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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE FORT HOWARD CORPORATION SHAREHOLDERS LITIGATION	))	CONSOLIDATED Civil Action No. 9991

MEMORANDUM OPINION

Date Submitted: August 4, 1988
Date Decided: August 8, 1988

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ALLEN, Chancellor

Pending is a motion to preliminarily enjoin the closing of a public tender offer for up to all of the currently outstanding shares of Fort Howard Corporation at $53 cash per share. The offer has been made by FH Acquisition Corp., an entity organized by Morgan Stanley Group, Inc., a Delaware Corporation, through the Morgan Stanley Leveraged Equity Fund II, L.P., a Delaware limited partnership (together, "Morgan Stanley"). The offer was extended on July 1, 1988. Pursuant to its original terms, which are still in effect, it may close no sooner than midnight August 8, 1988.

The tender offer represents the planned first stage in a two step leveraged buyout transaction. The CEO and other senior management of Fort Howard have affiliated themselves with Morgan Stanley in extending the offer. The transaction is a large one. Morgan Stanley and those affiliated with it will contribute $400 million and the balance of the required $3.7 billion purchase price will be borrowed, largely from banks.

Plaintiffs claim that the process followed by the directors of Fort Howard in negotiating the agreement pursuant to which the offer was made, and their conduct since, constitutes a violation of a duty arising when a sale of the company is being considered. That duty is said to require the directors to search, in good faith and advisedly, for the best available alternative and to remain perfectly neutral as between competing potential buyers. Plaintiffs claim that a realistic assessment of what occurred here shows the board, acting through a special committee, favored the management-affiliated prospective buyer from the beginning of the process; did all it could to push the transaction in its direction and to discourage the development of an active and effective auction for the Company.

Plaintiffs also claim that the Morgan Stanley Offer to Purchase omits material information and thus violates a duty of candor owed by the management directors and, in this case, shared by their co-venturer, Morgan Stanley.

The relief plaintiffs seek is delay in the closing of the tender offer in order to permit (that is, to require) a supplemental disclosure. They also seek an order requiring First Boston Corporation, the financial advisor to the Special Committee, to render a new opinion on the fairness of the $53 price after it has had access to certain financial information that it has heretofore neither seen nor sought to see.

Plaintiffs have not seriously attacked the $53 cash price as unfairly low. They have, for example, put in no expert affidavit to that effect. They do claim that it is an undependable price because the market has not been effectively explored and, putting disclosure points to one side, the correctness of that factual assertion is at the core of the matter presented by this motion.

It is essential for valid director action that it be taken on an informed basis. Indeed, it is essential of any rational human choice that alternatives to the proposed action be considered. The more significant the subject matter of the decision, obviously, the greater will be the need to probe and consider alternatives. When the decision is to sell the company, or to engage in a recapitalization that will change control of the firm, the gravity of the transaction places a special burden upon the directors to make sure that they have a basis for an informed view. Here the Special Committee did not conduct an auction of any kind before signing an agreement of merger with Morgan Stanley. It did, however, negotiate provisions purportedly intended to permit an effective check of the market before the Morgan Stanley offer could close. For purposes of this motion, I have concluded that this approach was adopted in good faith and was effective to give the board an informed, dependable basis for the view that the Morgan Stanley offer is the best available transaction from the point of view of the Fort Howard shareholders. (See Part IV, _infra_) So concluding, I may not issue a preliminary injunction predicated upon plaintiffs' _Revlon_ theory. _See_

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986).

As to the disclosure claims, I have considered them in the light cast by Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944 (1985). I cannot conclude now that the matters raised by plaintiffs would likely be of actual significance to shareholders. The reasons for this view are set forth below. (See Parts V and VI, infra).

Thus, finding at this time that plaintiffs have not established a reasonable probability of ultimate success, I will for the reasons more fully set forth below decline to issue the remedy sought.

I.

Fort Howard is a Delaware Corporation with its principal executive offices in Green Bay, Wisconsin. It is a manufacturer and marketer of diversified lines of paper products, including tissues. In fiscal year 1987 Fort Howard had net sales of $1.75 billion, net income of $158 million and balance sheet assets of $2.19 billion. Its stock price has not recovered from the market break of October 19, 1987 to the extent that the market generally has recovered, nor to the extent others in the paper products industry have. In late May, 1988, just prior to the emergence of the Morgan Stanley interest, its stock traded in the mid 30's. It had traded in the high 50's within the prior year.

Fearing that a temporarily depressed stock price might render the Company particularly vulnerable to an unfairly low and perhaps coercive takeover attempt, the Company's management on March 30, 1988, met with representatives of Morgan Stanley at Morgan Stanley's New York office and sought its advice concerning possible steps to protect Fort Howard shareholders from the perceived threat. Morgan Stanley had been engaged on a number of occasions in recent years to give investment banking advice or services to the Company. Defendant Paul Schierl, the CEO of Fort Howard and defendant Kathleen J. Hempel, its first Vice President and CFO, met with Donald Brennan, and others from Morgan Stanley. Mr. Schierl asked about a wide range of possible types of transactions that the Company might consider engaging in order to elevate its stock price. He mentioned recapitalizations, spin-offs, acquisitions and other structural transactions. Mr. Brennan apparently gave a description of the structure and mechanics of types of recapitalizations, commented on other possibilities and indicated that a possible alternative to recapitalization would be a leveraged buyout of the Company's shareholders with Morgan Stanley acting as a principal and management participating in such a transaction. No decisions were made at the March 30 meeting.

On May 3 management did ask Morgan Stanley to evaluate the various alternatives open to the Company. Morgan Stanley responded with a written report at a May 24 meeting with Messrs. Schierl and Donald DeMeuse, President of the Company and Ms. Hempel. According to Mr. Brennan, "all the possibilities were gone through, with the objective of what alternative would produce the highest value." (Brennan Dep. at 71). The session was "an analytical presentation;" the financial feasibility of each alternative was not discussed. Mr. Brennan reported that in Morgan Stanley's view, a leveraged buyout would generate greater value for shareholders than would a recapitalization transaction, a share repurchase or a spin-off. He stated that, in Morgan Stanley's view, a leverage buyout in the $48-50 range was feasible and the preferred alternative. It was again stated that Morgan Stanley would be interested in participating with senior management in such a transaction. Management did not commit to participate in such a transaction at that time, but rather took the matter under advisement.

On May 31 Mr. Schierl informed Mr. Brennan that he and others of the senior management of the Company were interested in pursuing such a transaction, but only if the Fort Howard board gave prior approval to their effort to structure a transaction and agreed to receive such a proposal.

That same day, Mr. Schierl met with director Thomas L. Shaffer at the Roanoke, Virginia Airport to advise him that senior management had decided to pursue a possible leveraged buyout of the Company in partnership with Morgan Stanley. Schierl informed Shaffer that a Special Committee of the board would have to be formed to consider the buyout proposal and that Schierl wanted Shaffer to serve as its chairman. They discussed other possible members of a Special Committee and agreed that directors Ziemer and Cuene were best suited for the job.

Mr. Shaffer, who was a law school classmate of Mr. Schierl's, has been on the Fort Howard board longer than any other outside director. He is a professor of law specializing in ethics. Mr. Cuene has been on the board for ten years; he owns a new car dealership in Green Bay. Mr. Ziemer has been on the board about one year; he is the retired chairman of a Wisconsin gas and electric utility company.

Over the next several days, Mr. Schierl flew to Florida to talk with Dr. Cofrin, a director and large shareholder, and spoke as well with Mr. Ziemer, Mr. Cuene and director Diane Rees, who had recently been named to the Fort Howard board. Mr. Schierl invited Dr. Cofrin to participate in the transaction. Cofrin asked that his children be given the opportunity to participate. Mr. Schierl declined that request.

The June 7 Board Meeting

Fort Howard's ten member board was scheduled to meet on June 7, 1988 to consider the adoption of a Shareholders Rights Plan as a defensive measure against hostile takeovers. Such a plan, however, was never considered by the board. Instead Mr. Schierl and Mr. Brennan presented the board with a "proposal to make a proposal". (Brennan Dep. at 138). Mr. Schierl discussed the results of the Morgan Stanley analysis and informed the board that Morgan Stanley and the three management directors, and possibly Dr. Cofrin were interested in exploring a leverage buyout of Fort Howard. In addition, the board was told that director Koerber's law firm might serve as counsel to the management directors in any such transaction. Mr. Schierl stated that if the board were willing to entertain a proposal, he would "seek to make one" but there was "no commitment that it could be done because we [are] collectively ignorant of the ability to get appropriate bank financing." (Brennan Dep. at 123).

The three management directors then left the meeting and (judging from the draft minutes of the meeting) outside legal counsel then guided the remaining directors through adopting the necessary resolutions to appoint a Special Committee and to select outside legal counsel, began the process of selecting a financial advisor and acted affirmatively on the request to indicate an interest in receiving a proposal.

The Special Committee was comprised the three outside directors discussed by Mr. Schierl and Mr. Shaffer. Shaffer was designated Chairman. The Special Committee made a determination at the June 7 meeting to keep these developments confidential. Outside legal counsel advised that disclosure was not legally required at that time. In the absence of advice that there was a legal obligation to do so, the Special Committee elected secrecy. As its chairman testified:

> It was very important to keep this matter confidential, until they [the buyout group] were in a position to present their proposal and we could listen to it.
>
> The reason for that was that it might be a good deal and if we introduce prematurely some sort of bidding war, we would lose it and we might lose in the bidding war as well; that all we would have done then is to invite a hostile takeover, and it had been our concern for two years to avoid a hostile takeover.
>
> So for that reason we determined among ourselves, talked about it a good deal, confidentiality until we had a proposal. (Shaffer Dep. p. 95).

The Special Committee acknowledged that the management group was served by this decision:

> They didn't want to be in the middle of a bidding war . . . their concern from the beginning was that there not be any third party offers. (Shaffer Dep. at 101).

The Special Committee retains First Boston and prepares to receive a proposal.

On June 9, 1988, the Special Committee met and retained First Boston Corporation as its independent financial advisor. On June 10, Morgan Stanley entered into a confidentiality and standstill agreement with Fort Howard pursuant to which Morgan Stanley agreed not to purchase (without the board's consent) any shares in furtherance of any acquisition of the Company for a period of one year. Over the next few weeks, Morgan Stanley received confidential information concerning the Company, including management's financial projection not earlier disclosed to shareholders or the market. First Boston was provided with the same information. Promptly following the June 7 meeting, Morgan Stanley started contacting sources of financing to arrange the more than $3 billion that, in addition to its own $400 million equity investment, would be needed to close a transaction.

The Special Committee met again on June 17. At that time, First Boston distributed a preliminary written analysis of the Company and of possible transactions. While apparently no specific range of fair values was mentioned at that meeting, defendant Shaffer drew the inference from it that First

Boston and Morgan Stanley might be very far apart with respect to opinions on that subject. The Special Committee then requested First Boston and Morgan Stanley to meet "to insure that everybody was dealing with the same factual information" (Brennan Dep. at 164-65; Koch Aff. at ¶ 14). Plaintiffs in this action contend that views about fair value were expressed at this meeting and, as a result, First Boston brought its estimates down to the neighborhood that Morgan Stanley was thinking about. The record developed to date, however, does not support that assertion. Rather, it now appears that the matters discussed were general valuation issues and the types of information being used by the two firms in their work. After the meeting, First Boston informed the Special Committee that both firms were using generally the same financial information and factual data.

On June 21, 1988 the Special Committee held a 7-hour meeting at which First Boston delivered and reviewed a second written report to the committee. Draft stock option and merger agreements, prepared by counsel for Morgan Stanley, were distributed. First Boston was not yet prepared to opine on a range of fair values for Fort Howard. Under questioning, however, it did opine that there were a number of factors that suggested that this might be a good time to sell the Company. The Special Committee also discussed at this meeting the need to test any acquisition proposal in the market. It was suggested that the need for such a test would, in part, be a function of the adequacy of the price proposed.

Towards the end of this meeting, a report came in that there had been remarkably high trading volume that day in the Company's stock. There was, of course, concern that there had been a leak of information concerning the prospect of a buyout. The Special Committee chairman reports that this gave rise to concern:

> If there was going to be some profit-taking on it, we felt that it was more important to give the old time share-holders an opportunity to take their profits and not to leave it all to the speculators. That led us to the conclusion that perhaps we ought to issue a press release. Mr. Atkins drafted one.
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> In the process of these discussions, we also got in touch with Mr. Schierl, who was in New York at Morgan with people there, and there were a few phone calls back and forth about that and the two groups negotiated a bit over it with speaker phones. They were very reluctant to have any press release at all . . .
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> * * *
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> We did not concede that we would not issue the press release in any case . . . [but concluded to reconsider the matter the following day].

The next day, there was a telephone inquiry to the Company reporting on a rumor that there was a management LBO in the works. Promptly thereafter, Fort Howard did issue a press release stating, in part, that "members of [Fort Howard's] management intend to seek a proposal with third parties to acquire the Company in a leveraged buyout."

<u>The June 23 Special Committee Meeting</u>

The Special Committee next met on June 23, augmented by independent directors Rees and Schoshinski. At that meeting, the directors received a presentation from First Boston reflecting its analysis of Fort Howard and several potential alternative transactions. A First Boston representative stated its opinion that it was not an inappropriate time to consider selling the Company. The Special Committee was told that, in First Boston's view, a recapitalization would not result in greater value to stockholders than a leveraged buyout, in part because the value of the resulting stub share would be highly speculative. First Boston recommended that if the board accepted a leveraged buyout proposal, that it provide for a test of any such proposal in the market to determine whether another acquiror would make a better offer.

The Special Committee then reviewed the terms of the draft merger agreement and a proposed stock option agreement calling for the creation of rights to acquire 18½% of the Company's shares. These had been prepared by Morgan Stanley. The committee found the option and several other provisions unacceptable. Among the provisions rejected were provisions calling for unspecified "break-up fees"; unlimited expense reimbursement; a broad prohibition against shopping the Company; and a provision acknowledging Morgan Stanley's right to commence and complete any tender offer within twenty days from the announcement of its agreement.

After about six hours, the Special Committee recessed to reconvene at 8 p.m. at which time the management directors and Morgan Stanley were invited to address the committee. Morgan Stanley then presented a proposal to purchase all outstanding Fort Howard stock at $50.00 per share in cash pursuant to the merger agreement. First Boston, in private, shared its view with the Special Committee that that price was below the low end of the range of fair values and stated that it could not opine that the price proposed was fair.

At about 9:35 p.m. the Special Committee announced that its members had "unanimously determined that they were disappointed with the price offered . . . and the group's financing arrangement." The Special Committee also told the buyout group that the limitation upon its ability to shop the transaction were "unacceptable, that we were not going to go forward at any price without a market test and depending on what the price was, that market test was going to have to be pretty broad . . . ." (Shaffer Dep. I at 113, 157; Ziemer Dep. at 106). The Special Committee named no price that it would consider fair. The Special Committee stated that it would enter into negotiations only if there was a substantial improvement in the price offered and that, if any price improvement was at the low end of the range of fairness, the committee would require more time to test the market and fewer restrictions on its ability to do so. (Shaffer Dep. at 173). The committee also said that it would not accept a provision precluding it from furnishing third parties with the same information provided to Morgan Stanley.

<u>The June 24 Special Committee Meeting and the $53.00 Offer</u>

The Special Committee reconvened at 7:30 a.m. on June 24. A further revised draft merger agreement was distributed and discussed. At 9:20 a.m., Mr. Brennan and the management directors joined the Special Committee. Mr. Brennan put forward a revised "final" proposal. The price was $53.00 per share cash for all shares. The tender offer would begin five business days after the public announcement of the transaction and remain open for twenty-five business days. Thus, the tender offer transaction was designed to be publicly known for a period of thirty business days after announcement (forty-three calendar days). During that period, the Special Committee would be free to negotiate with, and provide information to, any potential acquiror who contacted the Company or First Boston. This would be expressly disclosed in any press release announcing the transaction. If a competing party outbid the buyout group, the "final" proposal provided that the buyout group would be entitled to be paid up to $1.00 per share, including actual expenses (i.e., up to $67.8 million).

After receipt of the revised buyout proposal and after consulting with its counsel, the Special Committee informed Morgan Stanley, before making any decision with respect to that proposal, that, in the committee's view, it would be necessary for the Company to issue a press release which the Special Committee and its counsel had prepared. The Company then issued the following press release:

> Fort Howard Corporation (NYSE:NHP) announced today that it is engaged in negotiations with a group comprised of members of its senior management and an affiliate of Morgan Stanley Group, Inc. for the acquisition of the Company in a leveraged buyout. There can be no assurance that any transaction will be agreed upon or consummated.

After this press release was issued, the Special Committee and its advisers considered the further proposal. First Boston advised the Special Committee that the $53.00 per share was clearly within the range of acceptable prices for the Company and that the revised ability to check the existence of other opportunities — that is, the contemplation of a public announcement that the Company was willing to entertain third party interests and the extension of the tender offer to include a thirty business day period from the date of the announcement — would, even considering the size of the transaction, provide a reasonable opportunity for third party interests to present themselves. First Boston also advised the Special Committee that the buyout group would be able to finance the transaction, but $53.00 per share was the most it could finance. After a three-hour discussion, Mr. Shaffer announced that at $53.00 per share cash, the Special Committee was prepared to go forward with negotiating other aspects of the transaction.

The June 25th Meeting

The Special Committee reconvened at 8:30 on Saturday, June 25. Counsel reviewed with the directors the most recent draft of the merger agreement page by page. First Boston delivered a written opinion that $53.00 per share was fair from a financial point of view. At approximately 2:30 that afternoon, the Special Committee determined to approve the merger agreement (the proposed topping fee and expense reimbursement provision having been reduced to $67 million in the interim) and recommend that the entire board adopt the agreement. Immediately thereafter, the full board met (with Dr. Cofrin absent) and unanimously approved the execution of the merger agreement, with Mr. Koerber abstaining.

The Market Test

The Company and Morgan Stanley prepared a joint press release for release first thing Monday morning, June 27. In delaying public announcement while the markets in the U.S. were closed, the parties, in effect, extended slightly the time during which an alternative transaction might present itself. While the merger agreement permitted the Company to receive and consider alternative transactions, it did not permit the Company to shop the Company actively by soliciting offers. The Special Committee had, however, negotiated a provision to make clear in the initial press releases that the Company has the right and would entertain alternative proposals and would cooperate with any such person in the development of a competing bid. The press release that was issued provided, in part, as follows:

> The transaction was unanimously recommended by a Special Committee of Fort Howard's outside directors, which was advised by the First Boston Corporation. Notwithstanding its recommendation, and consistent with the terms of the merger agreement, the Special Committee directed the Company's management and the First Boston Corporation to be available to receive inquires from any other parties interested in the possible acquisition of the Company and, as appropriate, to provide information and, in First Boston's case in conjunction with the Special Committee, enter into discussions and negotiations with such parties in connection with any such indicated interest.

(Koch Aff. at ¶23).

This press release and the news accounts that it stimulated received widespread attention. The record shows that the story was reported prominently in the business section of _The New York Times_, _The Wall Street Journal_, _The Los Angeles Times_ and in other publications. Within days, eight inquiries were received.

The Special Committee instructed First Boston to screen these inquiries initially to filter out any that could not be considered serious possibilities in a transaction of this size. The next day, it reported back that all eight inquiries came from persons or entities that seemed worthy of further attention. The Committee then authorized First Boston to deliver to each all of the materials that had been given to Morgan Stanley and to First Boston including management's financial projections. These materials were those that were later filed pursuant to Section 13E-3 of the Securities Exchange Act by Morgan Stanley. The Special Committee instructed First Boston that further particular information, facility inspections or discussions with management would only be available if an inquirer was willing to sign a confidentiality and standstill agreement.

Only two of the eight entities that received the 13E-3 materials sought further access to information, to facilities and to management. The first of these did so promptly. It was a financial entity. It signed a confidentiality and standstill agreement similar to that signed by Morgan Stanley. It has not proposed a transaction.

After some delay the other of these two entities sought further information. This firm was a competitor of Fort Howard. On July 22, approximately three weeks after receiving the information Morgan Stanley had had, an investment banker, representing such entity, asked First Boston whether, if his client signed a confidentiality/standstill agreement, it could see specific types of information. This party was interested in certain financial data on a plant by plant basis; financial data broken down by broad product group and business segments; cost data for fiber by grade and site; capability of mills; total labor cost and headcount per site and other data of a kind that would be of interest to a competitor. <u>See</u> Shaffer Dep. at 279 and Exh. DX1 thereto.

At a meeting on July 22, the Special Committee discussed this second request from the competitor that had only been identified as "Company A" in this litigation. Company A is said to be a substantial competitor of Fort Howard in the tissue business. At the July 22 meeting, it was noted that much of the information sought could be provided, but that Company A would have significant antitrust problems in acquiring Fort Howard and, perhaps, would have some financing problems, as well. The Special Committee wanted to find out how Company A proposed to deal with the antitrust problems that its acquisition of Fort Howard would occasion. The Committee's outside legal counsel was instructed to propose to Company A discussion between its antitrust lawyers and the Committee's advisors and between the investment bankers for the two firms.

The Special Committee met by telephone on July 25 and its lawyer reported no agreement on the suggestion for direct discussion among advisors. Company A took the position that it was willing to "bear the antitrust risk" and that a merger agreement could so provide. Therefore, conversations as to how it might address the antitrust problem were said to be unnecessary. Such an approach would mean, however, that the provisions that would have such an effect would have to be agreed upon before the confidential materials were furnished.

The Special Committee reports that it was concerned to explore this potential opportunity but concerned as well to protect against risks to the Morgan Stanley deal that announcement of this interest might pose, especially if the antitrust or financing problems were not solvable. The concern for confidentiality of competitive information, while noted, is somewhat underplayed.

The Committee thus says that, acting through its counsel, it attempted to negotiate an agreement that balanced these concerns. Its counsel prepared a draft form of confidentiality/standstill agreement that had several unusual features designed, it is claimed, to deal with these special problems. Those special features, not included in the confidentiality agreement that Morgan Stanley had signed or that the earlier post-agreement potential bidder had signed, included the astonishing proposal that in order to see further information about the Company, Company A would have to agree to be liable to Fort Howard in the amount of $67.8 million if Company A (1) was provided with access to the information sought, (2) made no bid, (3) the Management Group's tender offer did not close, and (4) a substitute for it did not eventuate. Not surprisingly, Company A refused to put $67 million subject to risks it could not control simply to get a look at more detailed information.

Plaintiffs point to this most recent development as the most dramatic confirmation of their contention that the "market check" period purportedly negotiated for the purpose of providing to the Special Committee a technique to assure itself that the Management Group's offer was the most beneficial one available — was a sham. No one could believe that a potential bidder would take on the risk the Special Committee proposed. The proposal in fact was designed, it is said, to deter active interests from a logical source that First Boston has admitted could likely do the deal.

The Special Committee answers this charge by referring to further negotiations that did occur which removed the $67.8 risk and offered in substitution another approach that would have required Company A to make an offer, if any, by August 5th. Under that approach, the market would know with certainty on August 8th, the date of the scheduled closing of the Morgan Stanley offer, whether Company A intended to make an offer. Other special provisions treating the antitrust problems that Company A raised were also further negotiated. Before these matters reached conclusion, the CEO of Company A spoke to Mr. Shaffer, the Chairman of the Special Committee, informing him that Company A was suspending its activities with Mr. Howard.

II.

The pending motion is for a preliminary injunction. Such a remedy is discretionary in the sense that, in determining to issue such an order, a number of competing factors, whose weight is not scientifically ascertainable, must be evaluated. The factors themselves are not controversial. They include first, a preliminary determination of the likelihood that plaintiff will be able to prove his claims at trial. To issue the provisional remedy, the court must be satisfied that a reasonable probability of such success has been shown. Secondly, plaintiff must show that he is threatened with irreparable injury before final relief may be afforded to him. Should the court determine that both of these elements appear, it is necessary to consider what sort of injury, if any, may be visited upon defendant by the improvident granting of the remedy, how great might that injury be in relation to the injury with which plaintiff is faced, and whether a bond may offer adequate protection against that risk or whether it might be avoided by the shaping of relief. Lastly, the court must be alert to the legitimate interests of the public or innocent third parties whose property rights or other legitimate interests might be affected by the issuance of the remedy. All of this, of course, is perfectly well settled.

III.

To simplify, plaintiffs assert that the facts set forth above constitute at least four distinct legal or equitable wrongs accomplished by the management directors and the other directors working in sympathetic coordination with them. Morgan Stanley is, of course, seen as a co-venturer and an active participant in these wrongs which is jointly liable for resulting injury to the class of Fort Howard shareholders.

The first theory of liability is predicated upon plaintiffs' reading of Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., Del. Supr., 506 A.2d 173 (1986). It asserts that the independent committee engaged in a course of conduct that has had the effect of never shopping the Company; that the board never took steps that any prudent person seeking to locate the best available transaction would have taken and that, indeed, its actions throughout — from the secrecy designed to permit the management group to make its offer in a nonbidding context, to its direction to First Boston to meet with Morgan before a price was put forward and to the chilly reception it gave Company A — are consistent only with an inappropriate motive. That motive, of course, is the accommodation of management and its financial partners' desire to buy the enterprise in a highly leveraged transaction. This course of conduct is said to offend the central teaching of Revlon, that once a corporation is for sale, it is the board's duty to show no preference, but to seek the best transaction available.

The next proposed theory of liability relates to the disclosures contained in the July 1, 1988 Offering Circular. These are called grossly inadequate because they are said to fail to disclose the centrally important fact concerning Fort Howard — that, because it possesses a proprietary process, a deinking process, that permits it to use cheaper paper in the manufacture of tissues than do any of its competitors, it is the "superstar" of its industry. Plaintiffs contrast the lack of any description of the special nature of the Company with the descriptive material supplied by Bankers Trust to a prospective investor. Those materials, plaintiffs say, emphasized the special character of the Company's advantage. The details of this argument are treated below.

The third theory of liability involves a claim that First Boston's opinion as to the fairness of the $53 price is based upon inadequate information and the Special Committee's role in restricting First Boston's access to relevant information constitutes a breach of a duty of fair dealing. The specifics can be summarized: First Boston did not have access to Company data relating to the deinking process — either the technical information or the cost accounting information relating to the process. First Boston did not seek such information, however, stating now that it is irrelevant to the financial analysis of stock price that it was engaged to perform. Plaintiffs then join issue with First Boston on the question of what information is necessary to render a fairness opinion for a company such as Fort Howard and join issue with the Special Committee on the question whether one could, in good faith and competently, rely upon an opinion by First Boston, knowing that

First Boston did not have and did not want access to such information in rendering its opinion.

The fourth theory of liability has two aspects. It relates to the attempt by defendants to keep confidential or secret such contacts, action and prospects relating to a possible management affiliated leveraged buyout as occurred prior to the announcement of the signed merger agreement. From June 7, 1988 forward, it is contended that the defendants had an obligation to disclose to the market an evolving transaction of enormous importance to existing stockholders. Silence violated that duty, it is contended. The two press releases that were issued were misleadingly vague and compounded the wrong. During the period, many stockholders sold their stock for very much less than the defendants knew or should have realized would be available in a premium commanding LBO transaction. Indeed, it is asserted that many sold on the market to Morgan Stanley during this period.

This is said both to constitute a violation of a state law imposed fiduciary duty (compare Bershad v. Curtiss-Wright Corp., Del. Supr., 535 A.2d 840 (1987)) and, equally importantly, to be reflective of the lack of good faith that is necessarily intertwined with plaintiff's Revlon argument. The pending motion for preliminary injunction with respect to the Morgan Stanley tender offer, however, presents no occasion to express any preliminary view with respect to the questions raised by this theory insofar as it attempts to supply an independent basis for recovery. If class members were disadvantaged in a way that is legally compensable and if defendants or some of them are accountable in damages for some or all of the injury suffered, a money judgment can be made available. But the closing of the current offer has, as I see it, no current impact upon persons who have sold their stock prior to this time. Thus, I see no reason to further address this theory directly on this application.

IV.

I turn first to plaintiffs' argument built on their understanding of the Revlon case. On June 7, the Fort Howard Special Committee faced two important questions. The first of course was whether the board of directors would receive and consider a proposal by the management affiliated leveraged buyout group to acquire all of the stock of the Company. The other question was whether, in evaluating any such offer from management as it did receive, it would be necessary or prudent to shop the Company, that is, to explore whether others might be interested in such a transaction and on what terms. The board, or rather its Special Committee, decided that it was unnecessary to announce an interest in selling the Company and that prudence in the circumstances dictated that it not do so.

Two related critical issues that this motion presents are thus raised: first, whether that decision was legally permissible in light of the holding of Revlon, and second, whether, if legally permissible, it was made in a good faith effort to promote or protect the interests of the corporation and its shareholders.

The former issue is a legal one and is susceptible of resolution now. For the reasons that follow, I am of the view that — even assuming that the board action of June 7 was the equivalent of a board decision that the Company was for sale — Revlon does not so constrain the functioning of a board acting without a conflicting interest as to preclude the approach that was here followed when undertaken competently and in good faith. The second issue is essentially factual and may not be finally resolved now. Nevertheless, it is at the heart of the matter and decision of the pending motion does require a preliminary judgment concerning the bona fides of the board's action on June 7th and throughout the following period. I will discuss it first.

A.

Having read much of the testimony taken in the matter, reviewed all of the briefs and affidavits and inspected relevant documents, I am unable to conclude provisionally that the Special Committee was not motivated throughout to achieve a transaction, if there was to be one, that offered the assurance of being the best available transaction from the point of view of the shareholders.

In so concluding, I note that one's view concerning bona fides, will, in settings such as this, almost always rest upon inferences that can be drawn from decisions made or courses of actions pursued by the board (or a Special Committee). Rarely will direct evidence of bad faith — admissions or evidence of conspiracy — be available. Moreover, due regard for the protective nature of the stockholders' class action, requires the court, in these cases, to be suspicious, to exercise such powers as it may possess to look imaginatively beneath the surface of events, which, in most instances, will itself be well-crafted and unobjectionable. Here, there are aspects that supply a suspicious mind with fuel to feed its flame.

It cannot, for example, be the best practice to have the interested CEO in effect handpick the members of the Special Committee as was, I am satisfied, done here. Nor can it be the best procedure for him to, in effect, choose special counsel for the committee as it appears was done here. It is obvious that no role is more critical with respect to protection of shareholder interests in these matters than that of the expert lawyers who guide sometimes inexperienced directors through the process. A suspicious mind is made uneasy contemplating the possibilities when the interested CEO is so active in choosing his adversary. The June 7 decision to keep the management interest secret, in a sense, represents a decision to sell the Company to management if it would pay a fair price, but not to inquire whether another would pay a fair price if management would not do so. It implies a bias that, while as explained below, I accept as valid for purposes of this motion, nevertheless is a source of concern to a suspicious mind. Similarly, the requested meeting between First Boston and Morgan Stanley. For present purposes, I cannot conclude that plaintiffs' reading of that affair will be shown to be correct. But it is still odd for the Special Committee to risk infecting the independence of the valuation upon which it would necessarily place such weight, by requiring its expert to talk directly with Morgan Stanley. And that risk is run for what can only be seen as a minor benefit to the convenience of the individuals involved. So there is ground for suspicion with respect to the good faith of the Special Committee, but, on balance, not such that seem at this stage persuasive.

Here, I draw no inference of bad faith on the part of the Special Committee from its course of conduct in part because I am persuaded that the alternative course pursued[1] was reasonably calculated to (and did) effectively probe the market for alternative possible transactions. The alternative "market check" that was achieved was not so hobbled by lock-ups, termination fees or topping fees; so constrained in time or so administered (with respect to access to pertinent information or manner of announcing "window shopping" rights) as to permit the inference that this alternative was a sham designed from the outset to be ineffective or minimally effective. I am particularly impressed with the announcement in the financial press and with the rapid and full-hearted response to the eight inquiries received. Very full information was provided very promptly. The later developments with Company A have been explained to my satisfaction for purposes of this motion.

Moreover, the rationale for adopting this approach — for permitting the negotiations with the management affiliated buyout group to be completed before turning to the market in any respect — makes sense (and thus, cannot alone justify an inference of bad faith). Management had proposed to make an all cash bid for all shares if and only if the board endorsed it. The rest of the world was not bound by any of these three

[1]That is alternative to announcing an auction on June 7.

important qualifications. To start a bidding contest before it was known that an all cash bid for all shares could and would be made, would increase the risk of a possible takeover attempt at less than a "fair" price or for less than all shares. Accordingly, even if the approach adopted could be said to favor the management affiliated group — in the sense that it negotiated its deal without the imposition of time constraints and in a setting in which no other bidders were present — it does not do so in a way that would support the inference that the decision to do so was not made in the good faith pursuit of the interests of the stockholders.

B.

While plaintiffs contend that the Special Committee acted in bad faith, they also argue that without regard to that fact, the members of the Special Committee violated duties recognized by Revlon. The argument is as follows. The Company was for sale as of June 7 when the board indicated it would receive Morgan Stanley's offer, appointed a Special Committee, hired special counsel, etc. This, it is said, "established Revlon duties. From that point on, the Special Committee was required to maintain a neutral stance towards management and any competitor bidder in order to obtain the best possible transaction for the shareholders." (Reply Br. p. 13). Three specific examples are cited of favoritism, two of which (the claim that the Special Committee "implored First Boston to adjust its valuation in order to achieve a management buyout" and that the treatment of Company A was designed to discourage its interest) do not appear to be factual at this stage. But the basic decision on June 7 to keep the process secret was, or so its seems to me, not a wholly neutral step as between potential bidders.

For the reasons set forth above, that decision may plainly be thought to serve stockholder interests, and, as stated above, I have concluded, for present purposes, that it was a decision made in good faith. Thus, the question does arise whether Revlon establishes rules that came into play whenever the Company is for sale, such as once the Company is for sale, the board must, in all events, be neutral as between offerors or, what is the same thing, the board must maintain a "level playing field" or the board must not interfere with the free workings of an auction market. If so, and if plaintiffs have identified such a rule with its claim to neutrality, then I would think such a duty was breached here. As the recent case of In Re J.P. Stevens & Co., Inc. Stockholder Litigation, Del. Ch., C.A. No. 9634, Allen, C. (April 8, 1988) makes clear, however, that is not my understanding of the thrust of Revlon. I understand that case as essentially a breach of loyalty case in which the board was not seen as acting in the good faith pursuit of the shareholders' interests. Revlon explicitly recognized that a disinterested board acting in good faith and in an informed manner may enter into lock-up agreements if the effect was to promote, not impede, shareholder interests. (That can only mean if the intended effect is such, for the validity of the agreement itself cannot be made to turn upon how accurately the board did foresee the future).

More generally, a board need not be passive even in an auction setting. It may never appropriately favor one buyer over another for a selfish or inappropriate reason, such as occurred in Revlon, but it may favor one over another if in good faith and advisedly it believes shareholder interests would be thereby advanced. Even in the auction context, if one deal is all cash and more likely to close and sooner, a disinterested board might prefer it to a deal that may be thought to represent a somewhat higher price, but is not all cash and not capable of closing as quickly. See Citron v. Fairchild Industries, Inc., Del. Ch., C.A. No. 6085, Allen, C. (May 19, 1988). The need to exercise judgment is inescapably put on the board at points in an auction process and the validity of the exercise of that judgment is appropriately subjected to a business judgment form of judicial review. In J.P. Stevens, supra, the board did favor one bidder by granting it a substantial topping fee. While some aspects of the case made the question of good faith or not a quite close one, once one found good faith, it was clear that granting that fee could (and as things worked out, did) benefit shareholders.

Accordingly, I cannot share plaintiffs' view that Revlon duties were violated by the procedure adopted here, which I am persuaded, for present purposes, was followed in good faith and was sufficient to inform the exercise of judgment that the board made in entering the merger agreement, and, in a sense, continues to make while it awaits the close of the offer or the announcement of another bidder.

V.

With respect to plaintiffs' claim concerning First Boston's role in this process, I conclude that they have not established a probability of success on the merits of their claim that the withholding of information relating to Fort Howard's proprietary manufacturing process from First Boston constitutes a breach of fiduciary duty to the shareholders or renders the First Boston opinion unreliable.

The argument runs like this. Fort Howard's secret nonpatented process for deinking waste paper and making it into tissue paper which the Chairman of the Special Committee Shaffer estimated to be worth over a billion dollars (Shaffer

Dep. I at 113) makes the Company the "superstar" of the industry. While its competitors have to use expensive virgin wood pulp, Fort Howard's secret technology enables it to enjoy a much higher profit margin by substituting cheaper waste paper for the wood pulp. The competitive advantage to Fort Howard is said to be so great that its competitors have concentrated expansion of their businesses abroad instead of in the United States, where Fort Howard operates.

It is argued that disclosure to First Boston of information relating to the specific cost accounting aspects or implications of this secret process was absolutely critical to the rendering of a dependable estimate of fair value of Fort Howard stock. Plaintiffs do not, of course, mean that an engineer's or scientist's description of the technical details of how the process works should have been disclosed. Rather, they insist that a "meaningful evaluation" of the Company would require knowledge of the financial implications of the Company's most valuable trade secret. Thus, for example, management allegedly should have disclosed what grades of waste paper may be used to manufacture tissue paper when the secret process is employed; what are present prices and pricing trends for waste paper of those kinds; what are the objectives and the progress of research aimed at improving the secret technology. There is however, nothing in the record that suggests that a material change or improvement in the process has been developed which has not yet had an opportunity to be reflected in the Company's financial performance.

The conclusion that emerges from the record developed at this stage does not, in my opinion, show the withholding of critical information. Rather, it shows that First Boston, an investment banker of acknowledged expertise, did not ask for the information plaintiffs claim was withheld. In fact, First Boston states that it received all of the information it requested which was all that it needed in its expert judgment to conduct a financial analysis of Fort Howard. (See generally Koch Aff. at 18-22). Since the financial experts decided that they did not need specific information regarding Fort Howard's secret technology, it is difficult to conclude that it is likely that at trial it will be established that not providing this information constituted a breach of directorial fiduciary duty or rendered the Special Committee's reliance upon First Boston inappropriate.

VI.

With respect to the claim concerning the allegedly flawed disclosure contained in the Offer to Purchase, I also conclude that plaintiffs have failed to establish a probability of success on their claim.

I assume for present purposes that having entered upon a co-venture with the management directors relating to the Company, that Morgan Stanley (and its affiliates involved in this transaction) must operate under the same rules that apply to those fiduciaries. Thus, those defendants extending the offer bear the duty to make full and complete disclosure of all material facts within their knowledge relating to the proposed tender offer. The scope of that duty is defined realistically to catch material omissions or misstatements. Our Supreme Court has carefully defined just what "material" means in this context:

> A showing of a substantial likelihood that, under all of the circumstances, the omitted fact would have assumed actual significance in the deliberations of a reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix of information available".

Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944-45 (1985), quoting TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1978). (emphasis supplied). See also In Re Anderson Clayton Shareholders' Litigation, Del. Ch., 519 A.2d 680, 690 (1986); Weinberger v. Rio Grande Industries, Inc., Del. Ch. 519 A.2d 116 (1986).

In asserting that this standard was not met by the Offer to Purchase, plaintiffs focus not upon a single fact that was not disclosed. Rather, they compare what was sent to potential lenders by Bankers Trust Company, the lead bank in a $2.55 billion borrowing needed to fund the purchase, with what was said to the shareholders. This comparison demonstrates, they contend, the inadequacy of information in the Offer to Purchase regarding the Company, its condition, and prospects. Plaintiffs select particular statements appearing in the lengthy (perhaps 50 pages) memorandum sent by Bankers Trust, such as the fact that Fort Howard held the largest share of the U.S. commercial tissue market; that its proprietary process permits it to use waste paper in the manufacture of tissue products which is a substantial competitive advantage; that there are costs of entry into the industry; that earnings have tended to perform well during recessions; that the amount of waste paper is increasing; and that "based on projected additions to industry-wide capacity . . . and an expected increase in demand, tissue pricing could be favorably impacted with the result being enhanced margins."

The lengthy document that plaintiffs use to build this argument was, it appears, prepared by Bankers Trust based upon information from Morgan Stanley and from public sources. It was sent to entities (I assume principally depository institutions of large financial capability — $50 million being the minimum participation in this credit facility) and, one can safely assume, of great financial sophistication.

The offering document contains virtually no description of the business of the Company, its competitive strengths and weaknesses, or prospects for the future of the various markets within which the Company operates. It does contain a description of the capital structure of the firm (page 3). It includes selected consolidated financial data for three years (page 44) and contains the projected financial information that were supplied by the Company to Morgan Stanley (page 45). It sets forth certain assumptions that formed the basis for the projections (page 46).

I am not persuaded on the current record that plaintiffs have established a probability of success with respect to their claim that the omission from the Offer to Purchase of a description of the Company's comparative strengths and weaknesses vis-a-vis other producers of tissue products constitutes a material omission as that term is defined in our law. That is, I am not yet persuaded that the inclusion or exclusion of this information would have a "substantial likelihood" of having "actual significance" in the deliberations of shareholders. The real significance, for example, of the proprietary deinking process that gives Fort Howard a lower cost of production of tissues is how that fact affects the

Company's ability to generate cash flow, profits and dividends. The specific financial or accounting impact of the process at intermediate steps in financial reporting is fairly unimportant to one asked to value the stock of the Company at least if (1) there is no undisclosed further improvement in the process (or foreseen obsolescence) that can be expected to impact earnings in the future, or (2) no new management (who might arguably wring greater earnings out of known technology).

Suppose, for example, that one is furnished with the most reliable projections of income for a company for a five year period, with historical financial performance measures and with stock price history, and suppose that no material change in the utility of current technology is foreseen (either in improvement or in payment through obsolescence), it is submitted that a rational decisionmaker, asked if he is interested in selling the stock at a given price, will have no particular interest in asking whether the firm is a low cost producer of its products or a high cost producer. It simply should make no difference which it is — high cost or low — because the past stock price was determined with that cost performance (whatever it is) as an input, and the projections of future earnings which have been provided (of course, a most important factor), incorporated, or was premised upon, that