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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' ANSWERING BRIEF AFTER THE DAMAGES TRIAL

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1. Introduction

In its Opinion dated February 1, 1983, the Supreme Court articulated the proposition that a judicial review of the fairness of a corporate merger involves the scrutiny of the two major components of the transaction, namely the structure or procedure utilized in the merger, and the fairness of the price paid. Weinberger v. UOP, Inc., Del.Supr., 457 A.2d 701 (1983) ("Weinberger II"). The Supreme Court reversed this Court's determination that the procedure followed in the Signal-UOP merger was fair, and sent the case back to this Court for a reexamination of the question of the fairness of the price of $21 per share paid by Signal to UOP's minority shareholders. The Supreme Court did not itself decide that the price paid was unfair, nor did it direct this Court to find that monetary damages were due to the plaintiffs.

As defendants perceive the nature and purpose of the damages trial held before this Court in June, 1984, it was to do two things: (1) to determine whether monetary damages, in any sum whatsoever, should be awarded to the plaintiffs in this case; and (2) if so, to then determine the amount of such monetary damages considering, if appropriate, whether a standard of rescissory damages should be used. It is the defendants' interpretation of the Supreme Court's opinion that both of these issues were left to the sound discretion of this Court, but with some directions. First, in deciding whether the $21 per share received by UOP's shareholders was a fair price, this Court was not bound by earlier case precedent insofar as any accounting or financial formulation which might be used in arriving at an opinion of value. Specifically, the Supreme Court said that this Court should not refuse to consider plaintiffs' discounted cash flow methodology as a matter of law; by the same token, it did not direct this Court either as to the weight which should be given to plaintiffs' evaluation methodology, or as to whether this Court must or should consider that methodology as valid under the facts and circumstances of this particular case. In other words, as to the question of valuation and fairness of price, this Court is free to decide, in its discretion, what methodology and data should appropriately be considered in arriving at the valuation decision in this case. Defendants have no quarrel whatsoever with this procedure, either as a matter of law or as factually applied in this case. This Court has heard the testimony of plaintiffs' expert, Mr. Bodenstein, of Duff and Phelps, Inc., as well as the testimony of defendants' expert, Mr. Purcell, of Dillon, Read & Co. Inc. It is now up to this Court to decide from this testimony what to accept, what to reject, and what weight to give, if any, to the methodologies and opinions of the respective experts.

Judging by the contents of their opening brief after the damages trial ("PB __"), plaintiffs either disagree with the above-stated scope of the damages trial, or at least they make it appear so. At several places in their brief plaintiffs suggest that the Supreme Court has already decided that damages in some amount must be awarded, and that the only purpose of the damages trial is to determine the dollar amount to be paid. For example, plaintiffs state that "...the Supreme Court, while leaving the determination of the amount of damages to this Court, strongly implies that $24.00 is the starting point...." PB 17, fn. <u>See also</u>, PB 36, fn. Plaintiffs' inference is clear, and it is wrong. What the Supreme Court actually said was that "...in view of the Chancellor's <u>discretion</u>, the award, <u>if any</u>, should be in the form of monetary damages...." (emphasis added). <u>Weinberger II</u>, <u>supra</u>, 457 A.2d 714.

Plaintiffs also turn to selected portions of the Supreme Court's opinion to suggest that this Court must award damages. <u>See</u> <u>e.g.</u>, PB 28-30, 37-39. The fact remains that the Supreme Court, with knowledge of the facts which plaintiffs now argue, specifically remanded the action to this Court for a determination of whether damages in any amount should be awarded to the plaintiffs.

Finally, plaintiffs imply that not only did the Supreme Court direct an award of damages but that it also directed an award of rescissory damages. PB 24, 36-39. Actually, the Supreme Court stated that in considering the relevant factors and exercising its discretion in determining whether <u>any</u> damages should be awarded, this Court could consider "...the elements of rescissory damages if the Chancellor considers them susceptible of proof and a remedy appropriate..." under the circumstances. <u>Weinberger II</u>, 457 A.2d 714.

With what the Supreme Court actually mandated kept in mind, defendants now respond to those arguments in plaintiffs' opening brief which may justify a reply.

2. The Fairness of The $21.00 Merger Price

a. Purcell Considered The Relevant Factors.

Plaintiffs state that Dillon Read's 1980 opinion was based on four factors: "the three elements of the Delaware Block valuation method (market value, investment value and asset value) and the structure of the transaction." PB 8. In fact, Dillon Read did not base its opinion on the fairness of the merger price on the Delaware block method of evaluation, nor did it rely on the structure of the transaction. June, 1984 TR, Vol. II, 163-164, 176, 218-221.

The three factors usually taken into account in appraisal cases prior to Weinberger II were market value, earnings value (not investment value), and net asset value. See e.g., Francis I. duPont & Co. v. Universal City Studios, Inc., Del.Ch., 312 A.2d 344 (1973), aff'd, Del.Supr., 334 A.2d 216 (1975); Gibbons v. Schenley Indus. Inc., Del.Ch., 339 A.2d 460, 467 (1975). Purcell reviewed in detail and reported on the investment value of UOP's minority shares which included not only market, earnings, and asset values, but went far beyond those elements, including such data as UOP's balance sheet and capitalization data, lines of business, revenues and operating profits, identifiable assets, consolidated operations 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. Purcell also considered the premiums over market paid in other transactions. DX-40, pp. 17-18; DDX-13, p. 4. On the basis of his review and analysis of all of this information, Purcell concluded both in 1980 and again in 1984 that the $21 merger price was fair to the minority shareholders of UOP. June, 1984 TR, Vol. II, 163-164, 218-221; DX-40; DDX-13.* Moreover, contrary to plaintiffs' suggestion (PB 8), Purcell did not rely on the structure of the transaction in opining as to the fairness of the merger price:

> "The structure of the transaction as described in our [1980] report basically had to do with what I thought was, you know, an interesting aspect of the transaction at that time, which was providing the mechanism of the majority of the minority voting in favor, which was one of the first deals to do that, and on top of that making sure that enough people voted so that you had a 66-percent turnout at the ballot box, so to speak, in order to validate the election. That particular item had nothing to do with the value of what a fair price would be. It was an observation, if you will, and an extra, not to use a slang expression, but somewhat of a bonus, you know, in the fairness pot as

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* In light of then existing precedent, defendants' 1980 post-trial brief did contain an analysis of the fairness of the price by analogy to appraisal cases using some of the elements considered by Purcell. See the Post-Trial Brief Of The Signal Companies, Inc. and UOP Inc. (Docket Entry No. 178), pp. 129-140. However, neither Purcell nor this Court took that approach. <u>See</u>, Defendants' Opening Brief After The Damages Trial ("DB"), 6-9.

to just one extra thing that was being done for the shareholders to ensure fairness. Whether it was there or not there had nothing to do with, in our judgment, the fairness of the $21 price. The fact that it was there, we observed that fact.

> "I, frankly, liked that structure. It was one more element in the transaction that I personally thought was interesting and so commented upon it."

June, 1984 TR, Vol. II, 176.

b. Purcell's And Bodenstein's Premium Analyses.

Plaintiffs state that in his 1984 report Purcell used the same "noise-screening" analysis which Bodenstein used in determining premiums over market. Purcell did not. In support of their assertion, plaintiffs point to that part of Purcell's 1984 report which states: "Excluding the trading prices achieved during the 1975 Signal tender offer, the [UOP] stock did not trade above $16.25 in 1975 nor above $15.75 in 1976."* PB 59. However, in disregarding the market prices for UOP stock during the 1975 tender offer Purcell did not screen-out "noise", which Bodenstein defined as rumors, leaks, or market premonition of a transaction. June, 1984 TR, Vol. IV, 39-42. What Purcell eliminated was public market information, *i.e.*, the 1975 tender offer, the public announcement and pendency of which no doubt distorted UOP's market price. Purcell never attempted to analyze nor did he consider such speculative factors as rumors, leaks, or market premonitions.

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* A similar statement appears in Dillon Read's 1980 report. DX-40, p. 4.

The cases upon which plaintiffs rely (PB 60-62) do not support Bodenstein's noise-screening analysis. For example, In Re Olivetti Underwood Corp., Del.Ch., 246 A.2d 800 (1968), did not address the question of "noise-screening" as used by Bodenstein. There the Court specifically excluded consideration of the market value of Underwood common stock on and after the date on which Olivetti Italy made a public tender offer for Underwood. As the Court stated, "...it is unrealistic to say that the [public] announcement of the [tender offer] did not have an impact upon the market price." 246 A.2d 805. Similarly, in David J. Greene & Co. v. Schenley Indus., Inc., Del.Ch., 281 A.2d 30, 34 (1971), this Court noted that the "...Schenley [market] prices for portions of 1967 and for all of 1968 were distorted by the [public] competing take-over proposals of Glen Alden and of Lorillard." In Rosenblatt v. Getty Oil Co., Del.Ch., C.A. No. 5278, Brown, C. (Sept. 19, 1983), 8 Del.J.Corp.L. 366 (1983), this Court excluded market reaction to the public announcement of J. Paul Getty's death. Once again, the Court refused to consider market prices which may have been distorted because of public market information, not because of so-called "noise".

Neither Rosenblatt nor Schenley support plaintiffs' contention that in determining the premium paid in an acquisition one must seek some pre-acquisition value on a date determined by use of "noise-screening." Indeed, Bodenstein's calculation of premiums over market by looking to dates other than the day before a transaction is publicly announced (PB 9-11) is without precedent or practical value, and was apparently contrived to denigrate the generous premium paid by Signal--one of the highest premiums ever paid in a merger by a stockholder which already had a majority interest. DX 40C. The very concept of premium over market is a comparative one, and in making such comparisons, both the investment community and this Court determine the premium over market in any given transaction by looking at the market price just prior to the first public announcement concerning that transaction. See e.g., June, 1980 TR, 1134-1137; Tannetics, Inc. v. A.J. Indus., Inc., Del.Ch., C.A. No. 5306, Marvel, C. (July 17, 1979) (a copy of which is attached hereto as Exhibit A), Slip Op., pp. 14-15; Gibbons v. Schenley Indus., Inc., Del.Ch., 339 A.2d 460, 468 (1975); Tanzer v. Int'l Gen'l Indus., Inc., Del.Ch., 402 A.2d 382, 389 (1979); Joseph v. Shell Oil Co., Del.Ch., C.A. No. 7450, Hartnett, V.C. (Revised, June 21, 1984) (a copy of which is attached hereto as Exhibit B) ("the tender does represent a 32% premium over the reported closing price on the day before the public announcement of the initial proposal" (emphasis added)--Slip Op., p. 19).

In addition to miscalculating the premiums over market in other transactions, Bodenstein also failed in his comparable premium analysis to take into account the fact that Signal owned a majority of the outstanding stock of UOP prior to the merger. PDX-120, App., Appendix B, p. 16. As Purcell explained at the 1980 trial, premiums over market are usually higher in transactions in which the acquiror does not have control than in transactions where the acquiror already has a substantial stock position. 1980 TR, 1137-1140; DX-40, pp. 17-18. For example, DX-40B shows an average premium of 48% over market in merger and acquisition offers for selected industrial companies valued at $50 million or more from January 1, 1977 through May, 1978. However, DX-40C shows an average premium of only 35% over market in transactions where the acquiror owned at least 30% of the acquiree prior to making an offer for all or part of the remaining shares. Purcell testified that DX-40C was more comparable than DX-40B to the Signal-UOP merger because Signal owned 50.5% of UOP prior to the merger. 1980 TR, 1137. As this Court will recall, Signal paid a premium of 44.8% over market to the minority shareholders of UOP in the subject merger. 1980 TR, 1134. See also, Tanzer v. Int'l Gen'l Indus., Inc., Del.Ch., 402 A.2d 382 (1979) (parent owned 81% of subsidiary prior to merger; premium of 29% over market price on day prior to announcement of transaction held to be fair).

c. The Merger Price Was Fair

Plaintiffs' criticism of Purcell's opinion that the $21.00 merger price was fair to UOP's minority shareholders (PB 54-62) is strong evidence only of plaintiffs' displeasure with that opinion. We have shown that Purcell considered the relevant factors and came to a reasoned conclusion. DB 22-27.

Plaintiffs claim that Purcell "did very little actual analytical work" in concluding that the $21.00 merger price was fair. PB 54. A review of Dillon Read's reports and Purcell's testimony (DX-40; DDX-13; 1980 TR, 1049-1399; June, 1984 TR, Vol. II, 152-Vol. III, 239) completely dispels that claim. As to the discounted cash flow methodology, it was not utilized by Purcell as part of his evaluation because of UOP's volatile and unpredictable earnings and cash flows.

Plaintiffs state: "[C]ontrary to what this Court held to be the proper measure of damages,...Purcell's basic approach both in 1980 and again in 1984 was simply to find a minority interest value rather than finding the value of UOP as a whole, and then allocate to the minority shareholders their percentage of value of UOP as a whole...." PB 54. In fact, this Court specifically rejected plaintiffs' theory:

> "Thirdly, I have difficulty with the entire concept employed by plaintiff's expert. As noted previously, it is viewed from the standpoint of the value of a share of UOP to Signal, (or to any majority shareholder in a similar situation) because of the fact that the acquisition is transforming it into the 100 percent owner of its subsidiary. Thus, as I perceive it, plaintiff seems to be arguing that in order for the transaction to be fair to UOP's minority shareholders, they must be paid the value of the stock to Signal. And this would appear to be in contrast to the value of a share of UOP in the hands of all shareholders as of the time of the merger.
>
> * * *
>
> "I do not find this approach to correspond with either logic or the existing law."

Weinberger v. UOP, Inc., Del.Ch., 426 A.2d 1333, 1359-1360 (1981) ("Weinberger I"). The patent unreasonableness of plaintiffs' position is best illustrated by Bodenstein's testimony:

> "Q. In my hypothetical that I gave you a moment or two ago about the buyer who had come to you to ask for your opinion about a fair price to pay for 49 percent, you had told him $14.50 a share. Let us assume for a moment that that buyer then went to Signal, offered $14.50 a share, Signal accepted it, and a week later we now have a new shareholder owning 49-1/2 or 49 percent and Signal owning 51 percent. Will you assume that for me?
>
> "A. Okay.
>
> "Q. And the day after that Signal merges out that 49-percent shareholder. Is it your opinion that the fair value of those shares would be in the 28 to 30-dollar range?
>
> A. It is."

June, 1984 TR, Vol. V, 76.

Plaintiffs suggest that Signal intentionally took advantage of UOP's minority shareholders in connection with the merger. That simply makes no sense. As the owner of 50.5% of the outstanding stock of UOP, Signal could have effected the merger on the strength of its own vote. However, Signal conditioned the merger on the affirmative approval of a majority of the minority shares voting on the issue as well as the approval of not less than two-thirds of the outstanding shares. If Signal had wanted to take advantage of the minority shareholders it would not have given them the right to reject the merger.

At pages 7 and 31 of their brief, plaintiffs argue that Signal and the UOP Board should have made allowance for the rise in the stock market between February 28, 1978 and May 26, 1978. At the same pages, plaintiffs argue that the Signal and UOP Boards should have considered the elimination of the second quarter dividend in establishing the $21 price. With respect to plaintiffs' market increase theory, we know of no cash merger or acquisition in which the consideration for the transaction was tied to some market index. The vagaries of any such relationship are apparent. Moreover, this Court has already found that there was no evidence that UOP's stock would have increased in value at the rate of an overall market rise, that plaintiffs' assumption to that effect was speculation, and that UOP's Board therefore did not breach any fiduciary duty in failing to ask for a higher price based on a rise in the general market. Weinberger I, 426 A.2d 1355-1356. With respect to their second quarter dividend argument, plaintiffs had no right or entitlement to such a dividend in the absence of a declaration thereof, and plaintiffs have not even sought to make the required showing that the failure to pay the dividend "is explicable only on the theory of gross or oppressive abuse of discretion." Gabelli & Co., Inc. Profit Sharing Plan v. Liggett Group Inc., Del.Supr., No. 114, Herrmann, C.J. (May 29, 1984), a copy of which is attached hereto as Exhibit C. Slip Op., p. 8. Indeed, the minority shareholders of UOP were no longer shareholders as of the historical record date for the second quarter dividend. In any event, the prohibition against payment of any dividends, except for the 1978 first quarter dividend of 20¢ per share (which was declared and paid), was spelled out in the proxy statement and overwhelmingly approved by those minority shareholders who cared enough to vote on the merger. PX-U-7, p. 13.

Plaintiffs state that "Signal has again rested its entire case on the testimony of Mr. Purcell." PB 54. That is not true. Defendants showed at the 1980 trial and again at the June, 1984 trial that the merger price of $21.00 per share was fair. DB 22-27. The evidence presented on the fairness of the merger price included Purcell's testimony, Lehman Brothers' written opinion, the affirmative and unanimous vote of the independent directors of UOP, two of whom were substantial stockholders of UOP, and the affirmative vote of a majority of the minority shareholders. PX-U-7, pp. 10, 30; Link Aff. filed June 8, 1979. Although the Supreme Court commented upon the "hurried method" by which the Lehman Brothers' opinion was reached, and suggested that its time-table should have been disclosed more completely in the proxy statement, (Weinberger II, 457 A.2d 708), the Court did not hold that Lehman Brothers' opinion was wrong. Indeed, there has never been a finding that Lehman Brothers' opinion should be disregarded or that it was in any way invalid. In view of the facts that Lehman Brothers had been UOP's investment banker since 1959, and Glanville had been an active member of UOP's Board and Audit Committee for many years, Lehman Brothers' opinion is clearly relevant and certainly should be considered. See generally, Post-Trial Brief Of The Signal Companies, Inc. and UOP Inc. (Docket Entry No. 178), pp. 34-37, 73-78. The vote of the minority shareholders is also relevant. Any suggestion that the vote of the minority shareholders must be ignored on the issue of fair price because the minority shareholders did not have the Arledge-Chitiea report is refuted by plaintiffs' own expert. As Bodenstein testified, nothing in the Arledge-Chitiea report was needed to determine the fairness of the price. April, 1984 TR, Vol. II, 189-191.

In contrast to the foregoing, only Bodenstein has challenged the fairness of the $21.00 price. Defendants have discredited his testimony and analyses (DB 9-22, 39-49), and have shown that $21.00 per share was a fair price to the minority shareholders of UOP.

3. UOP's History From 1978 Through 1983

Plaintiffs state that "UOP's actual performance since the merger far exceeded expectations." PB 26. In support of that statement, plaintiffs compare the projections in UOP's 1978 Five Year Business Plan for the years 1978 through 1982 with UOP's actual performance for those years. PB 12. Before any conclusions can properly be drawn, however, one must compare equals, which in this case are the 1978 projections in constant dollars and the actual results also expressed in constant, *i.e.*, 1978, dollars. Indeed, Signal, in its annual reports to stockholders, has regularly complied with the SEC's requirement that financial comparisons be made in constant dollars in order "to eliminate the effect of general inflation from the historical-cost financial statements." See e.g., PDX-6, pp. 50-51; PDX-7, pp.44-45. In particular, one cannot ignore the rampant inflation which existed in the late 1970's and early 1980's when comparing the projections in UOP's 1978 Five-Year Business Plan with UOP's actual results. For example, plaintiffs' own evidence shows that the prime rate went from an average of 9.06% in 1978 to an average of 18.87% in 1981.* PDX-120, App., Table X. To ignore such inflation, as plaintiffs do throughout their financial analyses (PB 11-12), is to ignore reality. As defendants showed in their opening brief after the damages trial (DB 13), when UOP's actual results are adjusted to exclude the effect of the significant inflation which occurred after 1978, it becomes clear that they fall substantially short of UOP's 1978 projections. DDX-17. Thus, plaintiffs' statement that UOP's actual results "far exceeded expectations" is dead wrong.

DDX-10 and 11 represent UOP's 1983 consolidated income statement and balance sheet as a separate wholly-owned subsidiary. June, 1984 TR, Vol. II, 5. Those exhibits show that in 1983 UOP sustained a very substantial net loss. Specifically, those exhibits show that UOP's net loss in 1983

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* The average prime rates for the years 1978 through 1983 were: 9.06%, 12.67%, 15.27%, 18.87%, 14.86%, and 10.79%. PDX-120, App., Table X.

was $80,731,000, and its shareholders' equity decreased to $263,372,000 as of December 31, 1983. Plaintiffs use phrases such as "accounting legerdemain" (PB 21), "accounting effects" (PB 41), "accounting changes" (ibid), accounting "sleight of hand" (PB 42), and "accounting mumbo-jumbo" (PB 53), in an attempt to discredit UOP's actual results as a separate wholly-owned subsidiary. In so doing, plaintiffs ignore the unrebutted testimony of Corirossi and Kavanaugh who explained that under generally accepted accounting principles the reserves and losses shown in DDX-10 and 11 had to be taken in 1983. June, 1984 TR, Vol. II, 11; Vol. I, 162. They also ignore the fact that UOP's reserves and losses were reviewed and certified by Deloitte Haskins & Sells in connection with the independent audit of Signal's 1983 financial statements. Ibid.; PDX-7, p. 28. They ignore the testimony of both Kavanaugh and Corirossi to the effect that if UOP had prepared financial statements for year-end 1983 on a basis comparable to prior years, such statements would have contained all the losses and reserves shown in DDX-10 and 11. Incredibly, they even ignore the trial testimony of their own expert, Bodenstein, who stated that the reserves and losses "...were appropriate, well taken, and taken at a good time." June, 1984 TR, Vol. IV, 175. Bodenstein also testified that he had "no quarrel" with the amounts of the losses and reserves or when they were taken. June, 1984 TR, Vol. V, 105.

Plaintiffs contend that DDX-10 and 11 were prepared by Signal, at the direction of Mr. Arms, for use by Signal at trial.

PB 20. In fact, DDX-10 and 11 were prepared at Kavanaugh's direction in response to plaintiffs' request for production of documents. June, 1984 TR, Vol. II, 6. Defendants could have produced only UOP's 1983 preliminary report package (PDX-26) and then waited for the trial to show UOP's actual results as a separate wholly-owned subsidiary. However, to be fair, defendants prepared and produced DDX-10 and 11 in response to plaintiffs' request for documents, and then made Corirossi and Kavanaugh available for their depositions in Wilmington prior to the trial and even prior to the date when the experts' reports were to be exchanged.*

Plaintiffs refer to the 1983 losses and reserves as the "May 1984 adjustments". PB 44. Although DX-10 and 11 were prepared in May, 1984 in response to plaintiffs' request for documents, it is absolutely clear that all of the losses and reserves had to be booked in 1983, were, in fact, booked in 1983, and were certified by Signal's independent outside auditors in connection with their review of Signal's 1983 financial statements which included UOP on a consolidated basis.** June, 1984 TR, Vol. II, 6-13.

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* Plaintiffs argue that because Signal had not prepared similar financial statements for Signal's other subsidiaries, DDX-10 and 11 should not be considered. PB 49. There was no reason to prepare similar financial statements for the other subsidiaries because Signal reported on a consolidated basis. However, for purposes of a rescissory evaluation, UOP had to be reflected as a separate, wholly-owned subsidiary, i.e., as shown in DDX-10 and 11. June, 1984 TR, Vol. II, 49-50.

** Plaintiffs later concede that "major reserves...were itemized in April, 1983." PB 47.

Plaintiffs are also critical of the fact that UOP's 1983 losses and reserves were not charged to discontinued operations or considered to be extraordinary items. PB 20-21, 47. However, Kavanaugh's unrebutted testimony shows that the losses and reserves had to be charged against net income in accordance with generally accepted accounting principles. June, 1984 TR, Vol. II, 11. While discomforting to plaintiffs, the fact remains that as a separate, wholly-owned subsidiary, UOP lost $80 million in 1983, and its shareholders' equity declined to $263 million ($22.93 per share) as of December 31, 1983.*

Plaintiffs state that Signal tried to "poor-mouth" UOP and portray it as a "loser" at the June, 1984 trial. PB 53. That is not the case. What Signal did show was what has happened at UOP, in fact, since the 1978 merger. UOP was reasonably profitable in the years 1978 through 1982, and it had a very bad year in 1983. As shown in Dillon Read's 1984 report, UOP's return on equity during the 1978-1983 period was "not above average for publicly traded industrial companies." DDX-13, p. 10. Specifically, for the years 1978 through 1982, the return on Signal's investment in UOP was 13.6%, below the

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* Because the Come-By-Chance problem existed when Signal first acquired its interest in UOP, on a consolidated basis Signal is able to amortize over seven years the $28 million after-tax loss related to the Come-By-Chance litigation in accordance with generally accepted accounting principles. June, 1984 TR, Vol. II, 60-64. However, even as a wholly-owned subsidiary of Signal, on its separate financial statements UOP would have to charge the entire $28 million against net income in 1983 in order to be in accordance with generally accepted accounting principles. Id. at 62-63, 67-68; DDX-11, Note.

14.3% <u>average</u> return of the S&P 400 Industrial Group. <u>See</u> Exhibit D hereto. For 1983, UOP had a net loss of $80 million, resulting in a significant negative return on investment. Although the 1983 S&P 400 Industrial Group return on equity statistics are not yet available, the average earnings per share of that Group increased by almost 12% in 1983. DDX-13, Ex. 10, p. 1. Thus, plaintiffs' contention that through the end of 1982 "ownership of 100% of UOP was a truly wonderful investment" (PB 11) is incorrect. That contention is even less accurate when UOP's 1983 results are considered. Those are the facts based on the record as opposed to the figures selected by Bodenstein through "analysis". DB 10-11.

Plaintiffs' references (PB 13) to "'No Strings Attached' Cash" and "Advances to Signal" are also misleading. As Corirossi explained, the line entry "'No Strings Attached' Cash" did not represent free cash which could be arbitrarily taken out of UOP "[b]ecause of all the funds necessary to pay all the current liabilities and other monies needed to run the businesses in the following year." June, 1984 TR, Vol. I, 92. Moreover, the entry "Advances to Signal" represents cash which UOP had advanced to Signal over the years and on which interest was paid by Signal to UOP at prevailing market rates until UOP's treasury function was taken over by Signal in the fall of 1983. <u>Id</u>. at 94-98.

Plaintiffs suggest that there is something sinister about the fact that Signal "took" the $157 million cash account from UOP as of January 1, 1984. PB 22, 44. The reason for the transfer of the cash account was because Signal took over the treasury function for all of its subsidiaries except Garrett Corporation. June, 1984 TR, Vol. II, 15. As Kavanaugh explained at trial:

> "Q. Was the consolidation of the treasury function applicable only to UOP and Signal?
>
> "A. No, it was not. All of the subsidiaries within Signal except the Garrett Corporation were centralized. Signal is now the cashier, or the bill paying agent, for all of those subsidiaries.
>
> "Q. Does the 157.8 million-dollar entry represent cash which Signal could use at its sole discretion?
>
> "A. No, it does, and it does not for the reasons I have just enumerated.
>
> "Q. Would you repeat those again?
>
> "A. Those reasons are, one, customer advances of 68.6 [million]; two, day-to-day expenses, capital expenditures, working capital needs, and three, the Come-By-Chance payment of $30,000,000.
>
> "Q. As of January 1, 1984, what happened to the 157.8-million-dollar entry?
>
> "A. Well, as of January 1, 1984, UOP as a separate financial reporting entity no longer existed.
>
> "Secondly, I have indicated that because of the consolidation of the treasury function, Signal is now the bill paying agent for all of the UOP organization. So as of January 1, 1984, from an accounting sense the 157.8 was eliminated.
>
> It's proper accounting now no longer to have that balance outstanding. It just does not make accounting sense."

June, 1984 TR, Vol. II, 15-16.

Finally, plaintiffs state that this "Court could well make a rescissory damage award based on UOP's future earning potential--'the real key to value' as of December 31, 1983." PB 52-53. In fact, there was no evidence as to what the former divisions of UOP may earn in 1984 and later years (June, 1984 TR, Vol. II, 118-120), and even Bodenstein did not attempt an evaluation based on 1984 and later projections. As Corirossi explained, after January 1, 1984, it was not possible to prepare financial statements for UOP comparable to its statements in prior years. June, 1984 TR, Vol. I, 89-90.

4. Rescissory Damages Are Neither Appropriate Nor Susceptible Of Proof

We showed in our opening brief that rescissory damages must be determined as of the date of judgment, and that under the particular facts of this case, rescissory damages are neither appropriate nor susceptible of proof. DB 27-37. Recognizing that the facts of this case do not justify an award of rescissory damages, plaintiffs rely on Lynch v. Vickers Energy Corp., Del.Supr., 429 A.2d 497 (1981) and Joseph v. Shell Oil Co., supra, Exhibit B hereto, in an effort to convince this Court that the Supreme Court has already required an award of rescissory damages in this case. PB 34-39. Obviously, however, the Supreme Court's opinion in this case is controlling on the issue of damages. Weinberger II overruled Lynch v. Vickers Energy Corp., supra, insofar as the latter limited this Court's "discretion to a single remedial formula for monetary damages in a cash-out merger." Weinberger II, 457 A.2d 714. Moreover, with all of the facts in this case before it, the Supreme Court specifically held that this Court should consider rescissory damages only if it deemed them to be susceptible of proof and an appropriate remedy under all of the circumstances. Ibid. Plaintiff's reliance upon Joseph v. Shell Oil Co., supra, is also misplaced. Under the particular facts of that case, Vice Chancellor Hartnett held, at the preliminary injunction stage, that minority shareholders who had not received full and complete information in a tender offer by a majority stockholder would be given the opportunity to withdraw shares already tendered after corrective disclosures were made. The issue of rescissory damages was not even before the Court.

Plaintiffs then seek to convince the Court that rescissory damages are appropriate by asserting that Signal used confidential UOP financial information in connection with the merger. PB 30, 37. That is not true. As defendants proved at the April, 1984 hearing, all of the UOP financial information in the Arledge-Chitiea report was known to all of UOP's directors, and was contained in the proxy statement for the subject merger. Defendants also proved at that hearing that the 1977 Signal financial information in the Arledge-Chitiea report was published in Signal's 1977 annual report, and that the only information in that report which was not available to UOP's directors and minority shareholders came from Signal's 1978 profit plan which was proprietary to Signal and highly confidential. DB 29-30. Defendants further proved at the April, 1984 hearing, contrary to plaintiffs' contentions (PB 3, 25), that no director or officer of Signal believed that an acquisition of the minority shares at a price greater than $21.00 per share would have been a good investment for Signal. DB 29.

In a further effort to add color to their argument that rescissory damages are appropriate, plaintiffs also argue that Bodenstein showed at the April, 1984 hearing that Signal could have "economically profited" if it had acquired the minority shares of UOP at any price up to $30 per share. PB 16. That argument does not withstand analysis. In his April, 1984 "Preliminary Analysis of PX-74" Bodenstein expanded a chart which was contained in the Arledge-Chitiea report (PX-74) so that the range of purchase prices went from $18 to $35 per share rather than $18 to $24 per share. PX-120, App., Appendix C, Ex. C. That expanded chart shows that if Signal had acquired the minority shares of UOP on January 1, 1978 for $30 per share, Signal would have had additional income of $4 million in 1978. Put another way, if Signal had invested $170 million (5,688,302 minority shares times $30 per share) on January 1, 1978, it would have earned $4 million in 1978 on that investment, or a return of about 2%. That hardly represents "economic profitability" for a major industrial corporation. At any rate, Bodenstein testified at the April, 1984 hearing that he did not use, nor did he need, the Arledge-Chitiea report in evaluating the fairness of the $21 merger price. As Bodenstein explained, what a buyer may be willing to pay for an asset and what the fair value of that asset may be are "two different universes." April, 1984 TR, Vol. II, 191.

The evidence is clear that Signal and its directors and officers did not intentionally or maliciously deprive the minority shareholders of UOP of any material information concerning the merger. Even plaintiffs' expert conceded that the Arledge-Chitiea report was not material to a determination of the value of UOP's minority shares. This case does not involve "conscious wrongdoing" such as the court found in Myzel v. Fields, 8th Cir., 386 F.2d 718, 735 (1967), cert. denied 390 U.S. 951 (1968), to justify an award of rescissory damages. See also, Garnatz v. Stifel, Nicolaus & Co., Inc., 8th Cir., 559 F.2d 1357, 1361 (1977) ("plaintiff's losses were natural, proximate, and foreseeable consequences of defendants' fraud"), and the cases cited at DB 37. While defendants recognize that the Supreme Court's conclusions may well be the law of the case with respect to the fairness of the procedure, we submit that this Court can and should consider the unrebutted evidence presented at the April, 1984 hearing in determining whether rescissory damages are appropriate.

Seeking to justify an exception to the general rule that rescissory damages must be determined as of the date of judgment (DB 27-28), plaintiffs state that "defendants delayed the damages trial for more than a year," and they imply that

Signal's activities in 1983 were related to this litigation. PB 31. In the first place, this Court granted defendants' motion for a preliminary hearing and to stay discovery in a letter opinion dated April 12, 1983. The delay between that date and the April, 1984 hearing was occasioned by this Court's tremendous workload, not by the defendants. Secondly, the merger of Signal and Wheelabrator-Frye on February 1, 1983, the same day of the Supreme Court's opinion, was not related to this case. Obviously, it takes many months to to prepare for and accomplish a merger of two major corporations. Thirdly, UOP's 1983 losses and reserves had to be taken in 1983 in accordance with generally accepted accounting principles, and there is absolutely no relationship between those losses and reserves and this litigation. June, 1984 TR, Vol, II, 12. Finally, the redeploying of assets, divestitures, consolidations, discontinuances and general corporate restructuring which occurred at Signal in 1983 after the merger of Signal and Wheelabrator-Frye resulted from business decisions (PDX-7, p. 2), most of which were made in April and May, 1983. Accordingly, their economic impact would have to have been considered even if the damages trial had been held a year earlier.

Despite the unrebutted evidence to the contrary, plaintiffs also assert that "UOP still exists as a very profitable company with seven operating divisions." PB 40-41. The facts are that in the fall of 1983, the various operating management responsibilities of UOP's divisions were restructured and reassigned within Signal, and as of January 1, 1984, UOP discontinued the practice of maintaining separate consolidated books and records. June, 1984 TR, Vol. I, 66, 88-89. Thus, UOP no longer exists as a separate entity as it did prior to January 1, 1984, either operationally or on a financial reporting basis. June, 1984 TR, Vol. I, 110-114. Contrary to plaintiffs' suggestion (PB 42), there is simply no evidence which this Court could consider to establish a value for UOP after December 31, 1983.

5. The Plaintiffs Suffered No Damages Even Under A Rescissory Evaluation

Defendants showed in their opening brief that even if a rescissory evaluation were appropriate and susceptible of proof, such an evaluation shows that the minority shareholders of UOP suffered no damages. DB 49-53. Plaintiffs, on the other hand, would have the Court disregard UOP's actual 1983 results, give some unspecified weight to entirely unproven and inappropriate asset values, and ignore completely the conclusions reached by Purcell as to the hypothetical market value of UOP's minority shares as of December 31, 1983.

At pages 45 through 47 of their brief plaintiffs point to PDX-27, which is a report concerning UOP presented to Signal's Board on April 25, 1983. That report revised UOP's projected operating earnings for 1983 from $46 million to $39 million before reserves, and then set forth various reserves which had to be charged against UOP and its divisions. After discussing three pages from PDX-27, plaintiffs state: "The importance of the above is that it shows that (1) Signal in April 1983 continued to focus on UOP earnings... and (2) that neither the 'Major Reserves' nor 'Major Merger-Related Expenses' were charged against UOP's operating earnings..." PB 47. Obviously, Signal continued to be interested in UOP's performance, even though UOP was projecting a substantial loss for 1983. However, plaintiffs' statement that the reserves reflected in PDX-27 were not charged against net income is incorrect. Page 4 of PDX-27 shows a "Total Pretax" figure of $98 million and a "Total, Net" figure of $65 million for major reserves. Similarly, page 5 of PDX-27 shows a "Pretax Expense" figure of $38 million and a "Net Expense" figure of $25 million for major merger-related expenses. The fact that the reserves are shown on a pretax and net basis shows that they must be charged against net income. Thus, the net after tax effect was a charge of $90 million ($65 million plus $25 million) against the revised earnings shown on page 3 of PDX-27, resulting in a projected net loss for 1983 of $51 million. As we have shown, UOP actually sustained losses of more than $80 million in 1983. Those losses were real and had to be taken in 1983.

Plaintiffs' reference (PB 53, fn.) to UOP's patents and real estate holdings as "undervalued assets" is frivolous. Purcell explained at the 1980 trial that the value of the patents was reflected in the income statement and that they were carried on the balance sheet in accordance with generally accepted accounting principles. 1980 TR, 1130-1133; DX-40, pp. 15-17. Moreover, Corirossi testified at the June, 1984 trial that the real estate holdings were being operated at their highest and best use and that the value of such holdings was reflected in UOP's income statements. June, 1984 TR, Vol. I, pp. 98-106. Plaintiffs' suggestion (PB 42, 53, fn.) that "UOP was in effect liquidated" is also wrong. As the unrebutted testimony at the June, 1984 trial proved, the former operating divisions of UOP which were not closed were reorganized within Signal. They were not sold. DB 34-35.

Plaintiffs claim that Dillon Read's rescissory evaluation is flawed because no premium was added to the hypothetical market value of the minority shares as of December 31, 1983. PB 62-64, 66-68. That makes no sense. Apparently recognizing that the $21.00 merger price was fair, plaintiffs elected to seek rescissory damages. That is, plaintiffs want the hypothetical value of their shares as of the date of judgment. If that value can be determined at all, it is the hypothetical market price of the shares as of December 31, 1983. Plaintiffs are not entitled to a premium on that hypothetical price based on some hypothetical merger or acquisition. See generally, DB 47-48.

Plaintiffs also criticize Purcell for eliminating companies with depressed earnings in calculating price/earnings ratios. PB 64-66. However, Purcell explained that he eliminated from his price/earnings ratio calculations those companies whose earnings had declined by 25% or more from the prior year so that the ratios would not be distorted. June, 1984 TR, Vol. II, 197, 206, 222-223. By way of contrast, Bodenstein included in his list of "comparable companies," a company with a price/earnings ratio of 147:1. PDX-120, App., Table N.

Finally, plaintiffs urge that interest should have been added to the dividends which Dillon Read calculated that plaintiffs would have received if no merger had taken place. PB 66. However, that would have resulted in a compounding of dividends. Because Dillon Read did not compound the imputed return on the $21.00 per share which the minority shareholders received in May, 1978, the dividends were treated consistently on a non-compounded basis. DDX-13, pp. 17-18.

We have already shown that Bodenstein's reports and testimony should be given little, if any, weight by this Court. DB 9-22, 39-49. We will not repeat that analysis here. Suffice it to say that Purcell considered the relevant factors and properly concluded that UOP's minority shareholders received a fair price for their shares in 1978, and that even on a rescissory evaluation they suffered no damages.

CONCLUSION

In their conclusion, plaintiffs' attorneys present a chart (PB 79) which purports to show "damages" under various scenarios. That chart is as contrived as were Bodenstein's "analyses" pursuant to which he created financial data unrelated to actual performance and actual data. For example, the chart of plaintiffs' attorneys suggests that Arledge and Chitiea believed that the "1978 fair market value" of UOP's minority shares was $24.00 per share. That is a gross distortion of the record. See DB 29-30. Similarly, in their chart plaintiffs' attorneys arbitrarily and without justification add a premium to Purcell's rescissory evaluation of UOP's minority shares as of December 31, 1982 and 1983. PB 79, note (2). As we have shown, there is no basis for adding a hypothetical premium based on a hypothetical merger to the hypothetical market price of the minority shares as of December 31, 1983. In short, we submit that this Court should disregard plaintiffs' attorneys' chart because it is not based on the record, is self-serving, and finds support only on Bodenstein's discredited reports and testimony.

For the reasons stated in this and our opening brief, defendant's respectfully submit that judgment should be entered in their favor.

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Dated: August 24, 1984

CERTIFICATE OF SERVICE

This is to certify that the foregoing "Defendants' Answering Brief After the Damages Trial" was served this 24th day of August, 1984, by hand-delivering copies of the aforesaid document to:

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