1982 WL 8774

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.
Court of Chancery of Delaware, New Castle County.

SMITH
v.
PRITZKER

No. 6342
|
July 6, 1982

This is a class action suit brought by plaintiffs who were owners of a substantial portion of the outstanding shares of common stock of Trans Union Corporation. Defendants are the majority shareholders and chief executive officer of the private corporation that merged with Trans Union. Plaintiffs seek alternative remedies of (1) having the merger rescinded or (2) receiving money damages based upon the difference between the merger price and the fair market value price of shares immediately prior to the merger. The court of chancery entered judgment for defendants.

The directors and chief executive officers of Trans Union were faced with the problem of lacking sufficient taxable income to take advantage of available tax credits. Trans Union did, however, have considerable cash flow. After careful examination of the alternatives available, the corporation's president approached defendants concerning a merger. After several offers were discussed, a suggested selling price of $55 per share was agreed upon. Trans Union's president took that offer back to the board of directors of the corporation. The directors discussed the merger at three separate board meetings and finally unanimously agreed to recommend the merger terms to the shareholders. However, the parties understood that if Trans Union were to receive a better offer, they were under no obligation to Pritzker. In order to secure a better offer, Trans Union hired an investment banking firm which made a concerted effort to find a buyer at a higher price. As no further offers were forthcoming, the board presented the proposal to the shareholders on February 10, 1981, pursuant to proper notice requirements. Eighty-nine percent of the shareholders voted in favor of the merger.

Plaintiffs contend that the board acted negligently in recommending the merger to the shareholders. The court held that there exists a presumption that corporate directors form their business judgments in good faith. To overcome that presumption, plaintiffs must show that the directors 'acted so far without information that they can be said to have reached an unintelligent and unadvised judgment.' The court, in the case at bar, held that the directors of Trans Union made every effort to evaluate all possible alternatives and to secure the very best price for their shareholders. Furthermore, the court stated that the shareholders of Trans Union were fully informed as to the terms of the merger agreement. As such, the merger was properly placed before the shareholders with a recommendation that the merger be approved, based upon the best business judgment of the directors. Judgment for defendants.

Attorneys and Law Firms

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A. Gilchrist Sparks III, Esquire, of Morris, Nichols, Arsht & Tunnel, Wilmington, DE for defendant.

Robert K. Payson, Esquire, of Potter, Anderson & Corroon, Wilmington, DE for individual defendants.

Opinion

****408** MARVEL, *Chancellor*

***1** Plaintiffs Alden Smith and John W. Gosselin, who were substantial common stockholders of Trans Union Corporation at the time of the merger here in issue, seek in this class action a ruling after trial directing that the merger of Trans Union into the defendant New T. Company be rescinded, or, in the alternative, that damages be assessed against the members of the board of directors of Trans Union Corporation and awarded to the stockholders in the amount of the difference between the price of $55.00 offered for the shares of stock affected by such merger and the fair value of such shares immediately prior to the date of the merger in question, namely, February 5, 1981, plus interest.

The transaction under attack came to pass as a result of the efforts of Jerome Van Gorkom, formerly president and at the time chairman of the board of Trans Union Corporation, with board approval, to solve Trans Union's long-standing fiscal problems arising out of its inability to generate enough taxable income to use available investment tax credits efficiently, thus reducing its net

income, limiting dividends, and lowering the value of its stock in the market. This problem was exacerbated by Mr. Van Gorkom's failure to persuade Congress during 1980 to make tax credits refundable in cash and to legislate against further accelerated depreciation.

And while other solutions designed to remedy Trans Union's fiscal troubles, such as making a major acquisition which would generate up to $150,000,000 a year of taxable income, thereby enabling Trans Union to take full advantage of accelerated depreciation and investment tax credits were considered, the cost of acquiring such a company was estimated to be approximately $750,000,000, or more than the current value of Trans Union's assets.

Another possible solution which was considered by the board of directors as a means of remedying Trans Union's fiscal problems was to have the corporation purchase its own stock at an average price of $50.00 per share, such purchases to be made so as to acquire 30% of Trans Union's outstanding stock which would be later reissued to pay for acquisitions.

Still another plan designed to deal with Trans Union's financial problems was a so-called leveraged buyout[1] of Trans Union in which the members of management of Trans Union would participate. **409 However, as noted above, while Mr. Van Gorkom was philosophically opposed to this type of transaction because of the possible conflict of interest which would be therein involved in that the members of management would be interested in obtaining less than the best possible price for the company as well as interested in discouraging other offers for their company, he did not actively oppose such a proposal. Significantly, during his career as an officer of Trans Union, Mr. Van Gorkom had participated in over forty acquisitions and was thoroughly familiar with acquisition procedures, valuation methods, as well as negotiations leading up to such proposals.

*2 However, there were several factors which reduced the likelihood of the acquisition of Trans Union by a public company. First, Trans Union's debt-equity ratio was more than 60%, which meant that the acquisition of Trans Union would increase the debt-equity ratio of most potential acquisitors. Another obstacle to a proposed merger or sale of Trans Union was its low earnings as compared to the price which an acquisitor would have to pay for the stock of Trans Union, which would be likely to dilute the earnings per share of the acquiring company. Mr. Van Gorkom accordingly concluded that a public company would not pay as much for Trans Union as a private company, which would be able to use Trans Union's substantial cash flow without being constrained by debt-equity ratios, price-earnings retios or a dilution of earnings resulting from an acquisition.

In casting about for a possible private purchaser and having in mind Jay A. Pritzker, a business and social acquaintance, Mr. Van Gorkom had Trans Union's controller, Carl Peterson, calculate whether or not it would be reasonable for a propective purchaser to acquire Trans Union of as much as $55.00 per share or a total price of $690,000,000. In response to such a request, Mr. Peterson assumed that such a purchaser would contribute $200,000,000 in equity and would borrow $490,000,000 at an interest rate of 14%. In making this calculation, Mr. Peterson assumed that such a purchaser would **410 be repaid from Trans Union's cash flow, which was substantial, then being in the amount of approximately $162,000,000 a year, as well as from the proceeds of the sale of certain subsidiaries. In arriving at such a conclusion, Mr. Peterson made use of a recent five-year forecast of Trans Union's prospects as well as a study of Trans Union which had been completed during the summer of 1980 by The Boston Consulting Group.

Much to Mr. Van Gorkom's disappointment, Mr. Peterson's calculations indicated that a $490,000,000 loan could not be paid off in five years and that there would be an unpaid balance of $50,000,000 to $80,000,000 at the end of such five-year period, thus making a sale of the stock of Trans Union at a price of $55.00 per share difficult. Despite the discouragement found in such calculations, Mr. Van Gorkom arranged to meet with Mr. Pritzker on Saturday, September 13, 1980, such meeting taking place at Mr. Pritzker's residence in Chicago. Mr. Van Gorkom stated at the outset that he wished to explore the possibility of a transaction whereby the Pritzker family, or someone like them, would agree to buy Trans Union, it being understood that Trans Union would in the meantime be free to accept a better offer. Reviewing Mr. Peterson's calculations, Mr. Van Gorkom suggested that $55.00 per share would be a fair price for Trans Union's stock. In response, Mr. Pritzker asked Mr. Van Gorkom if he would consider a price of $50.00 per share, a suggestion which Mr. Van Gorkom rejected.

On Monday, September 15, 1980, however, Mr. Pritzker telephoned Mr. Van Gorkom to report that he was interested in the transaction which had been proposed by Mr. Van Gorkom but that he needed more information. Mr. Van Gorkom agreed to furnish such information at a meeting with Mr. Pritzker in New York City on Tuesday, September 16, and on that date the company's experts on Trans Union's financial affairs, namely Mr. Chilberg and Mr. Peterson, met with Mr. Pritzker, who demanded still more financial information. As a result, a Mr. Carpenter of The Boston Consulting Group, Trans Union's own financial consultant, flew down from Boston to provide Mr. Pritzker with the desired financial information.

***3** Following such meeting of September 15, 1980, Mr. Pritzker, who in the meantime had agreed to a merger price of $55.00 per share for Trans Union stock, demanded as part and parcel of the proposed transaction that he be allowed first to acquire 1,750,000 shares of Trans Union stock at the market price, a proposed arrangement which was negotiated so as to provide that Mr. Pritzker would acquire only 1,000,000 shares of Trans Union at $38.00 per share, the market price ****411** then being $37.25 per share, so that in the event of a higher bid being made for the stock of Trans Union, the Pritzkers would be compensated to some extent by having issued what amounted to a 'put' to Trans Union, in that during the 90 to 120 days required to gain approval of the proposed merger, the Pritzkers would be contractually obligated to consummate the proposed merger, while Trans Union would remain free to accept a better offer.

An agreement having been reached between Mr. Van Gorkom and Mr. Pritzker, Mr. Van Gorkom called a special meeting of the directors of Trans Union for noon Saturday, September 20, 1980 to be preceded by a meeting of senior management at 11:00 a.m., the board and senior management having been informed that Mr. Pritzker had demanded that his offer be acted on before the opening of the market in London on Monday, September 22. At such meeting of the board of directors, while it was decided not only to go along with Mr. Pritzker's offer but to recommend to the stockholders that it be accepted, apparently no discussion took place as to the adverse effect of the proposed transaction on those stockholders of Trans Union who had acquired their shares in tax free mergers and who would be faced with substantial capital gains in the event that the cash merger proposed by Mr. Van Gorkom should be consummated.

At the meeting of the board of directors of Trans Union held on September 20, 1980, after considering the Pritzkers' proposal favorably, the directors insisted upon the insertion in the agreement of merger of the underscored language in the agreement, which reads in part as follows:

> 'Within 30 days after the execution of this Agreement, TU shall call a meeting of its stockholders (the 'Stockholder's Meeting') for the purpose of approving and adopting the Merger Agreement. The Board of Directors shall recommend to the stockholders of TU that they approve and adopt the Merger Agreement (the 'Stockholders' Approval') and shall use its best efforts to obtain the requisite vote therefor; *provided, however, that GL and NTC acknowledge that the Board of Directors of TU may have a competing fiduciary obligation to the Stockholders under certain circumstances.*'

At the trial of this case, Mr. Pritzker testified that the underscored language contained in such agreement was intended to provide that the board of directors of Trans Union would have the clear right and in fact duty to recommend that its stockholders accept a higher bid for the stock of Trans Union should such an offer be forthcoming.

***4 **412** Furthermore, after the management of Trans Union had expressed opposition to the Pritzker transaction, mainly because they preferred to remain as employees of the present management of the corporation, at a meeting of board of directors held on October 8, 1981, the merger agreement was amended so as to establish the right of Trans Union to solicit as well as to receive higher bids, although the Pritzkers insisted that their merger proposal be presented to the stockholders at the same time that the proposal of any third party was presented.

Another amendment to the merger agreement, which became effective on October 10, 1981, further provided that Trans Union might unilaterally terminate the proposed merger with the Pritzker company in the event that prior to February 10, 1981 there existed a definitive agreement with a third party for a merger, consolidation, sale of assets, or purchase or exchange of Trans Union stock which was more favorable for the stockholders of Trans Union than the Pritzker offer and which was conditioned only upon receipt of stockholder approval and the absence of an injunction against its consummation.

Furthermore, following the October 8 board meeting of Trans Union, the investment banking firm of Salomon Brothers was retained by such corporation to search for better offers than that of the Pritzkers, Salomon Brothers being charged with the responsibility of doing 'whatever possible to see if there is a superior bid in the marketplace over a bid that is on the table for Trans Union.' In undertaking such project, it was agreed that Salomon Brothers would be paid the amount of $500,000 to cover its expenses as well as a fee equal to 3/8ths of 1% of the aggregate fair market value of the consideration to be received by the company in the case of a merger or the

like which meant that in the event that Salomon Brothers should find a buyer willing to pay a price of $56.00 a share instead of $55.00, such firm would receive a fee of roughly $2,650,000 plus disbursements.

At the first step in proceeding to carry out its commitment, Salomon Brothers had a brochure prepared, which set forth Trans Union's financial history, described the company's business in detail and set forth Trans Union's operating and financial projections. Salomon Brothers also prepared a list of over 150 companies which it believed might be suitable merger partners, and while four of such companies, namely, General Electric, Borg-Warner, Bendix, and Genstar, Ltd. showed some interest in such a merger, none made a firm proposal to Trans Union and only General Electric showed a sustained interest. As matters transpired, no firm offer which bettered the Pritzker offer was ever received.

On January 26, 1981, a board meeting of Trans Union was held ****413** at which all ten directors were present. At the conclusion of the meeting, which lasted almost four hours, and at which matters relevant to the proposed merger and pending litigation concerning it were discussed, each director voted in favor of recommending the merger to the stockholders, including Mr. Bonsar, who had remained silent at the earlier board meetings, and Mr. O'Boyle, who had been ill at the time of the September 20, 1980 meeting. On February 10, 1981, the stockholders of Trans Union met pursuant to notice and voted overwhelmingly in favor of the Pritzker merger, 89% of the votes cast being in favor of it.

*5 [1] [2] A presumption exists that corporate directors form their business judgments in good faith, *Allaun v. Consolidated Oil Co.*, Del. Ch., 147 A. 257 (1929), and, as stated in the case of *Sinclair Oil Corp. v. Levien*, Del. Supr., 280 A.2d 717 (1971):

> 'A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.'

Furthermore, the business judgment rule provides that room be afforded for honest differences of opinion in a corporate board of directors, *Allied Chemical & Dye Corp. v. Steel & Tube Co. of America*, Del. Ch., 120 A. 486 (1923), a wide discretion in the matter of valuation being granted to directors, *Cole v. National Cash Credit Ass'n.*, Del. Ch., 156 A. 183 (1931). And, as stated in the case of *Singer v. Magnavox Co.*, Del. Supr., 380 A.2d 969 (1977):

'To state the obvious, under § 251 two (or more) Delaware corporations 'may merge into a single corporation.' Generally speaking, whether such a transaction is good or bad, enlightened or ill advised, selfish or generous-these considerations are beside the point.'

[3] Next, in order to overcome the presumption that directors have acted in good faith and in the best interests of their corporation, one who attacks corporate action taken by the directors of a Delaware corporation must demonstrate that the judgment of the board of directors of such a corporation was not brought to bear with specificity on the challenged transaction, and that the directors acted so far without information that they can be said to have reached an unintelligent and unadvised judgment, *Mitchell v. Highland-Western Glass Co.*, Del. Ch., 167 A. 831 (1933).

****414** Arguing that the directors of Trans Union acted negligently in recommending the merger of Trans Union into the Pritzker corporation known as New T. Company, plaintiffs cite the cases of *Gimbel v. Signal Co.*, Del. Ch., 316 A.2d 599 (1974), aff'd, Del. Super., 316 A.2d 619 (1974), and *Bennett v. Propp*, Del. Supr., 187 A.2d 405 (1962). However, in the case of *Gimbel v. Signal Co.*, supra, the question of the valuation of the corporate assets proposed to be sold was before the Court on a motion for the granting of a preliminary injunction and the Court was faced with a contention that the price being offered for the assets in question was substantially less than their appraised value and that the directors of Signal Co. had acted recklessly in accepting an alleged inadequate price for the assets of a major subsidiary. Accordingly, the Court being concerned about the question of whether or not the directors of Signal Co. had been given enough time or information on which to make a sound judgment as to the desirability of the proposed sale, issued a preliminary injunction, convinced that to deny the granting of an injunction might well finally dispose of the case. On the other hand, in the case of *Bennett v. Propp*, supra, the directors of the corporation involved had no alternative but to approve the purchase of almost 200,000 shares of their corporation's own stock by the corporation's president who had made such a commitment in order to retain control of the corporation. On the other hand, in the case at bar, the board of directors of Trans Union was free to turn down the Pritzker proposal when it was submitted to a vote on September 20, 1980, on October 8, 1980, and on January 26, 1981.

***6** The Trans Union stock here in issue had been traded in the marketplace between January 1, 1975 and September 17, 1980, (the last trading date before the announcement of the merger), between a high of $39.50 and a low of $24.25, and had closed on September 17, 1980 at $37.50. It further appears that the merger price offered to the stockholders of Trans Union represented a premium of 62% over the average of the high and low prices at which Trans Union stock had traded in 1980, a premium of 48% over the last closing price, and a premium of 39% over the highest price at which the stock of Trans Union had traded anytime during the prior six years. Furthermore, in the case of *Gimbel v. Signal Co.*, supra, no effort had been made to determine whether or not another company would offer a higher price for the corporate assets in issue, while in the present case the proposed merger in issue was tested in the marketplace for at least 90 days with no tangible result, and I am satisfied that such a test of value supports the fairness of the premium offered over market price in the merger here involved. Furthermore, I consider it significant ****415** that whereas the proposed Pritzker merger had been considered by the board of directors of Trans Union on three separate occasions, namely on September 20, 1980, October 8, 1980, and on January 26, 1981, in the case of *Gimbel v. Signal Co.*, supra, the proposed sale of the assets of a major subsidiary of Signal Co. was considered only once. I therefore conclude that given the market value of Trans Union's stock, the business acumen of the members of the board of Trans Union, the substantial premium over market offered by the Pritzkers and the ultimate effect on the merger price provided by the prospect of other bids for the stock in question, that the board of directors of Trans Union did not act recklessly or improvidently in determining on a course of action which they believed to be in the best interest of the stockholders of Trans Union.

[4] [5] Next, while both plaintiffs and Trans Union engaged the services of financial experts to determine the intrinsic value of the shares of Trans Union at the time of the merger here in issue, I am satisfied that the effort to reach a fair value of the stock here in issue on the basis of discounting projected cash flows is not an appropriate method of determining the fair present value of the securities here in issue, the present value which would have been arrived at by such method of valuation fluctuating substantially, depending on the discount rate employed, *Weinberger v. UOP, Inc.*, Del. Ch. 426 A.2d 1333. Furthermore, no Delaware case has been cited which requires dependence on expert testimony in order to arrive at the fair present value of a corporate security in a merger proceeding such as the one under consideration, and this includes the formula used to arrive at intrinsic value in appraisal proceedings taking place after a merger.

I also conclude that the stockholders of Trans Union were fairly informed as to the pending merger, including those terms surrounding the issuance of 1,000,000 shares of Trans Union stock to the Pritzkers as a condition to the merger here in issue, which transaction, I believe, did not affect the vote of the stockhpolders which approved such merger, or stand in the way of possible bids by other interested parties. Thus, while a competing bidder would be required to pay $17 million more than the Pritzker's offer to equal such offer ($55 less $38 times one million shares equals $17 million), this is a modest amount in the context of a $690 million transaction. And while plaintiffs rely on *Mobil Corp. v. Marathon Oil Co.* (C.A. 6) § 98, 399 Federal Securities Law Reports, a case which was involved with offers for tenders of stock of Marathon Oil Co. in a case involving competing bids by Mobil and others in which the United States Steel Co. had acquired an option to purchase 10,000,000 authorized but unissued ****416** shares of Marathon for $90.00 a share at a time when there were 58,685,906 Marathon common shares outstanding, the Court stated:

> ***7** 'In our opinion, the stock option was large enough in this takeover contest to serve as an artificial and significant deterrent to competitive bidding for a controlling block of Marathon shares.'

I do not for the reasons stated believe that such case is controlling here.

Judgment will be entered for the defendants, and, on notice, an appropriate form of order denying rescission of the merger here in issue as well as an award of damages, as prayed for, may be submitted.

All Citations

Not Reported in A.2d, 1982 WL 8774, 8 Del. J. Corp. L. 406

Footnotes

1 Such a buyout scheme was submitted to Trans Union by the firm of Kohlbert, Kravis and Robertson and Co. in August 1980. And while Mr. Van Gorkom would have benefited by such a buyout in a stock for stock exchange inasmuch as he owned 60,000 shares of Trans Union stock

with a low tax basis as well as an option to acquire 15,300 additional shares, giving him a strong incentive to go along with such a proposition, which would have resulted in deferring substantial capital gains taxes for him, he had not liked such a proposal on principle. While the firm of Kohlbert, Kravis and Robertson actually made a bid of $60.00 per share for Trans Union stock on December 2, 1980, such offer was withdrawn three hours after it was made. Plaintiff argues that Mr. Van Gorkom did not actively support such a transaction because he would thereby lose his position as chairman of the board of Trans Union. However, it would appear that Mr. Van Gorkom was about to surrender such position in any event because of his imminent retirement at the age of 65.

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