301 F. Supp. 706 (1969) | Cited 0 times | N.D. Illinois | February 27, 1969

MEMORANDUM OPINION

Goodrich-Gulf Chemicals, Inc. ("Chemicals") is a joint ventureof B.F. Goodrich Company and Gulf Oil Corporation, each partnerhaving 50% of its stock. During 1965 Goodrich and Gulf seriouslyconsidered having one company buy out the other, but they couldnot agree on the price. On January 20, 1969, however, NorthwestIndustries announced its intention to make a tender offer forGoodrich and Gulf then reconsidered the further negotiationsmight be profitable, Goodrich and Gulf then reconsidered thevalue of a one-half interest in Chemicals. After a single day ofnegotiations, Goodrich agreed to exchange $35 million of itscommon stock for Gulf's share. The next day the purchase wasapproved by Goodrich's board of directors.

When Northwest discovered that Goodrich would finance thetransaction by issuing 700,000 shares of common stock, itinstituted the instant suit, claiming that the consideration wasgrossly inflated in order to guarantee that a substantial blockof stock would be held by interests friendly to Goodrich'spresent management. On February 14, 1969 this court issued arestraining order temporarily prohibiting the listing or deliveryof the stock. A lengthy hearing has now been concluded, at whichthe major officers of Goodrich, Gulf and Northwest testified.Since the plaintiff has failed to demonstrate any likelihood ofsuccess at the full trial, I deny its request for a preliminaryinjunction.

After describing the background of the parties' dispute, thisopinion will analyze Northwest's three principal allegations ofwrongdoing. The half interest in Chemicals will then be valued.Finally, in light of the discretion allowed in the making ofcorporate business judgments, I will specify why Northwestappears unable to prevail.

I. Background

Since October 1968 Northwest has been studying Goodrich indepth with a view to a possible tender offer. On December 23,1968, Northwest's president was authorized by the ExecutiveCommittee to acquire a 350,000 share investment position, to bepurchased at a price averaging not over $50 per share.[1] TheNorthwest press release which announced the tender offerspecified that Goodrich stockholders would receive a newNorthwest debenture, a fractional share of its common stock, anda warrant to purchase a fractional share of common. The proposedexchange offer was valued by an independent analyst at $77.65 perGoodrich share, in contrast to a closing price of $56.75 on thebusiness day immediately preceding the announcement.

Goodrich-Gulf Chemicals, Inc. was formed in 1952 to producesynthetic rubber and to engage in technical research. A majordomestic supplier of synthetic rubber, it manufactures increasingamounts of polybutadiene and polyisoprene. Most of its productionis sold directly to Goodrich, and its feed stock has beensupplied by Gulf.

By the early 1960's it became apparent to both Gulf andGoodrich that Chemicals could be more effectively utilized byeither of the parent companies than as a supplier to bothorganizations. Each partner analyzed the assets, earningpotential, and technological advantages of the subsidiary.Extensive purchase negotiations were held during the summer of1965, but Goodrich was unwilling to part with its interest. Gulf,on the other hand, would not sell its half for less than $45million.[2] Goodrich initially offered $30 million, later $35million, and finally $40 million, but refused to rise above thelatter figure. Consequently, negotiations were terminated in 1965and remained dormant until very recently.

Triggered by Northwest's announcement of a tender offer, talkswere resumed in late January and early February 1969. AfterGoodrich prepared a memorandum which valued a half interest inChemicals at approximately $31 million, it received a telephonecall from Gulf's president on January 30, suggesting thatnegotiations be reopened. On February 5 officers of Goodrich andGulf bargained most of the day,[3] finally agreeing upon a $35million tax free exchange.[4] Due to Northwest's takeover attempt,Goodrich common stock was then priced abnormally high.Discounting this temporary fluctuation, the parties agreed thata realistic value, based on past market performance, was $50.00per common share.[5]

Special meetings of the Goodrich board of directors were heldon January 30, 1969 and on February 6, 1969, the latterostensibly called to fix a record date for the annual meeting. Atthe February 6 meeting, which occurred the day after thenegotiations with Gulf, Goodrich officers presented a hastilyprepared two page memorandum and a one page statistical analysisof the transaction.[6] Management recommended that the board ofdirectors approve the purchase. The entire consideration andapproval of the multimillion dollar transaction consumed only thefirst hour of the directors' luncheon meeting.

II. Northwest's Allegations

Suing as a minority stockholder and derivatively on behalf ofGoodrich Company, plaintiff maintains that the proposed purchasewill dilute the shareholders' voting rights, will impair pershare earnings, and will diminish the value of each share ofGoodrich common stock.[7]

Two of these allegations are clearly meritless. First, theundisputed evidence demonstrates that, rather than reducingGoodrich's earnings per share, the acquisition will result in asubstantially enlarged cash flow from Chemicals, thus increasingexpected 1969 earnings by fifteen cents per share. Second, inlight of § 622(e)(1) of the New York Business Corporation Law,McKinney's Consol.Laws, c.

4, Northwest's objection to thedilution of its voting strength is without legal foundation. Thatsection provides:

"(e) Unless otherwise provided in the certificate of incorporation, shares * * * offered for sale * * * shall not be subject to preemptive rights if they: (1) Are to be issued by the board * * * for consideration other than cash."

Since the half interest which is being acquired constitutesconsideration other than cash, Goodrich's shareholders cannotprotest the diminution of their voting power.[8]

III. Valuation of Chemicals

Plaintiff's final claim is that corporate assets are beingwasted by the desire of the officers and directors to retainoffice. The issuance of the 700,000 authorized shares willallegedly decrease the value per share of the outstanding stock.On the other hand, if $35 million is a fair price, per sharevalue will be unaffected because the company will receive as muchas it delivers.

Due to the 50%-50% joint ownership of Chemicals, a halfinterest in that company can realistically be sold only toGoodrich or to Gulf. Lacking a market to value Chemicals, theofficers and directors of the respective companies must use theirbusiness judgment to establish the proper price. The detailedstudies and financial data assembled for the 1965 negotiations,and recently updated, provided ample support for Gulf to concludethat its interest was worth at least $45 million in 1965 and noless than $35 million in 1969.[9] The 1965 bargaining was at armslength, establishing a value then between $40 million and $45million. While the subsequent drop in earnings somewhat reducedthe subsidiary's value, $35 million appears to be a fair price atthe present time. Approximately fifteen times the projectedannual earnings for 1969-1971, that figure is substantially lessthan the $50 million valuation provided by Chemicals' chiefexecutive officer.[10]

Furthermore, Chemicals is particularly valuable to Goodrichbecause consolidation of the two companies' activities willresult in considerable cost savings, including economies ofpersonnel and plant. Goodrich will also obtain a source for itspeculiar research requirements and raw material needs, some ofwhich cannot be satisfied in the open market.

Although Northwest complains that Goodrich is paying more thantwice the net worth for its acquisition, plaintiff's announcedtender offer purports to offer an even larger multiple forGoodrich's net worth. Since the takeover attempt is essentiallyan offer to purchase Goodrich's assets, including the latter'shalf interest in Chemicals, Northwest has bid even more than $35million for 50% of Chemicals.

IV. Preliminary Injunction

To obtain a preliminary injunction, the moving party must (1)establish a reasonable probability that it will prevail on themerits, (2) demonstrate that irreparable injury will occur toitself if the injunction is not granted, (3) show that otherswill not suffer serious adverse effects, and (4) have no adequateremedy at law. See, e.g., Virginia Petroleum Jobbers Ass'n v.Federal Power Comm'n, 104 U.S.App.D.C. 106, 259 F.2d 921, 925(1958); Doeskin Products, Inc. v. United Paper Co., 195 F.2d 356,358-359 (7th Cir. 1952); Yakus v. United States, 321 U.S. 414,440, 64 S.Ct. 660, 88 L.Ed. 834 (1944). Moreover, as stated inParsons College v. North CentralAss'n of Colleges and Secondary Schools, 271 F. Supp. 65, 69(N.D.Ill. 1967):

"Even the greatest harm * * * will not support the issuance of a preliminary injunction if the defendant has committed no legal or equitable wrong."

The latter three of the four preceding criteria are probablynot satisfied. Any possible irreparable harm to Northwest isoutweighed by the adverse effect an injunction would have uponGulf, an innocent third party seller. In Corica v. Ragen,140 F.2d 496, 499 (7th Cir. 1944), the Seventh Circuit explainedthat:

"A court of equity must exercise its discretion in such manner as to safeguard the interests of both parties, and, in certain circumstances, such as those in the instant case, it is an abuse of judicial discretion to issue an injunction which permits one party to obtain an advantage by acting, while the hands of the adverse party are tied by the writ."

Gulf was not involved in any impropriety nor did it know of anywrongdoing. Accordingly, it should neither be denied the propertyfor which it has bargained nor deprived of the right to vote thestock received as consideration. Gulf is at least entitled toequal rights with Northwest in the struggle for stockholdercontrol. See, e.g., Wildes v. Rural Homestead Co., 54 N.J. Eq. 668,35 A. 896 (1896); Luther v. C.J. Luther Co., 118 Wis. 112,94 N.W. 69 (1903); Restatement (Second), Agency §§ 161 and 165.

Moreover, since the New York statute unequivocably deniesNorthwest preemptive rights in the 700,000 shares, the plaintiffcan only complain that its shares are diminished in economicvalue. This injury may be redressed in a court of law by a damageaward.

Disregarding the foregoing obstacles to plaintiff's recovery,however, Northwest is not entitled to a preliminary injunctionbecause it has shown no chance of prevailing at a trial on themerits. See, e.g., Unicon Management Corp. v. Koppers Company,366 F.2d 199, 204 (2nd Cir. 1966), where the Second Circuitstated:

"We reaffirm our holding in H.E. Fletcher Co. v. Rock of Ages Corp., 326 F.2d 13, 17 (2 Cir. 1963), that the party seeking a preliminary injunction has a `burden of convincing [the court] "with reasonable certainty" that it "must succeed at final hearing." Hall Signal Co. v. General Ry. Signal Co., 153 F. 907, 908 (2 Cir. 1907)' * * *."

See also Selchow & Righter Co. v. Western Printing & L. Co.,112 F.2d 430 (7th Cir. 1940); Hamilton Watch Co. v. Benrus Watch Co.,206 F.2d 738, 740 (2nd Cir. 1953).

Specifically, the hopelessness of plaintiff's case results fromtwo mutually reinforcing facts. First, rather than constitutinga fraud on the defendant corporation, the $35 million acquisitionprice represents a fair value for Gulf's ownership ofChemicals.[11] Second, and equally significant, the Goodrichofficers' and directors' determination that the exchange was inthe best interests of the corporation is conclusive.

V. Defendants' Business Judgment

Since Goodrich is a New York corporation, the duties and powersof the officers and directors are governed by New York law.National Lock Co. v. Hogland, 101 F.2d 576, 587-588 (7th Cir.1939); 3 Fletcher, Corporations, § 990, n. 16 (1965).

In performing their duties, directors are held to a standard ofexercising honest business judgment, defined as the exercise ofthat care which businessmen of ordinary prudence use in managingtheir own affairs. Greenbaum v. American Metal Climax, Inc.,27 A.D.2d 225, 228. 278 N.Y.S.2d 123, 129-130 (1967); N.Y.BusinessCorporation Law§ 717. Because of the wide measure of discretion allowed officersand directors, mere differences of judgment are not sufficient towarrant equity intervention. Diston v. Loucks, Sup., 62 N.Y.S.2d138, 145 (1941), aff'd 264 App. Div. 758, 35 N.Y.S.2d 715 (1942).See also Chelrob, Inc. v. Barrett, 293 N.Y. 442, 57 N.E.2d 825,833 (1944). Rather, there must be proof of fraud or manifestlyoppressive conduct to set aside an action of the directors.Kalmanash v. Smith, 291 N.Y. 142, 51 N.E.2d 681, 687 (1943).

In the absence of fraud,[12] the judgment of the board ofdirectors of Goodrich as to the value of the considerationreceived for the 700,000 shares is conclusive. N.Y.BusinessCorporation Law § 504(a). That section declares:

"In the absence of fraud in the transaction, the judgment of the board or shareholders, as the case may be, as to the value of the consideration received for shares shall be conclusive."

More specifically, while Northwest's January 20 announcementprompted the purchase, such a catalyst does not invalidate thetransaction if the exchange was in the best interests ofGoodrich. As stated in Cummings v. United Artists TheatreCircuit, Inc., 237 Md. 1, 204 A.2d 795, 805-806 (1964):

"Thus the cases relied on by the appellants [Northwest] do not support their contention that where a board of directors has as one of its motives manipulation for control the transaction is invalid, regardless of fairness, and regardless of whether a legitimate corporate purpose is also being served. * * *

"Therefore we hold that where a good corporate purpose is being furthered and is the principal motivation for an action by a board of directors, the fact that the consummation of such transaction may have some effect on the control of the corporation is immaterial and the agreement will stand or fall depending on whether it is fair to the corporation."

VI. Conclusion

Northwest's tender offer announcement galvanized Goodrich andGulf to complete the purchase at this time. Although the officersof both Goodrich and Gulf claim there was no mutual agreement todefeat plaintiff's takeover bid, there was a remarkable empathybetween the companies. On the other hand, Northwest appearsunable to establish that Goodrich officials' desire to remain inoffice was the sole or the primary motivation for theirdecisions.

Plaintiff has not shown any likelihood that it can prove thatthe transaction amounts to fraud. Considering all factors ofvalue, the persuasive evidence indicates that $35 million is afair price for Gulf's one half of Chemicals. Goodrich's officersand directors appear to have been exercising their honestbusiness judgment, so that their decision is conclusive.

Furthermore, whenever a tender offer is extended and themanagement of the threatened company resists, the officers anddirectors may be accused of trying to preserve their jobs at theexpense of the corporation. The alleged conflict of interest wascreated by Northwest, not by Goodrich. Yet, management has theresponsibility to oppose offers which, in its best judgment, aredetrimental to the company or its stockholders. In arriving atsuch a judgment, management should be scrupulously fair inconsidering the merits of any proposal submitted to itsstockholders. The officers' and directors' informed opinionshould result from that strict impartiality which is required bytheir fiduciaryduties. After taking these steps, the company may then take anystep not forbidden by law to counter the attempted capture.

Although the haste displayed by Goodrich officials casts somedoubt on the management's actions, I find no violation of thepreceding principles of sufficient magnitude to warrant judicialinterference. The instant economic struggle should be resolved inthe market place and by the stockholders at their meeting, not inthe courts. Accordingly, I have entered an order today denyingplaintiff's motion for a preliminary injunction. The order shallbe effective nunc pro tunc as of February 25, 1969, so thatGulf's newly acquired shares will qualify to vote at theforthcoming annual meeting.

1. Starting to buy common stock in December, Northwest owned about500,000 Goodrich common shares when the action was filed. It nowowns approximately 700,000 shares which have an aggregate marketvalue of roughly $40 million.

2. Gulf was also willing to buy Goodrich's share for this price.

3. While Gulf's officers had updated their 1965 studies ofChemicals, the only Goodrich documents were a brief,

handwrittenmemorandum of possible valuations of Gulf's one-half interest anda sheet of paper containing longhand calculations.

4. Due to potential capital gains taxation on Goodrich's payment,an equivalent cash transaction would have approached $60 million.

5. During the last six months of 1968, the stock was tradedexclusively in the $40's.

6. Though the Goodrich management had available all past studiesand financial analyses of Chemicals, the board of directorsreceived no advance information concerning the acquisition.

7. In addition, Northwest objects to the following directors'actions: (1) advancement of the record date and the time of the1969 annual shareholders' meeting, and (2) numerous proposedchanges in Goodrich's bylaws and articles of incorporation whichwill significantly restrict the shareholders' control of thecorporation. These two changes, however, may not be attacked incourt because they are both within the powers of the board ofdirectors. Under New York law, the first is not subject toshareholder control; the second will be presented at theforthcoming shareholders' meeting by management for approval.

8. If Gulf had agreed to Goodrich's 1965 offer of $40 million,Goodrich would have issued 1,035,000 common shares (adjusted fora three for two stock split). Thus, Northwest would have had toobtain a tender of substantially more shares than will benecessary after the instant purchase is consummated.

9. During 1967 and 1968 Chemicals experienced significant profitlosses, due partially to an extensive capital improvements plan.The future earning potential of the joint venture did not appearas encouraging in 1969 as it did during the 1965 negotiations.

10. Although Northwest's valuation witness testified that a halfinterest in the company was not worth more than $25 million, theexpert gave misleading testimony, spent barely two days on hisstudy, and overlooked several significant indices of value.

11. See part III supra.

12. No evidence of fraud or its equivalent has been proffered byplaintiff. Both Goodrich management and its board of directorspossessed detailed knowledge of Chemicals' operations. Thepositions of President and Chairman of the Board of Directors ofChemicals alternated between members of Gulf and Goodrich.Compare Heimann v. American Express Co., 53 Misc.2d 749, 279N YS.2d 867 (1967); Rous v. Carlisle, 14 N.Y.S.2d 498, 501-502(Sup. 1939).