction—

MR: SCHWARTZ: Correct.

MR. ROWE: -- on an expedited basis. But if the Chancellor or Vice-Chancellor who issues the injunction, particularly this was a mandatory—

MR: SCHWARTZ: Mandatory injunction.

MR. ROWE: -- injunction, that if the trial judge says I think you ought to hear this, very often, they will; though, not always.

MR: SCHWARTZ: Right.

MR. ROWE: And so, there was a discussion about whether or not his decision essentially made new law. And maybe you can comment on that because it was when I read that transcript, I found that discussion very interesting. #01:18:44#

MR: SCHWARTZ: Well, I mean look, in one sense, it was self-evident that it made new law, as you pointed out in your question of a few minutes ago, there was never a situation, at least in Delaware, I think you're right, anywhere, where a board had been compelled against its own judgment to redeem a pill. So, on the other hand, his view was Unocal sets up this test, and you have described it earlier in this conversation, and it kind of leaves it to me, as the trier of fact, to balance these things and you know, what was the risk and what was the response and was the risk substantial and was the response proportionate and so on? #01:19:26#

So, there is an argument to be made that – and not a frivolous one, I have to say, honestly, that the implementation, as it were, of Unocal, doesn't involve a

decision of law at all. I mean it's essentially an equitable decision which the Court of Chancery is a court of equity and you kind of make these decisions all the time. So, it did take some doing to persuade Allen that he should certify.
#01:19:51#

I have to say; I focused more on getting the stay. I did not really believe, although as I say, there was a non-frivolous argument that the case didn't have to be reviewed immediately. I didn't really believe that given, as you also pointed out, Paul, the recency of the Delaware Supreme Court's decision in Household itself, that Allen would, in effect, foreclose the Supreme Court of Delaware from deciding was this, indeed, the moment we visualized in which a pill would have to be redeemed, and an offer permitted to proceed?
#01:20:31#

MR. ROWE: So, I think what many of us felt the novelty was in Interco was the concept of the end stage because the way I would put it is, it made the pill into a gavel to conduct a sale process, but didn't really give the board an enormous amount of leverage because bidders could just wait out what appeared to be, however people were asking well, when do you get to an end stage? Is it six weeks? Is it six months? Could it be a year? And how did you—

MR: SCHWARTZ: Absolutely...I mean, when we were arguing that the case did involve a novel question of law, certainly, the end stage concept was novel. I mean there's nothing in the Supreme Court opinion in Household itself suggesting that the pill has a sort of a life expectancy at the end of which it has to be redeemed. So, we thought that was a very novel concept. #01:21:41#

We argued, when we filed our brief, we argued that the effect of that was essentially to neuter the pill, because as you put it, a bidder could simply say well, I'm going to make my offer; I'll wait till the end stage, and then I'll walk off with the company. I mean, we did not think – with all due respect to Chancellor Allen, we had to argue, and we did argue, that it really didn't make any sense that the judgment of the board, assuming, again, the prerequisites in the business judgment rule are satisfied that the board is not motivated by entrenchment, that it's acting on an informed basis, that it has competent advisors, etc., etc. All those prerequisites having been met that the board's judgment has to be sustained. #01:22:33#

And indeed, I'm not sure – I never litigated this in Delaware, but I did in another case involving a company out in Wisconsin called Universal Foods; we did a just say no defense. I mean along came these fellows and they want to take

over the company. Jack Murray, who was the Chairman – a wonderful guy – was the Chairman of Universal Foods, not only didn't do a competing transaction, he didn't even hire an investment banker. He just – he asked us – do I have the right to just say no? And we said yes. And my partner, Andy Brownstein, was the corporate guy and I was the litigator, and we – he didn't do anything. He just stood behind the pill as we articulated it. #01:23:20#

That issue did not – maybe it came up in Delaware, I'm not – and if it did, it was after my time. I don't remember such a case happening there. But that was basically our position. That the pill gave the board the decision whether to – again, assuming the board is acting in a responsible, if I can put it this way, Delaware-like way, and it was the total opposite from the way Ace Greenberg described directors in the Household trial. That we had the – that the board had the right to rely on the pill to actually stop an offer forever. #01:23:53#

In the particular facts of Interco, it was also true that the Raleses, as I mentioned, had increased their bid several times, and we argued that you know, who knows, I mean maybe there may be more there. And even if you take the view that the pill has some sort of a life expectancy, who's to say when the end stage is reached, and in effect, our argument

was, even that is a matter of judgment for the board.
#01:24:25#

I have stressed, and I want to reemphasize my high level of respect and regard for Bill Allen, but I really think he was just wrong here. And he was a gentleman enough to let us get to the Delaware Supreme Court on that, among other issues.
#01:24:42#

MR. ROWE: Though, oddly enough, in a way, the Delaware Supreme Court didn't get to speak on it in this case, though later—

MR: SCHWARTZ: Yes, well, what you're referring to is the fact that we filed a – here's our appeal brief, a very good brief, and I should mention one of the – let me mention, one of the things we told the Delaware Supreme Court – I'm starting at page thirty-three of our appeal brief, was that in the interim after Household, and before this case, seven hundred companies had adopted a pill, including four hundred Delaware incorporated companies. And we had a whole section of the brief demonstrating how Household had not impaired or prevented the emergence of takeover activity at these companies, and that it was associated to the contrary with higher prices in these transactions. Anyway, we filed this brief, and I don't remember how quickly thereafter, but the

Rales brothers folded and withdrew their offer and never filed an opposing brief. So, the Delaware Supreme Court never did get to decide the issue, as you say, not in this case, anyway. And that stay, which I got from Chancellor Allen, proved to be you know, very decisive in the matter. #01:26:02#

Not to feel sorry for the Rales brothers, they made off, I don't want to say like bandits, but they made, I think, sixty million dollars, or something like that, in the transaction on their Interco stock. And they went, later on, to become billionaire owners of Danaher Corporation; so, shed no tears for them. #01:26:22#

MR. ROWE: When you were arguing the PI motion, did you feel – did you get the sense from Chancellor Allen that he was ready to deliver an earthshaking opinion—[and going in this direction]? #01:26:37#

MR: SCHWARTZ: No, I did not. It came as a shock. When I said it was a dark day, I was amazed. I mean I don't want to say I considered it routine, nothing is routine. We, here at Wachtell Lipton, litigated cases; I was very blessed to be a partner at this particular firm. We litigated cases of enormous economic stakes and consequences, so I don't want to say it was routine, but it seemed to me that we had a – you know, we had done all the things we were supposed to do. We had gotten the right advice. We, meaning the Interco board and

gotten the right advice, we had created a competing transaction. And the Raleses were the kind of sort of takeover artists, if I can use that phrase, exactly of the sort that the Household court, and we, in the Household case, had cautioned against, you know, financed by junk bonds and motivated to break up the company and all the rest of it. I thought we had a winner. #01:27:41#

MR. ROWE: With one difference, which was important to the Chancellor, which was this was an all-cash, all-shares bid—

MR: SCHWARTZ: That's true.

MR. ROWE: -- which he relied on strongly—

MR: SCHWARTZ: That's true. That's true—

MR. ROWE: So, but in that timeframe, it did come, I won't say a bolt from the blue, but it was – it was certainly a surprise—

MR: SCHWARTZ: Yes.

MR. ROWE: -- at least to the Wachtell Lipton—

MR: SCHWARTZ: Yes.

MR. ROWE: -- side of the story. Was there anything about any of the discovery or testimony in the case that you think mattered? When you read Chancellor Allen's opinion, it's extremely logical and in order to be a mandatory injunction it

has to rely, at least in theory, on facts that can't be in dispute—

MR: SCHWARTZ: Right.

MR. ROWE: -- and so forth. But there's always color in any case, and there's always, as you put it before, a story. Was there anything in particular about the facts of Interco? You don't really get it from the opinion; I don't think. #01:28:51#

MR: SCHWARTZ: No. I guess I – first of all, the honest answer is I don't remember it that clearly, so... I mean, as I say, it didn't really stand out until he ruled. But it was another takeover case, you know, and I was familiar with – I had done a lot of them, and this one didn't seem to stick out in any particular way. His opinion relies very heavily upon a law review article by Gilson and Kraakman about takeover defense. And there again, a little bit as in the Household case itself was a point that we made in our Interco brief, you had the sort of academic philosophic concept competing with a sort of a real-world situation. And, indeed, as your listeners may not be aware, although this case never got decided, in a later case, the Delaware Supreme Court in a case involving Paramount and Time Inc., the Delaware Supreme Court went out of its way in a very abrupt and unceremonious

manner, if I can quote you, to disapprove of the Chancellor's opinion in Interco. #01:30:08#

So, while it would not be fair to say that we won the case ultimately, it would be fair to say that the Chancellor's opinion, and I guess in a phrase in Justice Frankfurter's, is a derelict upon the waters of the law, although you didn't know it at the time. #01:30:27#

MR. ROWE: Or in a recently famous phrase, the court of history.

MR: SCHWARTZ: Yes, the court of history ruled against him. #01:30:36#

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