IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

WILLIAM B. WEINBERGER and EDWARD U. NOTZ,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 5642
UOP, INC., and THE SIGNAL COMPANIES, INC.,	)	
Defendants.	)	

DEFENDANTS' OPENING BRIEF AFTER THE DAMAGES TRIAL

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NATURE AND STAGE OF THE PROCEEDINGS

On February 1, 1983, the Delaware Supreme Court reversed this Court's Final Judgment Order which had been entered on February 19, 1981, after trial, and remanded the case for further proceedings on the issue of damages. Weinberger v. UOP, Inc., Del.Supr., 457 A.2d 701 (1983) ("Weinberger II"). In general, the Supreme Court found that The Signal Companies, Inc. ("Signal") had not met its burden of showing that it had dealt fairly (insofar as procedure was concerned) with the minority shareholders of UOP, Inc. ("UOP") with respect to the merger of UOP and a wholly-owned subsidiary of Signal in May of 1978. On the issue of damages, the Supreme Court stated that because the 1978 merger "...is too involved to undo, and in view of the Chancellor's discretion, the award, if any, should be in the form of monetary damages...." (emphasis added). Id. at 714. The Supreme Court also held:

> "On remand the plaintiff will be permitted to test the fairness of the $21 price by the standards we herein establish in conformity with the principle applicable to an appraisal--that fair value be determined by taking 'into account all relevant factors....' In our view this includes the elements of rescissory damages if the Chancellor considers them susceptible of proof and a remedy appropriate to all the issues of fairness before him." (emphasis added).

Ibid.

On April 5 and 6, 1984, in response to defendants' motion, this Court heard testimony and received evidence on the question of whether rescissory damages are an appropriate remedy in this case. Thereafter, this Court held:

> "...[R]egardless of whether the wrongs of the defendants were deliberate or unintentional, they deprived the minority of the right to make an informed decision on whether or not they wanted to accept the $21 per share or remain shareholders of UOP. In view of this, I find it difficult to rule the possibility of rescissory damages out of the case <u>at this juncture</u> based upon the arguments put forth by the defendants.
>
> "By so holding I do not mean to imply that I am inclined to award rescissory damages after a final hearing. I may or may not, depending on what the evidence of value may show. The object is to see that the minority is treated fairly in the long run, and it is difficult to do this until all the options are put before this Court." (Emphasis added).

<u>Weinberger v. UOP, Inc.</u>, Del.Ch., C.A. No. 5642, Brown, C. (April 24, 1984) (copy attached as Exhibit A), Slip. Op., p. 15.

During the week of June 18, 1984, this Court heard testimony and received evidence on the value of UOP's minority shares as of May 26, 1978, the date of the subject merger. The Court also heard testimony and received evidence on the hypothetical value of such shares as of several dates after the merger. This is defendants' opening brief after that trial in support of the following propositions: (1) the price of $21 per share paid to the UOP minority shareholders was fair as of the date of the merger, May 26, 1978, and therefore a hypothetical evaluation of their shares at some date subsequent to the merger is not warranted; (2) a rescissory evaluation is neither appropriate nor susceptible of proof in this case; and (3) even if a rescissory evaluation were appropriate and susceptible of proof, such an evaluation shows that the minority shareholders of UOP are in as good or better position having received the $21 per share in June, 1978, than they would be if they were to receive some hypothetical value for their shares as of December 31, 1983 (the latest date prior to judgment that such shares were even arguably susceptible to rescissory evaluation).

STATEMENT OF FACTS AND ARGUMENT*

A. The May 26, 1978 Merger Price Of $21 Per Share Was Fair To The Minority Shareholders Of UOP

On May 26, 1978, the merger of UOP and a wholly-owned subsidiary of Signal became effective. Pursuant to the merger agreements, the minority shareholders became entitled to immediately receive $21 in cash for each share of UOP common stock formerly owned by them.

It is established that

> "one who is induced to sell his stock by fraud [**] [cannot] recover damages for deceit where it is worth no more than the price which he received. Moreover under the Securities Exchange Act, a buyer claiming a violation of its broad antifraud provisions, particularly the SEC Rule 10b-5, must show that he has been damaged." (footnotes omitted).

12A Fletcher Cyclopedia Corporations §5594 (rev.perm.ed. 1984). Plaintiffs' counsel conceded this to be the law in this case in the first argument before the Delaware Supreme Court:

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* Because of the posture of this case, defendants have combined the Statement of Facts and Argument for ease of presentation. The parties have agreed that the record with respect to the issues before the Court include the record of the 1980 trial, the record of the April 5 and 6, 1984 hearing, and the record of the June, 1984 trial. See, Final Pretrial Stipulation entered by the Court on June 18, 1984.

** The Supreme Court did not hold that Signal was guilty of fraud or intentional wrongdoing. At worst, the Supreme Court held that Signal did not deal fairly, from a procedural point of view, with the minority shareholders of UOP. See Section B, infra.

"JUSTICE QUILLEN: Mr. Prickett, assume--and I understand your position is to the contrary--but assume that the Court found that the $21 was intrinsically fair to the minority.

"MR. PRICKETT: Yes.

"JUSTICE QUILLEN: What does that do to the first argument?

"MR. PRICKETT: Well, I would suppose that you would find then that there has been a violation. You are assuming that they haven't carried out their responsibilities, but $21 happens to be fair. No damage." (emphasis added).

Weinberger v. UOP, Inc., Del.Supr., No. 58, 1981, Transcript of Oral Argument of September 14, 1981, p. 15.

Defendants proved at the 1980 trial and again at the June, 1984 trial that the price of $21 per share paid to the UOP minority shareholders as of May 26, 1978, was fair. At the June, 1984 trial, both plaintiffs' and defendants' experts again employed the same basic financial evaluation techniques which they had used at the 1980 trial in evaluating the UOP minority shares as of May 26, 1978. Plaintiffs' expert, Kenneth Bodenstein ("Bodenstein"), utilized both a comparative analysis and a discounted cash flow analysis, but he relied principally on the latter. Defendants' expert, William Purcell ("Purcell"), analyzed all facets of UOP's business and "employed all relevant techniques generally considered acceptable in the financial community. These factors included market value, investment value, asset value, the requirement for market value premium, various financial statistics and ratios, and future earnings projections." DDX-13, p. 3. At the June, 1984 trial, both experts had available to them the identical financial information and data which they had when they prepared their 1980 studies and testified with respect to the value of the UOP minority shares as of May 26, 1978. Neither expert used any post-merger financial data in arriving at their opinions of the value of the UOP minority shares as of the merger date.

Although the Supreme Court suggested that this Court may have rejected Bodenstein's discounted cash flow analysis as a matter of law (Weinberger II, supra, 457 A.2d 714), defendants submit that this Court did consider Bodenstein's approach as part of the factual mix but gave it little weight because of its inherent weakness in evaluating a company such as UOP, and the lack of credibility of plaintiffs' evidence of value.* See generally, Weinberger v. UOP, Inc., Del.Ch., 426 A.2d 1333, 1356-1361 (1981) ("Weinberger I"). Defendants further submit that in reaching its earlier finding that the $21 price was fair, this Court did not rely upon or utilize the so-called "Delaware block method" of determining value. In fact, this Court specifically turned to the teaching of Sterling v. Mayflower Hotel Corp., Del.Supr., 93 A.2d 107 (1952), in determining that all relevant factors should be considered in determining "fair value". Thus, in its Decision After Trial, this Court stated:

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* Plaintiff's evidence of value at the 1980 trial was not premised solely on the discounted cash flow method. Indeed, the 1980 Duff & Phelps written report (PX-3) does not even discuss that method, but is founded on the comparative analysis approach.

"Further, at 93 A.2d 114 [Sterling, supra], after making its statement that in order to arrive at a judgment of the fairness of a merger all of its terms must be considered, the Supreme Court observed as follows:

"'A similar rule obtains in ascertaining the value of stock in appraisal proceedings under the merger statute. In such cases the liquidating value of the stock is not the sole test of value; all relevant factors must be considered.[*]'" (emphasis added).

Weinberger I, supra, 426 A.2d 1360

A further indication that this Court did not use the Delaware block method in finding after the 1980 trial that the $21 price was fair is the dialogue between the Court and Purcell at that trial. In that dialogue, Purcell made it clear that Dillon Read's opinion as to value was reached in the same manner as in any other evaluation done by that firm, without regard to the methodology formerly used in appraisal proceedings. 1980 TR,** 1392-96, copies of which are attached hereto as Exhibit B.

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* In support of the emphasized statement from Sterling, this Court cited Tri-Continental Corp. v. Battye, Del.Ch., 74 A.2d 71 (1949), the same case which the Supreme Court relied on in this case to support the proposition that "[f]air price obviously requires consideration of all relevant factors involving the value of a company." (emphasis added). Weinberger II, supra, 457 A.2d 713.

** Exhibits admitted into evidence at the 1980 trial are cited herein as "PX-___" or DX-___", and testimony therein is cited as "1980 TR, ___". Exhibits admitted into evidence at the April 5 and 6, 1984 hearing are cited herein as "PPX-___" or "DPX-___", and testimony therein is cited as "April, 1984 TR, ___". Exhibits admitted into evidence at the June, 1984 trial are cited herein as "PDX-___" or "DDX-___" and testimony therein is cited as "June, 1984 TR, ___".

Purcell also testified at the June, 1984 trial that he did not use the Delaware block method in his 1980 or 1984 evaluations of UOP's minority shares as of May 26, 1978. June, 1984 TR, Vol. II, 162-64.

Finally, the best evidence of the fact that this Court considered all relevant facts in finding that the $21 price was fair to UOP's minority shareholders is this Court's Decision After Trial. In that decision, this Court discussed Bodenstein's discounted cash flow analysis in depth (Weinberger I, supra, 426 A.2d 1357-1359), and then explained why that analysis should be given little, if any, evidentiary weight:

> "In short, this opportunity for the subjective selection of factors, a small variation in which can cause a wide divergence in the end result, renders Bodenstein's discounted cash flow approach unnerving when one sets out to rely upon it in an attempt to ascertain whether or not the amount paid for minority interests in a cash out merger is fair and reasonable."

Id. at 1359.

This Court then turned to Purcell's testimony and the financial statistics presented in the 1980 Dillon Read report (DX-40), and concluded:

> "From all of the foregoing, as well as the supporting statistics and documentation provided in the Dillon, Read report, there is a reasonable basis for finding that the merger price of $21 represented a price which was fair to the minority shareholders of UOP."

Weinberger I, supra, 426 A.2d 1362.

In summary, with respect to the evidence and findings from the 1980 trial, we submit that (a) Bodenstein's discounted cash flow analysis was received into evidence and considered by the Court, but given little weight under the particular circumstances; (b) Purcell did not limit his methodology and analysis to the Delaware block method, but rather he considered the generally accepted techniques used in the financial community and the courts; and (c) this Court considered all relevant factors in concluding that the $21 merger price was fair to the minority shareholders of UOP, and thereby has already applied the "new" valuation standards mandated by the Supreme Court in Weinberger II. Notwithstanding the foregoing, we will now turn to the testimony and evidence presented by Bodenstein and Purcell at the June, 1984 trial with respect to the fairness of the $21 merger price.

1. The Plaintiffs' "Proof" As To The May 26, 1978 Value

Before turning to the details of Bodenstein's analysis and testimony some general observations are useful. Bodenstein conceded that he approached his task as an advocate for the UOP minority shareholders rather than as a neutral third-party undertaking an independent evaluation. June, 1984 TR, Vol. IV, 229-232. Purcell on the other hand, used the same approach which he and Dillon Read employ in rendering fairness opinions in all cases, whether representing the buyer or the seller, i.e., the consideration of "all available information and all factors deemed relevant involving the value of a company." DDX-13, pp. 2-3; June, 1984 TR, Vol. II, 156-157.

Bodenstein recognized that the process of determining the value of a particular company involves the credibility of the individual making the analysis. June, 1984 TR, Vol. IV, 235. However, much of Bodenstein's analysis strains credulity. For example, in 1980, Bodenstein calculated that the present value, in 1978, of UOP's residual value was $229.7 million. PX-7. In his 1984 study, having available only the identical source material, Bodenstein calculated that the present value, in 1978, of UOP's residual value was $316 million. PDX-120, App., Table I. In other words, with no change whatever in the financial data available to him, between 1980 and 1984 Bodenstein raised his calculation of the same figure from $229.7 million to $316 million. Bodenstein testified that the "...choice of the method of determining the present value of the residual value...on Table I was solely because [he] thought it would be easier to understand." June, 1984 TR, Vol. V, 37. Under the guise of "ease of understanding," Bodenstein's change in the choice of method resulted in a difference of more than $86 million, or $7.51 per share.

Similarly, whenever Bodenstein encountered actual financial information which, if used in his formulations would result in a lower per share "value", he "analyzed" the information to come up with other figures more to his liking. For example, in calculating the fair value of UOP's minority shares based on comparative dividend yields, Bodenstein used a figure of $20 million for UOP's 1983 dividends (PDX-120, App., Table P), when he knew that UOP had actually paid only $10 million in dividends in 1983. PDX-120, Rpt., p. 5. Once again, through "analysis" Bodenstein doubled an actual figure for purposes of his own evaluation, thereby increasing the per share "value". June, 1984

TR, Vol. V, 125-130. Another example of Bodenstein's "analysis" is reflected in the Total Assets chart in PDX-120, App., Table F. In that table, Bodenstein used UOP's actual figures exclusively for the years 1974 through 1982, but no figure appears for 1983, despite the fact that PDX-24 shows total assets for 1983 of $566.3 million, down $66.7 million from 1982. Bodenstein explained that, using "analysis", he concluded that the figure of $566.3 million in PDX-24 was not realistic so he did not include it (or, for that matter, any other figure for 1983) on his chart. June, 1984 TR, Vol. V, 52-56. With this background in mind, defendants now turn to a more specific discussion of Bodenstein's studies and testimony, and their inherent lack of credibility.

As he did at the first trial, at the June, 1984 trial Bodenstein relied on the discounted cash flow analysis as the "more definitive" part of his evaluation of UOP's minority shares as of May 26, 1978. June, 1984 TR, Vol. IV, 241. And, once again, Bodenstein showed that by using the discounted cash flow method, one can arrive at almost any "value" one wishes, merely by the choice of the discount rate and other data, and the application of the selected discount rate to various projected "free cash flows", which the analyst himself may determine.*

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* The discounted cash flow method requires initially the determination of the "free cash flow" for a number of years into the future. The "free cash flow" requires the prediction of such items as net income, depreciation, deferred taxes, long term debt replacement, capital spending, and working capital for up to five years. The number of variables, then, as to which future estimates must be made are many, and are no more reliable than any other predictions of future economic and financial variables.

Defendants agree that the discounted cash flow method is a recognized and useful tool in certain financial evaluations. Both Purcell and Bodenstein so testified. However, it is only one of many financial "tools", and is not appropriate for use in every situation.

Bodenstein defended his use of the discounted cash flow method in this case on the "fact", as he stated, that UOP's management had done an "outstanding" job in making projections. June, 1984 TR, Vol. IV, 104-106. According to Bodenstein, the "fact" that UOP's operations "moved steadily in a growing pattern" (Id. at 114), justified his use of the discounted cash flow method in evaluating UOP. Id. at 113-117. The evidence is to the contrary.

UOP's actual earnings over the past thirteen years show wide and unpredictable swings:

Year	Income (Loss) Before Extraordinary Items (000's omitted)
1971	($19,468)
1972	11,674
1973	18,128
1974	27,752
1975	(34,868)
1976	16,622
1977	24,328
1978	27,162
1979	38,451
1980	45,375
1981	52,990
1982	46,682
1983	(80,731)

DX-19; DDX-10; DDX-13, Exs. 2A and 2B.

When UOP's projections are compared with UOP's actual results, Bodenstein's testimony about management's outstanding job of projecting UOP's future loses all credibility. For example, for the years 1973 through 1977, UOP's budgeted net income and actual net income were as follows (PX-U-7, p. 10):

(In Millions)

Year	Budgeted Net Income	Actual Net Income	Percentage Difference
1973	$18.2	$20.9	+ 14.6%
1974	23.7	27.8	+ 17.3%
1975	26.4	(34.9)	-232.0%
1976	18.6	23.6	+ 26.6%
1977	32.7	31.4	- 3.9%

For the years 1978 through 1982, the net income projected in UOP's 1978 Five-Year Business Plan (PX-U-400) and UOP's actual net income (adjusted to exclude the effect of the significant inflation which occurred after 1978) (DDX-17) were as follows:

(In Millions)

Year	Projected Net Income	Actual Net Income (as adjusted)	Percentage Difference
1978	$28.2	$27.2	- 3.7%
1979	28.2	34.6	+22.7%
1980	37.8	35.9	- 5.3%
1981	45.7	38.0	-20.3%
1982	55.7	31.5	-76.8%

Contrary, then, to what Bodenstein claims to be the "facts" justifying the use in this case of the discounted cash flow method, in actuality UOP's management was unable to predict with any degree of precision its future earnings and/or profits, and UOP's income (loss) pattern was anything but stable.

Purcell testified that the discounted cash flow method is a recognized tool of financial evaluation, and is one used by Dillon Read in appropriate situations. June, 1984 TR, Vol. II, 164.

However, because of the volatility and unpredictability of UOP's earnings, both on a consolidated and lines of business basis,* Purcell opined that use of the discounted cash flow method to evaluate UOP would be "meaningless". Id at 167. See DDX-13, pp. 3-4, 7-10, Exs. 2A, 2B, 4A, 4B, 5A and 5B. As Purcell testified:

> "So in terms of anybody making any sort of intelligent estimate of what the future earnings of this particular company were going to be in terms of utilizing a discounted cash flow financial tool, in my judgment it was, you know, a very difficult task and for this type of study, frankly, inappropriate."

June, 1984 TR, Vol. II, 169. Defendants submit that Purcell was correct, and that this Court should give little, if any, weight to Bodenstein's evaluation of UOP's minority shares as of May 26, 1978 based on his use of the discounted cash flow method.

For purposes of argument, even assuming that this Court were to decide that the discounted cash flow method is an appropriate tool for financial analysis in this case, defendants submit that plaintiffs' own evidence shows that little or no weight should be given to Bodenstein's analysis. At the 1980 trial, Bodenstein's analysis of value was based on discount rates of 7.5%, 8.5%, 10% and 12% which he used in the discounted

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* In Weinberger I, supra, this Court held that UOP's earnings were "volatile and unpredictable." 426 A.2d 1362. A Value Line analyst noted on February 24, 1978 (DDX-13, pp. 3-4):

> "We caution, however, that the company [UOP] ranks near the bottom in Earnings Predictability, so our three to five year projection is perforce tentative. The difficulty of earnings estimation is inherent in the company's business."

cash flow method. Using those different discount rates, he arrived at present values of UOP's future cash flows, using UOP's actual 1977 earnings, UOP's estimated 1978 earnings and, in part, UOP's 1978 Five-Year Business Plan. PX-4, 5 and 7.* Not until the June, 1984 trial, did Bodenstein for the first time testify that the "appropriate" discount rate for evaluating UOP as of May, 1978 was 12%, determined by the use of a formulation of the weighted average of UOP's expected cost of debt and future return on equity, a formulation which Bodenstein never revealed either in his 1980 report or trial testimony. June, 1984 TR, Vol. IV, 120, et seq.; PDX-120, Rpt., pp. 7-8; PDX-120, App., Table G. Bodenstein's explanation of why he failed in 1980 to reveal his use of the weighted average formulation at the 1980 trial was that it was too sophisticated a method for the Court and counsel to understand! June, 1984 TR, Vol. V, 43-44.**

Purcell, on the other hand, testified that the 12% discount rate derived through use of Bodenstein's formula (PDX-120, App., Table G) was actually UOP's minimum "hurdle

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* We respectfully refer the Court to pages 102-122 of the defendants' post-trial brief (Docket Entry No. 178) for a detailed discussion of Bodenstein's 1980 study and testimony at the 1980 trial. Copies of those pages are attached hereto as Exhibit C.

** It is of interest to note how Bodenstein uses this "ease of understanding" to explain his testimonial inconsistencies. He testified that in 1984 he used an easier method to determine residual value (to enhance understanding) June, 1984 TR, Vol. V, 36, while he used a harder method to determine the discount rate.

rate", and that to establish an appropriate discount rate one would have to increase the hurdle rate by some percent "based on the project involved and judgment of management." June, 1984 TR, Vol. III, 38-40. Purcell explained that the hurdle rate is a minimum rate of return, below which a company would never go in making a capital expenditure or investment, and that an appropriate discount rate is always higher than the hurdle rate:

> "What is on this first line [of PDX 120, App., Table G] in terms of weighted average cost of debt and expected return on equity, which is defined in the corporate world, if you will, as at least a measure of a corporation's blended cost of capital--okay--is a minimum hurdle rate. It is not the discount rate that a company uses.
>
> "A company establishes, first of all, a minimum rate below which it would never go for any particular reason in making an internal capital expenditure on a product line or whatever, never mind mergers and acquisitions, which go higher. Now, that particular number in Item 1 is what I would define as the minimum hurdle rate that a company would never go below in spending its money.
>
> "As to making a decision to go or not to go in applying a discount rate on a particular expenditure, the discount rate is always higher than the minimum rate, and how much higher than the minimum rate it is is a function of what the particular project is. Is it one that involves a very minimal amount of risk because it is an internal capital expenditure on something they know about, or is it something that involves a more major element of risk, like an acquisition? And that will determine how much higher than the minimum rate the corporation uses as a discount rate." (emphasis added).

June, 1984 TR, Vol. III, 39-40. In effect then, when Bodenstein used his calculated "hurdle rate" of 12% as the "appropriate" discount rate in his discounted cash flow analysis, he improperly ignored the element of future risk with respect to the acquisition of the minority shares of UOP in 1978.

At the June, 1984 trial, Bodenstein admitted, contrary to the suggestion made in his written report (PDX-120, Rep., p. 2, ¶2), that in 1984 he in fact had <u>no</u> information or data beyond that which was available to him in 1980 when he arrived at his opinion of the value of the minority shares of UOP as of May 26, 1978. June, 1984 TR, Vol. IV, 244-45. During the 1980 trial, Bodenstein did a discounted cash flow analysis ostensibly using UOP's 1978 Five-Year Business Plan (Basic) (PX-U-400) for his projections. PX-7. At the June, 1984 trial, Bodenstein once again turned to the very same 1978 Five-Year Business Plan for his projections. This time, however, he used several different numbers for the earlier years, and he made a major change in one part of his discounted cash flow methodology. PDX-120, App., Table I. What follows is a comparison of Bodenstein's projections in 1980 and 1984 (from PX-7* and PDX-120, App., Table I), both of which were supposedly founded on the contents of UOP's 1978 Five-Year Business Plan:

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* PX-7 was reproduced, except for the NOTE, as Table J in PDX-120, App.

Year	Bodenstein 1980 (In Millions) Free Cash Throw-Off	Bodenstein 1984 (In Millions) Free Cash Throw-Off
1978	$ 9.1	$ 17.6
1979	9.1	(23.6)
1980	17.8	17.8
1981	22.8	22.8
1982	45.3	45.3
Residual	453.0(a)	557.0(b)

(a) The $453 million represents UOP's projected 1982 free cash throw-off maintained into the future (no growth), discounted back at 10%, *i.e.* using the discounted cash flow method.

(b) The $557 million represents UOP's 1982 projected net income using a price/earnings ratio of 10:1, *i.e.*, using the comparative analysis approach.

In 1980, Bodenstein used for his calculations for 1978 and 1979 a positive $18.2 million of free cash throw-off. This $18.2 million figure represented Bodenstein's estimate of the total dividends which UOP would "pay" during those two years. For those two years (only) he did not project UOP's free cash throw-off. In 1984, Bodenstein changed his approach. He now used the actual figures from UOP's Five-Year Business Plan for the years 1978 and 1979, resulting in the projection of a combined net negative cash throw-off of $6 million. The cash flow projections for the years 1980, 1981 and 1982 were the same in both his 1980 and 1984 analysis.

In addition to his change in the 1978 and 1979 net free cash throw-off figures, Bodenstein made another change in his 1984 analysis which had a very significant impact on the bottom line figures. As part of his 1980 discounted cash flow analysis, Bodenstein calculated a residual value for UOP of $453 million by, in effect, doing another discounted cash flow analysis as of 1982, by taking UOP's 1982 projected free cash throw-off and projecting it into the future, assuming no growth, and then discounting that number back to 1982 present value using a discount rate of 10%. He then discounted this $453 million residual value to a 1978 value by using a discount rate of 12%. PDX-120, App., Table J. In his 1984 study, Bodenstein changed his approach and now calculated the residual value as of 1982 at $557 million by multiplying UOP's 1982 projected <u>net income</u> by a factor of 10 (by assuming that in 1982 an appropriate price/earnings ratio would be 10:1)* and then discounting that number back to 1978 present value at 12%. PDX-120, App., Table I. The selection of one or the other of these two methods of determining residual value (and Bodenstein said either was acceptable--it was simply a matter of the analyst's choice) makes a difference in the value of UOP of about $86 million, or $7.51 per share.** PDX-120, App., Tables I and J.

If one were to use consistently the applicable data from UOP's 1978 Five-Year Business Plan, and determine the residual value based on UOP's 1982 projected free cash

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* Bodenstein testified at the June, 1984 trial that his 1984 opinion was new, "...based on our now definitive work on DCF [discounted cash flow analysis]." June, 1984 TR, Vol. V, 90-91. Tellingly, the largest number in his most recent "definitive work," the residual value of $557 million, is based on a comparative analysis, <u>i.e.</u>, applying a price/earnings ratio, and <u>not</u> the discounted cash flow method.

** For more of Bodenstein's "finds" see Exhibit C hereto, pp. 102-103, 109, 112.

throw-off, using a discount factor of 14%,* the results would be as follows:

Year	(In Millions) Free Cash Throw-Off	Discounted At 14%
1978	$ 17.6	$ 15.4
1979	(23.6)	(18.2)
1980	17.8	12.0
1981	22.8	13.5
1982	45.3	23.5
Residual Value	377.5(a)	172.0
		$218.2 or $18.99 per share

(a) The $377.5 million residual value represents UOP's 1982 projected free cash throw-off projected into the future, with no growth, discounted back at 12%, UOP's minimum hurdle rate.

At the June, 1984 trial, Purcell testified that when use of a discounted cash flow method is appropriate, a range of discount rates, rather than any one particular rate, should be used. As Purcell explained:

> "We always set out the numbers in a range for precisely the point that I was stating, that there is no number. In any particular piece of work that you would see either us or our client doing, you would find a range of discount rates, you know, anywhere from 12 to 20 percent, and you will also see a range of terminal values down one side. And the way the discounted cash flow method is utilized as a tool by most people is coming--is using it as one tool to make judgments in certain areas where it's helpful to make one feel either more comfortable or

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* At the 1980 trial, Purcell testified that the discounted cash flow method was not a proper financial tool to evaluate UOP, but that if he had been instructed to utilize that method, he would have used a discount rate of at least 15%. 1980 TR, 1152. At the June, 1984 trial, Purcell testified again that the discounted cash flow method was inappropriate for an evaluation of UOP, but that a discount rate of 18-20% should have been used if that method were utilized. June, 1984 TR, Vol. III, 97-105.

> less comfortable, and you have a range of numbers going across with different ranges of discount rates, and going down a different range of terminal values. And as you see this flow of numbers and different valuations that come out from them when you are dealing with a set of cash flows that are susceptible to this methodology, you then look at that along with all the other information that you have in the back of your brain, and you make judgments.
>
> "So there is no one number. We do not make a judgment as to any one number...."

June, 1984 TR, Vol. III, 58-59.

If one uses Purcell's approach and the projections set forth in UOP's 1978 Five-Year Business Plan, and if the residual value is determined by using a 12% discount rate, the same discount rate used by Bodenstein for 1978 through 1982, rather than 10%,* the "values" become:

(In Millions)

		Discounted At				
Year	Free Cash Throw-Off	12%	14%	16%	18%	20%
1978	$ 17.6	$ 15.7	$ 15.4	$ 15.2	$ 14.9	$ 14.7
1979	(23.6)	(18.8)	(18.2)	(17.5)	(17.0)	(16.4)
1980	17.8	12.7	12.0	11.4	10.8	10.3
1981	22.8	14.5	13.5	12.6	11.8	11.0
1982	45.3	25.7	23.5	21.6	19.8	18.2
Residual value	377.5(a)	191.5	172.0	154.9	139.8	126.4
Present Value		$241.3	$218.2	$198.2	$180.1	$164.2
Per Share Value		$ 20.98	$ 18.99	17.25	$ 15.68	$ 14.29

(a) Discounted future cash flow at 12%

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* Obviously, Bodenstein's projection, as of 1978, that beginning in 1983 UOP would have annual free cash throw-off of $45.3 million, forever, is far from risk-free. Yet he used a discount rate of only 10%, less than UOP's minimum hurdle rate, in determining the residual value of UOP's projected future free cash throw-offs. If 12% is used, the residual value becomes $377.5 million ($45.3 million divided by .12 equals $377.5 million) instead of $453 million ($45.3 million divided by .10).

As shown above, simply by selecting a discount rate only 2% higher than Bodenstein's choice of 12%, the "valuation" of UOP, and hence of its minority shares, changes by tens of millions of dollars.

In short, while the discounted cash flow method is one recognized tool in the financial community for evaluating some companies, transactions and assets, it is not a proper tool to evaluate UOP's minority shares as of May 26, 1978, because of the volatile and unpredictable nature of UOP's earnings and cash flows. Furthermore, as we have shown, Bodenstein's use of the discounted cash flow method in this case is entirely result-oriented. For these reasons, the results of Bodenstein's discounted cash flow analysis should be given little weight in arriving at any conclusion as to the value of UOP's shares in 1978. Accordingly, this Court should reject Bodentstein's opinion as to the value of UOP's minority shares as of May 26, 1978, as being without probative value, based as it is primarily on his discounted cash flow analysis.

2. The Opinion Of Dillon Read--Purcell's Testimony As To The Value Of The UOP Minority Shares As Of May 26, 1978

In the recently completed 1984 trial, Signal again called as its expert William H. Purcell, a Managing Director of Dillon, Read & Co., Inc. In general, at the June, 1984 trial, Purcell reiterated Dillon Read's 1980 opinion as to the value of UOP's minority shares as of May 26, 1978 and the financial bases therefor. June, 1984 TR, Vol. II, 160-162, 170-175; DX-40; DDX-13.

Purcell testified that he considered all relevant information and that he did not use the "Delaware block method" in either of his evaluations. June, 1984 TR, Vol. II, 163-64, 218-221:

> "A. The Delaware Block Method, as I understand it--
>
> "Q. Yes.
>
> "A. --covers some items which any analyst should obviously cover in that sort of an assignment, but it is a very, at least as I understand it, and as I have read other court cases in the past--it's very formulistic. It is almost like a scale where somebody comes up with a number, and they say okay, this has such and such a weight, and this has such and such a weight, and then they calculate, and come up with a final number, and based on just looking at those particular items say that is the price without taking into consideration any number of facts that may be relevant in that particular situation.
>
> "As you know, every particular situation is different, so the Delaware Block by definition, in my judgment, always leaves something out."

June, 1984 Tr, Vol. II, 220.

Purcell also testified that he did not use the discounted cash flow method because that method is not a suitable financial tool for evaluating UOP.* Id. at 164-166. As Purcell explained:

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* Significantly, Bodenstein himself did not use the discounted cash flow method in arriving at his opinions of value of UOP as of 1983 and 1984. PDX-120, App., Table U; June, 1984 TR, Vol. V, 92-94.

"The discounted cash flow tool as a financial tool is most useful when one has a situation that has a certain amount of predictability and consistency. UOP as a company, both during the six or seven years, and, frankly, its entire history for ten years prior to the 1978 merger, and in fact after the 1978 merger, has been a diversified conglomerate type of company which has had a number of lines of businesses most of which have had great volatility in their earnings. So the company not only has volatility and unpredictability in its earnings from a consolidated point of view, but even on a divisional point of view it has that characteristic.

"So in order to make any projection, it would be very difficult to have any degree of faith in that projection. And in fact because of the level of uncertainty, if one were to apply a discounted cash flow method, you would be using a discount rate basically that would have to be high enough to reflect that, and in my judgment would make the analysis meaningless from our point of view in coming up with what was a fair price in that particular merger, and so we did not utilize that financial tool in either the 1980 or the 1984 study."

June, 1984 TR, Vol. II, 166-67. Purcell also testified that the results of the 1975 tender offer and direct purchase of UOP shares by Signal from UOP were "not a factor in our opining on the fairness of the $21 price." Id. at 175.

The specifics of how and why Dillon Read reached its opinion as to the fairness of the $21 price, as of May 26, 1978, are set forth in detail in Dillon Read's reports (DX-40 and DDX-13) and Purcell's testimony which need not be repeated here. However, a brief review of what Dillon Read considered may be helpful. Dillon Read first considered the historical market value of UOP's stock, (DX-40, pp. 3-4; DDX-13, p. 3), and then the investment value of UOP's stock. That analysis included the consideration of UOP's balance sheet and capitalization data, lines of business, revenues and operating profits, identifiable assets, consolidated operating record, profit margins, return on average equity, stability and consistency of earnings, dividend growth and consistency, estimated future earnings, capitalization of earnings, and comparable market statistics. DX-40, pp. 7-15; DDX-13, pp. 3-4. Dillon Read also considered net asset value and the fact that premiums over market price are generally paid in merger and tender offer transactions. DX-40, pp. 15-18; DDX-13, p. 4. In addition, Purcell met personally with members of UOP's and Signal's management both in 1980 and 1984 to make certain that Dillon Read had all relevant information about UOP. June, 1984 TR, Vol. II, 161.

Finally, Purcell testified that Dillon Read had noted the Come-By-Chance contingent liability in its 1980 Report, but that it had not discounted its valuation of UOP's minority shares because of that liability. June, 1984 TR, Vol. II, 179; DX-40, p. 8. Thus, even though UOP's and Signal's certified financial statements had been qualified by their outside auditors because of the Come-By-Chance contingent liability, (see e.g., PDX-49, p. 11; PDX-4, p. 34), in its 1980 study Dillon Read did not discount the value of UOP's minority shares as of May 26, 1978, in light of "management's opinion that the litigation could be successfully defended and that the ultimate liability, if any, would not be material." DX-40, p. 8; June, 1984 TR, Vol. II, 179.

Unfortunately, management's assessment did not prove to be correct, and by the end of the second quarter of 1983, a reserve against earnings of $52 million had to be established for UOP in respect to the Come-By-Chance litigation. June, 1984 TR, Vol. II, 9. That reserve, along with others, was finalized in connection with the year-end 1983 independent audit examination for Signal's 1983 consolidated financial statements. Ibid. The $52 million reserve resulted in an after-tax charge against UOP's 1983 income of $28 million, and a reduction of 1983 shareholders' equity by the same amount. DDX-10, 11; June, 1984 TR, Vol. II, 9-10. Although Purcell did not use this information in arriving at his opinion of value as of May 26, 1978, he explained the impact of the 1983 Come-By-Chance reserves as follows:

> "Well, in terms of our 1984 study, in hindsight, which is obviously much easier than foresight--in hindsight, in terms of reviewing our opinion of 1980 it made me feel even more comfortable by, you know, a rather large order of magnitude in that in 1980 we opined and felt comfortable that a $21-cash price was fair and equitable to the minority shareholders of UOP. If in fact we had known then what eventually happened in the Come-By-Chance litigation, i.e., a $28,000,000 hit that would have been applicable to UOP back in 1977 and '78 if it had been settled then, which would have been about $2.44 in terms of an effect on book value, a $28,000,000 reduction in cumulative earnings, in our judgment knowing that today just makes us be able to reconfirm our opinion with that much more, for lack of a better word, enthusiasm, or what have you, or a comfort feeling that the transaction was clearly fair and equitable to the minority shareholders of UOP at that time."

June, 1984 TR, Vol. II, 180-181.

Having reviewed and analyzed all relevant information, facts and data, Dillon Read opined in 1980 that "...$21 in cash per share was fair and equitable from a financial point of view to the holders of common stock of UOP other than Signal" as of the May 26, 1978 merger. DX-40, p. 17. In 1984, after again reviewing all of the material which had been reviewed in 1980, Dillon Read concluded: "...it is our current [June 7, 1984] opinion that the...[1978 merger price] of $21 in cash per share was fair and equitable from a financial point of view to the holders of common stock of UOP other than Signal." DDX-13, p. 1. Defendants respectfully submit that the probative value of the Dillon Read opinion far surpasses that of Bodenstein and that it should be accepted as correct by this Court.

In summary, Signal has shown that when the relevant factors are considered, the $21 merger price was fair to the minority shareholders of UOP. Because Signal has met its burden of proving that the merger price was fair, this Court need not, and should not, undertake to find a hypothetical value of the minority shares of UOP at some date subsequent to the merger. As we will show, such an evaluation is neither appropriate nor susceptible of proof under the circumstances of this case.

B. A Rescissory Evaluation Of UOP's Minority Shares As Of The June, 1984 Trial Is Neither Appropriate Nor Susceptible Of Proof Under The Circumstances Of This Case

As a general rule,

"rescissional damages for a plaintiff seller equal the fair value he gave up in the fraudulent transaction (measured at a time

> subsequent to that of the transaction) minus the fair value of what he received in that transaction (measured at the date of the transaction). The fair value of what he gave up should be determined on the date of judgment...." (Emphasis added).

5B Jacobs, The Impact of Rule 10b-5 §260.03 [c][vi][1], pp. 11-60 to 11-61 (rev.ed. 1980). See also, Lynch v. Vickers Energy Corp., Del.Supr., 429 A.2d 497, 503 (1981) ("Vickers will be required to pay rescissory damages to plaintiffs measured by the equivalent value of the Trans Ocean stock at the time of judgment").

Signal, as the owner of 50.5% of the outstanding common shares of UOP, had the statutory right under 8 Del.C. §251 to effect the subject merger with UOP without regard to the wishes of the minority shareholders of UOP. Signal, however, chose to make the merger contingent upon the approval of a majority of the minority shares voting on the merger, and the affirmative vote of not less than two-thirds of the total outstanding common shares. In fact, more than 56% of the minority shares (3,208,652) were voted on the merger of which 2,953,812 voted in favor, and 254,840 voted against. Including Signal's shares, 76.2% of the outstanding shares of UOP were voted in favor of the merger.

In its opinion, the Supreme Court held, in effect, that the vote of the minority shareholders should be disregarded, primarily because the contents of the Arledge-Chitiea report (PX-74) were not disclosed in the proxy materials for the merger. Weinberger II, supra, 457 A.2d 701, 708. In this regard, the

Supreme Court found that "...the minority stockholders were denied the critical information that Signal considered a price of $24 to be a good investment." Id. at 712. While defendants disagree with this conclusion, we recognize that it may be the law of the case and we do not seek to reargue the point as it relates to the question of the fairness of the procedure. However, defendants respectfully submit that the evidence presented at the April 5 and 6, 1984 hearing can and should be considered by this Court in determining whether rescissory damages are appropriate in this case.

As the uncontradicted evidence presented at the April, 1984 hearing proves, no director or officer of Signal believed that any price greater than $21 per share would have been a good investment for Signal. April, 1984 TR, Vol. I, 79-81, 89; Vol. II, 27-29. The evidence also proved that all of UOP's financial information contained in the Arledge-Chitiea report (PX-74) was available to UOP's directors and was contained in the proxy materials for the subject merger, and that all of Signal's 1977 financial information contained in PX-74 was published as a part of Signal's 1977 annual report. April, 1984 TR, Vol. I, 89-93, 97-98, 101, 119-121. The only information in PX-74 which was not available to UOP's directors and shareholders came from Signal's 1978 profit plan which was proprietary to Signal and highly confidential. April, 1984 TR, Vol. II, 19-20. Obviously, information from Signal's 1978 profit plan was irrelevant to UOP's minority shareholders. In addition, one of the most important facts established at the April, 1984 hearing came from the testimony of plaintiffs' own expert, Bodenstein. Bodenstein testified that he did not need, nor did he use, the Arledge-Chitiea report in performing his financial analysis or in arriving at his opinion of value, although he was aware of the report and had read it prior to the 1980 trial. April, 1984 TR, Vol. II, 189-190. Indeed, Bodenstein explained that the seller's concern is fair price while the buyer's concern is investment opportunity, and these perspectives are "two different universes" (id. at 191), i.e., whether or not it was a good investment for Signal at any particular price had nothing to do with the fairness of the price paid to the UOP minority shareholders.

Based on the full record in this case, defendants respectfully submit that a rescissory evaluation is not appropriate. It is clear that Signal and its directors and officers did not intentionally or maliciously deprive the minority shareholders of UOP of any material information with respect to the subject merger. The determination of the fair value of UOP's shares was in no way related to the quality of Signal's investment opportunity. There simply was no fraud, duress, undue influence or mistake of fact which one ordinarily associates with rescissory relief. Moreover, the evidence shows that there were no hidden assets in this case, and that Signal received no "windfall" of any kind. The parties disagree as to the value of certain assets, as they do about the value of the minority shares, but this is very different from a situation where a buyer may have received some tangible asset about which the seller was unaaware at the time of the transaction. Additionally, as we have shown, the merger price of $21 was fair to the minority shareholders of UOP at the time of the merger.*

It is also apparent that a rescissory evaluation is not reasonably susceptible of proof in this case. More than six years have elapsed since the merger became effective. Since the merger, UOP has been completely restructed within the Signal organization, the country has been through rampant inflation with rising and then declining interest rates, a major recession, an international oil shortage and then an oil glut. There have been changes in political parties, military positions in the Middle East and elsewhere, and many other factors which would have a bearing on the value of UOP and its minority shares. It would, therefore, be speculative at best to attempt now to determine what UOP's former minority shares might have been worth, on a per share basis, as of the June, 1984 trial.

Among the factors which courts consider in determining whether rescission, or its corollary, rescissory damages, may be appropriate are:

> "Is the fraud collateral to the contract or, instead, is the contract for an illegal purpose? In which direction does a balancing of the equities point? What does the public

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* In considering whether a rescissory evaluation is appropriate in this case, it is important to keep in mind that plaintiffs never sought to enjoin the merger despite the fact that they could have done so between March 6, 1978 and May 26, 1978. This action was not commenced until July 6, 1978.

> interest suggest? How long before the judgment did the fraud occur? How many changes in position have taken place since the fraudulent transaction? Were those changes serious? What are the interests of third parties? Is the transaction difficult to rescind? Will rescission in a mismanagement case have an adverse impact on the corporation's stockholders? Was the fraudulent transaction fair? Are damages adequate relief?"

5B Jacobs, The Impact of Rule 10b-5 §260.03 [c][vi], pp. 11-53 to 11-54. We will discuss such of these factors as are relevant, restated so as to apply to the facts of this case, *seriatim*:

1. Was The Breach Of Fiduciary Duty Collateral To The Contract Or, Instead, Was The Contract For An Illegal Purpose?

Obviously, the merger between Signal and UOP was not for an illegal purpose. Mergers of two or more Delaware corporations are expressly sanctioned by statute. 8 Del.C. §§251, 253. Moreover, the breach of fiduciary duty found by the Supreme Court was collateral to the merger because Signal could have effected the merger on the strength of its own vote under 8 Del.C. §251. In light of the evidence presented at the April, 1984 hearing, including Bodenstein's testimony quoted above, defendants submit that the vote on the merger would not have been materially different had the Arledge-Chitiea report been printed verbatim in the proxy materials. As Bodenstein conceded, the Arledge-Chitiea report had nothing to do with the fairness of the $21 price to the UOP minority shareholders, nor did one need that information to decide upon the fairness of the offered price.

2. <u>In Which Direction Does A Balancing Of The Equities Point?</u>

Plaintiffs never sought to enjoin the subject merger. In fact, this action was not commenced for more than a month after the merger became effective, and many months after it was first publicly announced. At the 1980 trial plaintiffs attempted to prove, unsuccessfully, that the value of UOP's shares was more than $21 at the time of the merger. There was no proof of damages based on a rescissory evaluation. Because of the speculation inherent in a rescissory evaluation of UOP more than six years after the merger, a balancing of the equities suggests that damages should be limited to the difference, if any, between the value of the UOP minority shares as of May 26, 1978, and the $21 merger price.

3. <u>What Does The Public Interest Require</u>?

The public interest does not require use of a rescissory evaluation in this case. The difference between the value of the UOP minority shares as of May 26, 1978, and the $21 merger price, if any, would provide the class with an adequate remedy. As the court held in <u>Occidental Life Ins. Co. of N.C. v. Pat Ryan & Assoc's, Inc.</u>, 4th Cir., 496 F.2d 1255, 1267 (1974), <u>cert</u>. <u>den</u>. 419 U.S. 1023 (1974):

> "Unless the public interest requires, we are reluctant to nullify a contract which has been executed [the practical effect of rescissory damages], and this is especially true where the parties have other remedies at their disposal <u>which will produce an equitable result</u>." (Emphasis by the court).

4. How Long Before The Judgment Did The Breach Of Fiduciary Duty Occur?

The nondisclosure of the contents of the Arledge-Chitiea report occurred in May, 1978 when the proxy statement with respect to the subject merger was disseminated to the shareholders of UOP. At the time of the 1980 trial, plaintiffs' counsel was fully aware of the Arledge-Chitiea report, but chose to offer no proof of rescissory damages at that trial. There have been far too many changes since 1978 to now make a rescissory evaluation of UOP's minority shares meaningful.

5. How Many Changes In Position Have Taken Place Since The Breach Of Fiduciary Duty And Were Those Changes Serious?

Between May 26, 1978 and mid-1983, UOP was operated as a wholly-owned subsidiary of Signal, both operationally and for financial reporting purposes. As with any major ongoing industrial corporation, many important changes occurred at UOP during that period. For example, the chemical division was closed in 1979, and the Forest Products Division and a major product line of the Wolverine Division were sold in 1981. June, 1984 TR, Vol. I, pp. 62-63. Thereafter, during the summer and fall of 1983, following the February 1, 1983 merger of Signal and Wheelabrator-Frye, other significant changes occurred throughout the Signal organization, many of which had a direct and immediate impact on UOP. June, 1984 TR, Vol. I, 65-66. Various operating management responsibilities of UOP were reassigned within Signal, UOP's treasury function was combined with that of

Signal, and the major employee benefit plans of UOP were combined with the benefit plans of Signal. Id. at 66. In addition, the Procon and Air Correction divisions (UOP's entire construction segment) were closed, the Flexonics division was sold, and the Aerospace and Bostrom divisions were put up for sale. Id. at 70. Notwithstanding these changes, UOP continued to report financially to Signal during 1983, except for the establishment of reserves. Id. at 73-74. As of January 1, 1984, UOP discontinued the practice of maintaining separate consolidated books and records. Id. at 89. UOP has ceased to exist as a separate operating entity, and the former UOP operating divisions now report directly to Signal. Id. at 109-113. Thus, it is now impossible, both from operational and financial reporting points of view, to evaluate UOP as of the June, 1984 trial, and it would be unreasonably speculative to attempt such an evaluation.

6. What Are The Interests Of Third Parties?

Because of the highly speculative nature of a rescissory evaluation of UOP's minority shares at the time of the June, 1984 trial, it would be inequitable to the holders of Signal's 108 million shares of common stock (including former shareholders of Wheelabrator-Frye who received Signal shares when the companies merged) to attempt to base damages on such an evaluation. This is especially true where the plaintiff class already has an adequate remedy, i.e., the difference, if any, between the fair value of UOP's minority shares as of May 26, 1978 and the $21 merger price.

7. Was The Transaction Fair?

As shown in Section A, supra, the $21 cash merger price was fair and equitable to the minority shareholders of UOP. Despite the finding by the Supreme Court, the evidence presented at the April, 1984 hearing clearly shows that no director or officer of Signal believed that the merger would have been a good investment for Signal at any price above $21 per share. The evidence also proves that all UOP financial information in the Arledge-Chitiea report was known to UOP's directors and was in the proxy materials, and that all pre-1978 Signal financial information in that report was publicly available. Defendants submit that this evidence is relevant and should be considered in the present determination of whether rescissory damages are appropriate in this case.

8. Are Damages Adequate Relief?

The difference, if any, between the fair value of UOP's minority shares as of the date of the merger and the $21 merger price would make the plaintiff class whole. We have shown that there is no difference, and there is no need to undertake a highly speculative rescissory evaluation in this case. Although the Supreme Court has held that Signal did not deal fairly with the minority shareholders of UOP, primarily because it did not disclose the Arledge-Chitiea report to the non-Signal directors of UOP and/or the minority shareholders of UOP, the minority shareholders did receive a fair price for their shares in the merger. As plaintiffs' counsel conceded before the Supreme Court, "No damage"!

A review of some of the cases in which rescissory damages have been awarded makes it clear that such damages would _not_ be an appropriate remedy in this action. _See_ _e.g._, _Mansfield Hardwood Lumber Co. v. Johnson_, 5th Cir., 263 F.2d 748 (1959), _reh_. _denied_, 268 F.2d 317 (1959), _cert._ _denied_, 361 U.S. 885 (1959); _Janigan v. Taylor_, 1st Cir., 344 F.2d 781 (1965), _cert_. _denied_, 382 U.S. 879 (1965); _Barnes v. Eastern and Western Lumber Co._, Or.Supr., 287 P.2d 929 (1955); and _American Gen'l Ins. Co. v. Equitable Gen'l Corp._, E.D.Va., 493 F.Supp., 721 (1980). In each of those cases, there were intentional fraudulent misrepresentations in connection with purchases of stock, and relatively short time periods from such purchases to a resale or corporate liquidation which established a precise value upon which rescissory damages could be calculated. None of those elements is present in the instant case.

In the present case, there was no intentional fraudulent misrepresentation, there is not a relatively short time period between the subject merger and the June, 1984 trial, and there is no subsequent sale, liquidation, or market value upon which to base a rescissory evaluation. Under the circumstances, attempting to establish some hypothetical value for UOP's minority shares as of the June, 1984 trial would be speculative at best. In light of the foregoing, a rescissory evaluation in this case is neither appropriate nor susceptible of proof.

C. <u>The Former Minority Shareholders Of UOP Are In As Good Or Better A Position Having Received The $21 Per Share In June, 1978 Than They Would Be If They Received The Hypothetical Value Of A UOP Share As Of December 31, 1983</u>

For the reasons set forth in Section B, <u>supra</u>, any award of rescissory damages in this action would be inappropriate. However, in light of this Court's indication in its April 24, 1984 opinion that it wanted to consider post-merger evidence of value in connection with its decision as to whether rescissory damages would be appropriate, both experts gave opinions at trial as to the hypothetical value of UOP shares subsequent to the merger.* Given the requirement that rescissory damages be computed with reference to the date of the damages trial, only the December 31, 1983 conclusions of both experts will be analyzed in this brief. An analysis of the conflicting expert testimony on the hypothetical value of UOP shares as of December 31, 1983, the closest date to the damages trial for which any evaluation was attempted, demonstrates that a former UOP minority shareholder is in as good or better position having received $21 per share in June, 1978 than he would be if he received the hypothetical value of a UOP share as of December 31, 1983.

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* In an effort to relate his rescissory damage valuations to the date of the damages trial, as required by <u>Lynch v. Vickers Energy Corp.</u>, Del.Supr., 429 A.2d 497, 505 (1981), Bodenstein's report characterizes his conclusions to be as of the spring of 1983 and the spring of 1984. In fact, however, those valuations, like Dillon Read's, were prepared utilizing UOP 1982 and 1983 year-end information. <u>See</u> June, 1984 TR, Vol. IV, 174; Vol. V, 103.

1. Plaintiff's "Proof" As To 1984 Value

As was the case with his analysis of the value of the UOP minority shares as of May, 1978, Bodenstein's 1984 valuation is fatally flawed and should be given no weight whatsoever by the Court. While his 1984 valuation is replete with errors and internal contradictions, the overriding flaws in Bodenstein's post-merger valuation arise from his failure to take into account the 1983 UOP losses and reserves, his application of an artificial 1982 price/earnings ratio to an incorrect 1983 UOP year-end earnings figure to construct his "comparable companies" analysis, his arbitrary and improper addition of a premium to his 1984 valuation conclusions, and his failure to give defendants credit for the imputed return on the $21 per share which UOP's former minority shareholders were paid in May, 1978.

(a) Bodenstein's Failure To Take Into Account UOP's 1983 Losses And Reserves

At trial, defendants presented extensive testimony of Jerry Corirossi, vice president-finance of the UOP group, and Edward Kavanaugh, deputy controller of Signal, with respect to UOP's 1983 financial results on a stand alone basis, and particularly the impact of certain losses and reserves which had to be included in those results. June, 1984 TR, Vol. I, 71-87; Vol. II, 12-13; PDX-102; DDX-10-11. That testimony established conclusively that, had UOP issued year-end financial statements as of December 31, 1983 comparable to those issued for prior years, it would have reported a net loss for 1983 of $80,731,000, and a year-end book value of $263,372,000. June, 1984 TR, Vol. I, 87; Vol. II, 12-13; PDX-10 (p. 2 and note); PDX-11 (note). In addition, Corirossi explained, as he had also done at his earlier deposition, that because of financial reporting and operational changes made within Signal in 1983, UOP's 1983 year-end report package was not prepared on a basis comparable to UOP's earlier year-end audited financial statements. That is why the 1983 report package did not include the losses and reserves which were instead booked for UOP at Signal's headquarters in LaJolla, California. June, 1984 Tr, Vol. I, 73-74.

Bodenstein, after listening to the trial testimony of Corirossi and Kavanaugh, concluded that the losses and reserves were "appropriate, well taken and taken at a good time in Signal's development", and that he had "no quarrel" with the amount of the losses and reserves. June, 1984 Tr, Vol. IV, 175; Vol. V, 105. Notwithstanding, in preparing his 1984 valuation Bodenstein erroneously assumed that UOP's 1983 year-end report package, PDX 26, was prepared on a basis comparable to UOP's earlier financial statements, an error which changed UOP's 1983 actual year-end results from a loss of $80,731,000 to a profit of $41,700,000.* June, 1984 TR, Vol. IV, 177; Vol. V, 98. As Bodenstein testified:

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* Because Bodenstein had available to him prior to his report the transcripts of the depositions of both Corirossi and Kavanaugh and the information contained in DDX-10 and 11, his erroneous assumption cannot be excused by any claim of lack of information.

"Q. Was it your understanding at the time you prepared your report that this 1983 year-end report package, PDX26, was prepared on a comparable basis to the UOP 1980 and 1981 and 1982 report packages?

"A. Yes.

"Q. And in doing your comparative analyses then, you did your work predicated upon that conclusion?

"A. Yes.

"Q. The 1983 year-end report package, which is in front of you, PDX26, and the summary, which is PDX24, do not reflect the year-end reserves and write-down adjustments for UOP for 1983, do they?

"A. As I understand it now, they don't."

June, 1984 TR, Vol. V, 98.

For each of the years 1979-1984, Bodenstein based his conclusions as to value upon the summary of seven analyses set forth in Table U of the appendix to his June, 1984 report. PDX-120, App., Table U; June, 1984 TR, Vol. IV, 159. However, Bodenstein did not make a discounted cash flow analysis for 1984.* June, 1984 TR, Vol. V, 78. Of the six remaining analyses for 1984, four ("Comparative P/E Ratios", "Comparable Transactions' Ratio of Offer Price Earnings", "Comparative Multiples of Book Value", and "Percentage of Signal's Market Value") were fatally infected by Bodenstein's erroneous assumption.

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* In his 1984 written report, Bodenstein states that he used the same methods of analysis as he used in 1980. PDX-120, Rep., pp. 10-11. This is clearly not the case, since for 1983 and 1984 he did not use the discounted cash flow method on which he principally relied for his 1978 evaluation.

In Table Q, which formed the basis for both the "Comparative P/E Ratios" and "Comparable Transactions' Ratio" conclusions in Table U, Bodenstein calculated his 1984 ratios using a $41.7 million income figure for UOP at year-end 1983. June, 1984 TR, Vol. V, 100 and PDX-120, App., Table Q. Had Bodenstein recognized the fact of a loss year in his 1984 analysis, he could not have even calculated the ratios upon which he purported to rely.* June, 1984 TR, Vol. V, 140-141.

Most telling with respect to the integrity of his report, however, was Bodenstein's testimony at trial with respect to the effect of his erroneous 1983 earnings assumption upon his "Comparative Multiples of Book Value" analysis. While he readily admitted that the book value of $385.8 million which he utilized in his Table R as a basis for his $59 per share conclusion in Table U was erroneous, June, 1984 TR, Vol. V, 101-102, 108-109, he testified as follows with respect to the effect on his analysis of a $90 million decrease (approximately $8 per share) in book value:

> "Q. And is it correct that if those adjustments and write-downs for 1983 are entered in the books, as they should be entered, that the effect would have been that the loss shown by those reserves and write-offs would affect and lower the book value as reported by the company?

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* For this very reason, the Dillon Read report does not include a comparable companies analysis for the year ended December 31, 1983. DDX 13, 17-18.

"A. It does. And I agree that the book value as they come out in 1983 is not the 385. But I don't know what the book value is, because if we look at--and I still don't know today. If we look at the Dillon Read balance sheet, which is Exhibit 1-B, the book value is 293,491,000. And I think if you look at one of the Kavanaugh exhibits, it might be a different number.

"So whatever number you tell me it is or Signal tells me it is, I will accept. And as I said, you know, it is not going to affect my decision, because book value, net asset value, is not a key determinant of value in this case.

"Q. The book value as a number is certainly not a determinant to you, is it?

"A. The book value as anything is not a key determinant to value."

June, 1984 TR, Vol. V, 109. Bodenstein then concluded this remarkable line of testimony by stating:

"And I agree, we could substitute the 295 or, again, whatever number is given to me. We could substitute it in any one of my exhibits, and I will accept it, and I think it should be.

"Q. And no matter what it does to the numbers or the ratios, it is not going to change your opinion?

"A. No, it will not."

June, 1984 TR, Vol. V, 110.

Finally, Bodenstein's erroneous book value assumption also infected his 1984 "Percentage of Signal's Market Value" analysis in Tables T and U. June, 1984 TR, Vol. V, 102, 145; PDX-120, App., Table T. Notwithstanding his testimony that book value is not a key determinant of value, Bodenstein, in fact, used his inflated $385.8 million book value figure for year-end 1983 to develop his "UOP Earnings as Percentage of Signal's Net From Operations" figure for 1984 in Table T, which he then utilized to derive his "Market Value Per UOP Share" conclusion for 1984. <u>See</u> June, 1984 TR, Vol. V, 145-149. In short, except for his dividend analyses, <u>every one</u> of the analyses upon which Bodenstein testified he premised his 1984 conclusion as to value was rendered invalid and meaningless by his failure to give any credence to the 1983 losses and reserves, which even he conceded were proper and well-taken.

(b) Bodenstein's Meaningless 1984 <u>Comparative Analyses</u>

In direct testimony, Bodenstein agreed that Table U in the appendix to his report was a summary of "all the various spokes or analyses that had been made before in determining the per share value of the minority shares from '79 through '84." June, 1984 TR, Vol. IV, 157. Clearly, in the absence of a discounted cash flow analysis, the comparative analyses were the most important "spokes" in Bodenstein's 1984 valuation. As we have already shown, Bodenstein's 1984 comparative analyses were fatally flawed because he utilized an erroneous 1983 year-end earnings figure of $41.7 million in his calculations. However, even if one were to accept the erroneous 1983 earnings figure used by Bodenstein as correct, his comparative analyses still fail.

In Table N of his appendix, Bodenstein seeks to develop an April 15, 1984 price/earnings ratio to apply to his chosen

1983 year-end earnings figure. However, of his ten "comparable companies," three did not exist, four reported losses, and the average price/earnings ratio of the remaining three was 62:1. June, 1984 TR, Vol. V, 114, and PDX-120, App., Table N. Concluding that number to be "unrealistic and unusable," Bodenstein instead utilized the price/earnings ratio of 12:1 that he had developed as of April 15, 1983 to apply to UOP's 1982 year-end earnings and applied it again to UOP's supposed 1983 year-end earnings! June, 1984 TR, Vol. V, 115-116, and PDX-120, App., Table Q. This mixing of time periods is both misleading and unjustified.

Even standing alone, Bodenstein's price/earnings ratio as of April 15, 1983 was contrived. It was based upon an arithmetic average of only four "comparables," Combustion Engineering (7:1), Fluor (11:1), Morrison-Knudsen (8:1), and Signal (21:1). The Signal price/earnings ratio "jumped out" at Bodenstein as perhaps being a number that was not truly representative. June, 1984 TR, Vol. V, 117. Nonetheless, he persisted in including it in the price/earnings ratio average which formed the basis for both of his post-merger comparative analyses.* In short, neither the 1983 earnings base nor the price/earnings ratio applied to it by Bodenstein were valid,

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* Had Bodenstein excluded Signal, his P/E ratio for April 15, 1983 would have been 8.7:1 instead of 12:1. By way of comparison, for year-end 1982, Dillon Read, based upon a much broader sample of companies, utilized a P/E ratio of 6.7:1-7:1. DDX-13, pp. 15-16.

rendering the important "Comparative P/E Ratios" spoke of his 1984 analysis meaningless.

Just as meaningless was Bodenstein's 1984 "Comparable Transactions' Ratio of Offer Price to Earnings" analysis in Table U, which he derived from his appendix Table O. First, this analysis is based upon a comparison of UOP with acquisitions of various companies. This assumption of an acquisition in 1984 is completely unjustified and is contrary to the very concept of rescissory damages (see Argument C(1)(c), infra). Second, the calculation of $53 per share in Table U is derived by multiplying the average "Offer Price as Multiple of Earnings" of 14.5:1 derived from Table O by the erroneous $41.7 million income figure for year-end 1983 and dividing by the number of shares outstanding. Third, Bodenstein utilized construction and engineering companies as comparables in arriving at his 14.5:1 factor, even though he knew that UOP was not a construction and engineering company, and that by the end of 1983 UOP did not even have a construction and engineering division. June, 1984, TR, Vol. V, 119; PDX-10, App., Table O. Finally, Bodenstein made no effort in Table O to determine whether or not the acquirors already had a control position prior to the acquisition transactions he relies upon. June, TR, Vol. V, 120. In short, the theory of this analysis as well as both of the variables utilized to reach the mathematical conclusion are erroneous.

(c) Bodenstein's Faulty Dividend Analysis

Bodenstein's "Comparative Dividend Yields" and "Signal Dividend Yield" analyses for 1984 summarized in his Table U, the last spokes upon which he relied, are clearly secondary to his overall analysis. Moreover, like his other "analyses," they do not stand up to inspection. In each case, Bodenstein (in PDX-120, App., Table P) assumed that UOP paid dividends to Signal in 1983 of $20 million when in fact (as Bodenstein knew) UOP paid to Signal only $10 million in dividends in 1983. June, 1984 TR, Vol. V, 127-128. The effect of this "assumption" was to double UOP's 1984 value per share under each of the two dividend yield approaches.

(d) Bodenstein's Unwarranted Addition Of A Premium Over Market To His Valuation For 1984

Not only are each and every one of the "spokes" utilized by Bodenstein in his 1984 valuation faulty, but also he compounded the unreality of his valuation by including in or adding a premium over market to each of those analyses. June, 1984, TR. Vol. IV, 156-157. He did this on the assumption that there would be a cash-out merger in the spring of 1984, and conceded that if there were not such a cash-out, the premium would be inappropriate. June, 1984 TR, Vol. IV, 150, 153; Vol. V, 77-78.

In point of fact, there is no justification whatsoever in the law or theory of rescissory damages to justify Bodenstein's hypothetical cash-out merger assumption. In its pure form, rescission in this case would call for the restoration of the parties to the status quo before the sale of the shares to Signal in the merger. See Lynch v. Vickers Energy Corp., Del.Supr., 429 A.2d 497, 501 (1981). Rescission is the act of voiding a prior relationship. 5B Jacobs, The Impact of Rule 10b-5 §260.03[c][vi], p. 11-47. Rescissory damages are a substitute for rescission when rescission is not feasible. Id., p. 11-59. Prior to the merger, the value of the stock held by the minority shareholders, as determined by the market, obviously did not include a premium. Signal already had control, and as Bodenstein conceded, if Signal were to resell the full minority interest to a third party it would have received no premium over the prior market from the buyer. June, 1984 TR, Vol. V, 71-73. In short, there is simply no room in the legal theory of rescission for the arbitrary addition of a premium over market.

(e) Bodenstein's Failure To Credit Signal With A Return On The $21 Per Share Which The Plaintiff Class Has Had Since May 26, 1978

Since the theory of rescissory damages is to return both parties to the status quo ante, an integral part of any rescissory damage calculation is the return to defendants not only of the consideration paid for property, but also the benefit to plaintiff of the use of that property from the time of its receipt to the date of judgment. Thus, in Lynch v. Vickers Energy Corp., supra, the Supreme Court held that "Vickers is entitled to credit arising from the fact that plaintiff (and each other member of the class) has had the use of $12 per share since the transaction was made in October, 1974." 429 A.2d at 506. No precise formula is followed in determining the rate of return to be applied. Instead, this Court must apply a "fairness principle" in the factual setting of the particular case. Lynch v. Vickers Energy Corp., supra, 429 A.2d at 506.

Bodenstein presented no evidence or testimony on this important issue. The only evidence on the fair rate of return to be applied to the $21 per share under the particular facts of this case was that presented by Dillon Read. See p. 51, infra. In light of plaintiffs' absence of proof on this issue, defendants' evidence must be accepted by this Court.

In summary, Bodenstein's entire 1984 rescissory damage valuation is premised on faulty and self-serving assumptions, is result-oriented, and is incomplete. It is of no probative value whatsoever and is not entitled to be given any weight by this Court.

2. The Opinion Of Dillon Read--Purcell's Testimony As To The Value Of The UOP Minority Shares As Of December 31, 1983

In anticipation of plaintiffs' proof on the issue of rescissory damages, Signal asked Dillon Read to make a judgment as to what the value of the UOP common shares, not held by Signal, would have been at the end of both 1982 and 1983, assuming that the 1978 merger had not taken place and that the UOP common shares continued to be traded on the New York Stock Exchange. June, 1984 TR, Vol. II, 182-183; DDX-13, p. 6. Dillon Read also analyzed the growth of the $21 merger proceeds from mid-1978 using various investment alternatives. June, 1984 TR, Vol. II, 188-189; DDX-13, p. 18 and Ex. 9.

In forming its opinion, Dillon Read reviewed the UOP documents and deposition transcripts which were also made available to Bodenstein, together with the nature of the businesses conducted by UOP and the industries in which it operated, the market prices and ratios for securities of selected companies which it deemed to be somewhat comparable to UOP, and the movements and ratios of the stock market in general during the 1978-1983 period. June, 1984 TR, Vol. II, 183-185; DDX-13, p. 6.

Based upon all of its work, Dillon Read estimated that the per share value of UOP's minority shares at the end of 1983, had those shares been then publicly traded, would be $23.00 to $24.25. Therefore, were the plaintiffs to be entitled to rescissory damages as of the end of December, 1983, the value of their shares would not exceed $24.25.* Dillon Read also concluded that the UOP minority shareholders should be given credit for $7.38 per share in dividends which Dillon Read calculated they probably would have received from the time of the merger through 1983.

Under a rescissory damage theory, before substracting the proper credits to defendants, the sum to which plaintiffs would be entitled is $31.63 made up of the per share value as of December 31, 1983 ($24.25) plus the imputed dividends per share from May 26, 1978 through 1983 ($7.38). From this amount, there

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* It should be remembered that the market price of the publicly traded UOP shares as of the date the merger was announced in 1978 was $14.50. To compare the increased value of those shares in 1983 to their 1978 value, one must use $14.50, <u>not</u> the $21 merger price.

must be substracted the total of that which was actually paid to the UOP minority shareholders in the 1978 merger ($21.00 per share) plus a reasonable imputed return on that amount from May 26, 1978 through 1983.

Dillon Read's report shows that the amount received by the minority shareholders in 1978 ($21.00 per share) plus a reasonable return thereon equals $43.14 to $43.54.* DDX-13, p. 18. Accordingly, even if a rescissory evaluation were to be undertaken in this case, plaintiffs in fact would have suffered no damages since the amount actually received in 1978 plus a reasonable return thereon substantially exceeds the "rescissory value" as of December 31, 1983.

Once again, the specifics of how and why Dillon Read reached its opinion as of December 31, 1983 are set forth in detail in Dillon Read's report and in Purcell's direct testimony. June, 1984 TR, Vol. II, 182-211; DDX-13A; DDX-13, pp. 6-17 & Exs. 1B, 2B, 3B, 4B, 5B, 7-10. However, a brief review of certain aspects of the Dillon Read report demonstrates that, as contrasted with the Bodenstein report, Dillon Reed's December 31, 1983 valuation is based upon realistic assumptions and sound

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* Dillon Read utilized the return on an average equity security in its analysis on the assumption that because each UOP shareholder had been an equity investor in UOP in fact, he would have reinvested the merger proceeds in another equity investment. June, 1984 TR, Vol. II, 188. However, even had the UOP stockholder invested the merger proceeds in a conservative mix of treasury bills, 30-day certificates of deposit and money market funds, the $21.00 plus the non-compounded return thereon as of December 31, 1983 of $34.18 would have been greater than $31.63. June, 1984 TR, Vol. II, 188-189; DDX-13, Ex. 9, pp. 3-4.

anaylsis. First, unlike Bodenstein, Dillon Read properly recognized the 1983 UOP actual results, including losses and reserves. Dillon Read considered both the $55.2 million loss for 1983 reflected on DX-10 and the additional $28 million after-tax reserve for Come-By-Chance which would have to be allocated to UOP on a stand-alone basis. However, in its analyses it adjusted those loss figures downward to give effect to its conclusion that certain of the reserves were related to the Signal/Wheelabrator--Frye merger. As a result, Dillon Read utilized a $55.2 million loss figure for UOP in 1983. DDX-13, pp. 10-11. This analysis of UOP's 1983 results stands in stark constrast with Bodenstein's report, which simply ignored UOP's actual 1983 results.

Since UOP had no positive earnings for 1983, Dillon Read could not prepare a comparable company analysis for 1983. However, it did so for 1982. Utilizing a range of comparable companies (DDX-13, Exs. 6-8), and considering various other factors, Dillon Read concluded that at year-end 1982, UOP stock would have traded in a range of 6.7X to 7.0X earnings, or at $27.25 to $28.50 per share. DDX-13, pp. 14-16.* For 1983, Dillon Read concluded that UOP's stock would have traded at a level at least 15% less than the previous year, just as it had in 1975 when it reported another large loss also related to the Newfoundland refinery project. DDX-13, p. 17. In this

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* By way of comparison, UOP had traded at 6.8X earnings immediately prior to the announcement of the 1978 merger. DDX-13, p. 13.

connection, Dillon Read also took into account that, even without the reserves, both 1982 and 1983 were down years for both UOP and its important petroleum and petrochemical segment, DDX-13, p. 8, and that all other segments had a very erratic record from 1978 through 1983. DDX-13, p. 9.

Finally, Dillon Read considered that at $23 to $24.25 per share, UOP shares would be trading at a market to book value ratio of 90.0% to 94.9%. DDX-13, p. 17. This ratio compared favorably to UOP's experience during the five years preceding the 1978 merger, when its common stock traded at an average price equal to 74.0% of its stated book value. DDX-13, p. 15.

In summary, Dillon Read's valuation for 1983 is based upon real numbers for UOP and reflects real trends in UOP's business segments and the securities markets. It demonstrates that the former minority shareholders of UOP are in as good or better financial position having received the $21 per share in June, 1978 than they would be if they received the hypothetical value of a UOP share as of December 31, 1983. Accordingly, for this reason also, this Court should decline to award rescissory damages in this case.

CONCLUSION

Defendants have shown that, when the relevant facts are considered, the price of $21 per share paid to UOP's former minority shareholders in connection with the subject merger was fair. For this reason alone, a rescissory evaluation is not justified.

Defendants have also shown that no director or officer of Signal believed that the merger would have been a good investment for Signal at any price above $21 per share, that all UOP financial information in the Arledge-Chitiea was known to UOP's directors and was in the proxy materials, and that all 1977 Signal financial information contained in the Arledge-Chitiea report was publicly available. These facts, coupled with the other factors discussed in Section B, supra, compel the conclusion that rescissory damages are neither appropriate nor susceptible of proof under the particular facts of this case.

Defendants have further shown that even if a rescissory evaluation were appropriate and susceptible of proof, a former minority shareholder of UOP is in as good or better position having received the $21 cash in May, 1978, than he would be if he were to receive the hypothetical value of UOP's minority shares as of December 31, 1983. Therefore, the UOP minority shareholders have suffered no damages even on a rescissory evaluation.

Based on all of the foregoing, defendants respectfully submit that judgment should be entered in their favor.

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