# **UNREPORTED CASE: ROSENBLATT v. GETTY OIL CO., No. 5278., Court of Chancery of the State of Delaware, New Castle, September 19, 1983**

WINTER, 1984

**Reporter**

8 Del. J. Corp. L. 366 \*

**Length:** 14990 words

**Author:** BROWN, Chancellor

**Highlight**

In 1977 the Getty ***Oil*** Company (Getty) acquired all of the outstanding minority shares of Skelly ***Oil*** Company (Skelly) in which it had previously held a controlling interest. Under the terms of the merger, each share of Skelly was exchanged for .5875 of a share of Getty. Plaintiff, a former minority shareholder of Skelly, filed this class action charging that the exchange ratio agreed upon by the boards of directors was unfair.

Characerizing the plaintiff's suit as "marginal at best," the court of chancery, per Chancellor Brown, found: (1) the burden of proving entire fairness to the minority shareholder rested upon Getty, as it stood on both sides of the transaction; (2) the evidence failed to support plaintiff's "radical proposition" that the negotiating personnel of Skelly and Getty were in error in proceeding on the premise that the future prospects of Getty were stronger than those of Skelly; (3) the board of directors of Skelly had not violated its statutory duties and thus there was no impropriety in the agreement entered into between the parties to have an independent engineering firm fix a fair market value on the subsurface assets of the companies based upon economic assumptions determined soley by the firm, and that there was no impropriety in using those values for the purpose of negotiating an overall exchange ratio; (4) the proxy statement was not false or misleading because it failed to relate the role of the engineering firm in absolute detail; (5) the plaintiff failed to introduce any evidence which seriously impugned the engineering firm's competence or the accuracy and fairness of the appraisal itself; and (6) a 26% dilution in earnings and an 8% dilution of dividends on a *pro forma* basis was insufficient to establish that the merger terms were unfair to the minority shareholders where Getty had established the entire fairness of the transaction. Finally, the court approved the approach taken by the parties in determining the valuation of their respective assets and noted that the final figures and the weight accorded to each, clearly favored Skelly. In conclusion, the court held that Getty did not abuse its position of control, and found both fair dealing and fair price in the transaction.

[1.] In mergers where the minority interest is not eliminated but where each minority share is exchanged for an interest in the surviving corporation, the minority shareholders are entitled to receive the substantial equivalent in value of what they had before the merger. This standard applies in determining whether the transaction was fair.

[2.] A majority shareholder who stands on both sides of a merger has the burden of proving the entire fairness of the transaction to the minority shareholders.

[3.] An energy corporation's board of directors does not violate its statutory obligation to manage corporate affairs when, as part of the process to establish an exchange ratio for minority shares during merger negotiations, both companies assign an engineering firm the task of valuing their respective subsurface assets. This is true even if both boards agree to be bound by those valuations, although one board did not agree to weigh a particular asset in a particular way, thereby committing itself to any particular exchange ratio. DEL. CODE ANN. tit. 8, § 141(a) (1975).

[4.] A corporate board of directors does not have an absolute duty to bargain at arms' length in establishing asset values during merger negotiations. The board may rely on an honest and independent appraisal.

[5.] The requirement of full disclosure does not mean that a proxy statement must satisfy unreasonable or absolute standards. The test is whether the facts are germane in the sense that they are those which a reasonable shareholder would consider important in deciding whether to vote for or against the terms of the merger that has been presented to him.

[6.] While evidence of post-merger events is normally inadmissible by a defendant or prove the fairness of its actions at the time of the merger, documentary evidence placed into the record by the plaintiff which supported defendant's position need not be ignored.

[7.] A dilution of dividends and earnings on a *pro forma* basis is insufficient to establish that the terms of the merger were unfair to minority-shareholders where the party standing on both sides of the transaction has come forward with evidence to establish the entire fairness of the transaction.

[8.] Courts in Delaware will continue to view favorably traditional valuation of corporate assets even though this method is now considered outmoded.

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Charles F. Richards, Jr., Esquire, Donald A. Bussard, Esquire, William J. Wade, Esquire, Samuel A. Nolen, Esquire, and Thomas A. Beck, Esquire, of Richards, Layton & Finger, Wilmington, DE for defendant.

**Text**

**[\*369]** This is a decision after trial in a class action suit which challenges the fairness of the terms of the 1977 merger entered into between Skelly ***Oil*** Company and Getty ***Oil*** Company, both Delaware corporations. As a result of that merger, Getty ***Oil*** Company (hereafter "Getty") acquired all outstanding minority shares of Skelly ***Oil*** Company (hereafter "Skelly"). The merger was accomplished by means of an exchange of Getty shares for Skelly shares, thus converting the minority public shareholders of Skelly into shareholders of Getty. On behalf of the class of the minority shareholders of Skelly plaintiff Rosenblatt, a former Skelly shareholder, charges that the exchange ratio agreed upon by the boards of directors of Skelly and Getty, and approved by an overwhelming number of those minority shareholders of Skelly who chose to vote, was unfair.

Immediately prior to the merger Getty owned directly 7.42% of Skelly's outstanding shares. However, Getty also owned 89.73% of the shares of Mission Corporation which, in turn, owned 72.6% of Skelly's shares. [[1]](#footnote-2)\* Thus, collectively, Getty controlled 80% of Skelly's outstanding shares as of the time of the merger as well as at the times referred to herein. By virtue of its ownership position Getty controlled the board of directors of Skelly as a result of nominating and electing a majority of Skelly's board. Thus, within the contemplation of Delaware corporation law Getty stood on both sides of the transaction during the negotiations that led up to the determination of the merger exchange ratio.

The exchange ratio that was finally agreed upon and approved was .5875. In other words, each minority share of Skelly was exchanged for .5875 of a share of Getty. Plaintiff contends that this was unfair to the Skelly minority in view of the respective financial condition and future prospects of the two corporations at the time. He charges that **[\*370]** Getty breached the fiduciary duty owed to Skelly's minority shareholders by imposing an unfair exchange ratio upon the class. Plaintiff asks the Court to find on the evidence that the exchange ration should have been one share of Getty for each share of Skelly or, at a very minimum, .75 of a share of Getty for each share of Skelly, and to enter judgment in favor of the class accordingly.

[1] The issue thus presented for decision in this case is the fairness of the exchange ratio to the Skelly minority. This was not a cash-out merger whereby the Skelly minority was eliminated. Rather, the members of the minority were continued on as shareholders in the surviving corporate enterprise. In this scenario they were entitled to receive in the form of Getty stock "the substantial equivalent in value of what [they] had before." Sterling v. Mayflower Hotel Corp., Del. Supr., 93 A.2d 107, 114 (1952). That is the test for fairness in a case such as this.

As to who bears the burden of proof on this issue of fairness the parties are in disagreement. However, their respective positions on this point cannot be properly analyzed without resort to the facts produced by the evidence. Thus it is necessary to turn to the relevant facts of the matter as I find them to be. In so doing, I naturally concede that I make no attempt to cover them all.

I

For many years prior to the merger Getty, directly and indirectly through Mission Corporation, owned a controlling interest in Skelly. During this period, however, J. Paul Getty individually owned and controlled more than a majority of the outstanding shares of Getty. For reasons of his own, J. Paul Getty was never in favor of a merger of Skelly and Getty even though it was recommended to him on more than one occasion by Getty personnel and even though such a move was favored by Getty's management. Mr. Getty felt that the continued separate operation of the companies would result in a greater discovery of ***oil*** and gas. Thus, so long as J. Paul Getty was the majority shareholder of Getty there was to be no merger. It is my distinct impression from the evidence that J. Paul Getty either made or gave the final approval as to all major policy decisions of his corporation.

On June 6, 1976, J. Paul Getty died. Approximately one month later, on July 12, 1976, Getty initiated merger discussions. This was accomplished by a telephone call from Harold Berg, then the President of Getty, to his counterpart James Hara, the President of Skelly. Hara was immediately receptive to the idea of a merger of the two companies and was in favor of pursuing it. Accordingly, on July 15, **[\*371]** 1976, a meeting was quickly convened in Dallas, Texas, between representatives of the two companies. Both Berg and Hara were in attendance and headed their respective delegations.

As a result of that meeting it was agreed by those present that a merger of the companies offered many advantages and that it should be pursued. It was further agreed that an exchange of stock would be the fairest and simplest way to proceed so as to afford the Skelly minority shareholders the opportunity to own a continuing interest in the larger and more viable corporation that would result from the merger. December 31, 1976, was fixed as the target date within which to have the merger accomplished. Press releases announcing that merger negotiations were being commenced were prepared and released. Stock exchanges were contacted and asked to suspend trading in Getty, Skelly and Mission shares pending an announcement.

At the July 15 meeting it became obvious immediately that the task of working out a proper exchange ratio would be one of monumental proportions. This was so because no exchange ratio based upon the value of the shares of the two corporations could be determined in the absence of a complete evaluation of both companies. More to the point, some agreement as to the overall valuation of both companies had to be reached before the parties could turn to the task of negotiating an exchange ratio. The magnitude of the undertaking can be illustrated by the following comparisons between the two companies.

Getty was organized originally under the laws of Delaware on November 10, 1928 under the name of Pacific Western ***Oil*** Corporation. Its name was changed to Getty ***Oil*** Company on April 25, 1956. Getty was, as of 1976, and remains today an integrated ***oil*** company operating principally within the United States and having various foreign interests.

Getty's lines of business as of 1976 included exploration and development of ***oil*** and gas lands and leases in the North American continent and overseas; the production, purchase and sale of crude ***oil***, natural gas and natural gas liquids; the transportation of crude ***oil*** and refined products by pipelines, tank ships, tank cars and automotive equipment; the refining of crude ***oil*** into various grades of gasoline, jet fuel, distillates, fuel ***oils***, and other petroleum products; the manufacture and sale of petrochemicals; and the distribution of refined petroleum products through wholesale and retail outlets in the eastern portion of the United States and in the Philippines. Getty also conducted mineral exploration and production programs in the North American continent and in Austrialia, including the milling and mining of uranium in Wyoming, and agricultural operations in Southern California and Liberia.

**[\*372]** Getty's assets as of the summer of 1976 included crude ***oil*** and natural gas reserves in Alaska, California, the Rocky Mountain region, the Gulf and mid-continent areas of the United States, Canada, Spain, and Saudi Arabia-Kuwait Partitioned Neutral Zone, Algeria, the United Kingdom sector of the North Sea and rights to crude ***oil*** production in Indonesia and Iran. It owned a crude ***oil*** refinery with petrochemical operations located at Delaware City, Delaware, a refinery in the Saudi Arabia-Kuwait Partitioned Neutral Zone, natural gasoline plants, ***oil*** and product pipelines, a fleet of foreign flag and domestic tankers, and other transportation facilities. Getty also owned marketing outlets in the estern portion of the United States and in the Philippines. In addition, Getty had mineral reserves in the United States, including uranium, coal, gold and copper reserves, and an interest in uranium and gold deposits in Australia. (The Australian uranium deposits are said to be the largest in the world.) As of June 30, 1976, Getty owned 50% of the common stock of Mitsubishi ***Oil*** Company, Limited, a Japanese corporation engaged in refining and marketing of petroleum products in Japan.

Skelly was incorporated on August 20, 1919 under the laws of Delaware. At the time of the merger, Skelly too was an integrated ***oil*** company engaged principally in the business of acquisition, exploration and development of ***oil*** and gas properties; the production, purchase, transportation and sale of crude ***oil***; the refining of crude ***oil*** at a refinery in El Dorado, Kansas; wholesale and retail marketing of refined petroleum products; the production, purchase and sale of natural gas; and the production, purchase, sale and distribution at wholesale and retail of liquefied petroleum gas. Skelly was also engaged either solely or as a participant with others in the manufacture and marketing of wood products, petrochemical and chemical operations, and the mining and milling of uranium. Skelly held interests in crude ***oil*** and natural gas reserves in Alaska, the Rocky Mountain region, the Gulf coast and mid-contenent areas of the United States, Canada, the Persian-Arabian Gulf (offshore Sharjah) and the United Kingdom sector of the North Sea.

As of the summer of 1976, Skelly owned 50% of the common stock of Vancouver Plywood Co., Inc., a Louisiana corporation engaged in the manufacture of wood products; a substantial interest in Yong-Nam Chemical Company, Ltd., a Korean corporation engaged in the manufacture of fetilizer in South Korea; and 50% of Osage Pipe Line Company and 10% of Texoma Pipeline Company, both Delaware corporations engaged in the transportation of crude ***oil***.

Because of the widespread activities and holdings of both corporations **[\*373]** it was decided that the valuation effort should be approached on a two-phased basis, that is to say, by first attempting to fix a total value for all surface assets of both companies and by thereafter turning to a valuation of the subsurface assets, such as ***oil*** and gas leases, mineral deposits, etc. With regard to the subsurface assets there was general agreement between the representatives of Getty and Skelly that the petroleum and engineering consulting firm of DeGolyer and MacNaughton should be involved in the valuation process.

The immediate decision to have both corporations utilize the services of DeGolyer and MacNaughton (hereafter "D & M") was attributable to several factors. For one, based upon the evidence presented in this case, D & M is said to be the largest consulting engineering firm for ***oil*** and gas type of work in the world. The firm has an international reputation for competence and integrity within the ***oil*** and gas industry. Its top echelon personnel have, and had at the time, vast experience in placing present values on ***oil*** and gas reserves. D & M had engineers, technicians and geologists who specialized in specific geographic and geological areas. Its library and resource capabilities are said to be second to none.

In addition, D & M had been routinely doing annual reserve studies for both Skelly and Getty for many years prior to 1976. Therefore, as of the summer of 1976, D & M already possessed all background and other necessary information on the ***oil***, gas and mineral holdings of both Skelly and Getty, and consequently, for the purpose of the merger negotiations, it was simply a matter of D & M bringing that information up to date. The ability of D & M to respond quickly to the needs of both corporations was therefore significant in view of the goal of the parties to complete the merger by December 31, 1976.

D & M was contacted by the parties on July 15, 1976, and agreed to accept the assignment. Specifically, D & M was asked to prepare updated estimates of the ***oil***, gas and mineral reserves of the constituent companies by October 1, 1976. It is to be noted that at this point, and indeed throughout the ensuing merger discussion until late October 1976, it was contemplated by the Getty and Skelly managements that D & M would do two things, namely: (1) estimate the quantities of the ***oil***, gas and mineral reserves of the two companies (as well as those of Mission, which were relatively insubstantial by comparison) and (2) prepare projections of the cash flow to be generated through future production of the reserves, discounted to present worth, based upon various alternative price schedules and discount factors to be supplied to D & M by the parties to the merger and their investment bankers. It was not contemplated by the parties at the time that D & M **[\*374]** would actually value the ***oil***, gas and mineral properties. The significance of this will appear hereafter.

As to the surface assets of the corporation, it was agreed that each side would independently prepare a compilation -- or book -- showing the valuation of all such assets of each corporation and the method or theory used in reaching each separate determination. It was further agreed that once this was accomplished the parties would exchange books, that each would review the various valuations claimed by the other, and that thereafter they would negotiate any differences of opinion so as to arrive at an arm's length bargaining figure representing the agreed-upon value of the surface assets of each company for the purpose of thereafter negotiating and agreeing upon the exchange ratio to be employed in the merger. Initially, it was contemplated that the same bargaining procedure would be utilized to arrive at a valuation of the subsurface assets once the quantitative estimates and the various present worth of the reserves projections were completed and furnished by D & M.

For the purpose of assisting it in the negotiation of the merger terms Getty retained the investment banking firm of Blyth, Eastman Dillon & Co. (hereafter "BEDCO"). After an interview and selection process, Skelly retained Smith Barney, Harris Upham & Co. (hereafter "SBHU") as its investment banker. Following the meeting of July 15, 1976, the Getty and Skelly sides organized their respective teams to work on the merger evaluation and negotiations during the following months.

At Skelly, some 200 people became involved in the project, including as many as 75 personnel on a full-time basis. A senior negotiating team was formed consisting of Hara, Skelly's president, Robert N. Miller, Skelly's executive vice president, and Harold C. Stuart, an outside director representing the Skelly minority interests. At the time, Mr. Stuart, the son-in-law of the late William Skelly, the founder of the company, owned more than 120,000 shares of Skelly having a then market value in excess of $ 13.5 million. SBHU assigned six professionals to the project, including four of its more senior people who collectively had some 75 years of experience in investment banking in addition to extensive experience in ***oil*** and gas related matters.

At Getty, 50 department coordinators were assigned to the merger project and several hundred other personnel became involved in the evaluation effort. BEDCO assigned seven of its professionals to work on the project, including two who had extensive experience in transactions involving ***oil*** and gas companies. Robert J. Menzie, manager **[\*375]** of corporate financial planning at Getty, was assigned the task of coordinating the effort. D & M also organized its personnel for the assignment, involving some 100 employees. This number included 45 professionals who averaged more than 25 years experience in the ***oil*** and gas industry.

During August and most of September the Getty and Skelly teams prepared evaluations of their own respective surface assets. It is significant, however, that the two sides took different approaches in so doing. Getty was aware of its responsibilities under Delaware law as majority shareholder of Skelly. Also, a memorandum of law had been provided to both sides at the outset dealing with the formula and procedures developed by Delaware case law over the years with regard to placing values on corporate stock. Because of certain minority shareholder activity, Getty was reasonably sure that shareholder litigation would follow the merger in the event that it was completed. As a result it was the objective of the Getty team to arrive at asset values and an exchange ratio that would be fair to the shareholders of both companies and which would withstand scrutiny by the courts.

The Skelly people, however, being unrestrained by any such legal standard, took an entirely different approach. From the outset it was their objective to value each and every asset in such a way as to gain maximum advantage for Skelly. Stated generally, they undertook to value all surface assets in every was possible, i.e., by depreciated value, by a capitalization of earnings, by replacement value, by book value, etc. and to use in each case the result that best favored Skelly when compared against comparable assets of Getty, regardless of the comparative logic or justification of the position taken.

Overall, it was the game plan of Skelly to maximize the surface asset values (since Skelly had a higher proportion of surface assets than Getty); to minimize the ***oil***, gas and mineral values (since Getty had a far higher proportion of subsurface assets than did Skelly); to emphasize current earnings (since 1976 Skelly was experiencing record earnings); and to minimize any considerations of the market price of Getty and Skelly stock (since the Getty shares were trading at a far higher price immediately prio to the merger announcement). This approach by Skelly was not disclosed to Getty during the valuation preparations.

While the parties were engaged in preparing their surface asset valuations other members of their teams were directing their energies to the subsurface assets. The quantity of such assets held by each corporation posed no major problem. However, the effort to develop economic parameters for valuing the ***oil***, gas and mineral reserves, **[\*376]** i.e., future prices, future production costs, the discount factors to be applied to reduce assets in different geographical and political areas to present worth, etc. proved to be another matter. Members of the Getty and Skelly teams met on numerous occasions over a two-month period in an unsuccessful effort to work out some resolution of these matters. Many of the discussions involved D & M personnel.

Consistent with its overall strategy, Skelly advocated using as low a price schedule as possible for the future production value of the reserves (again, Since Getty had for more reserves than Skelly the lower the value placed on the reserves of both companies the better Skelly's position would appear in a ratio of assets between the companies). Skelly took this position even though its own internal view and that of SBHU was that future ***oil*** and gas prices were likely to rise rapidly. Getty, on the other hand, argued for a substantially higher price schedule.

As a result of these differences between the two sides, D & M, at the request of the parties and with their informational input, prepared several different computer runs -- or economic cases -- applicable to all reserves of both companies. These computer runs were known as the Base Case, Base Case A, Base Case B, Case II, Case III and Case IV. The Base Case generally reflected then current prices, costs and conditions. The other cases applied different pricing, cost and discount factors suggested by the parties based upon their respective positions and viewpoints. By mid-October it became apparent that the parties might not be able to reconcile their various disagreements over the manner of valuing the subsurface assets. Each side began to consider the possibility of having D & M arbitrate the matter. The likelihood of an impasse concerning the subsurface assets was fortified by that which happened during the interim with regard to the surface assets.

By September 29, 1976 each company had completed its "book" on its surface assets. On that date, in Los Angeles, the two sides met and exchanged their asset books. The Getty People were staggered upon discovering the approach that Skelly had taken. In fact, some members of the Getty team were of the opinion that there was no way to continue the merger based on Skelly's surface asset book.

Nonetheless the two sides pressed onward and thereafter, over the next month, they engaged in what was described by Mr. Miller of Skelly's senior negotiating team, as "the toughest negotiations that I have ever been in in the years that I have been in the business." In this regard I think it is appropriate to note here that even though Getty had been the parent company of Skelly for many years, the fact that the two companies operated independently of each other in **[\*377]** the same competitive industry is said to have produced a continuing atmosphere of rivalry between the managerial personnel of the two companies. It is perhaps this element of individual and company pride that formed the core of the many heated negotiating sessions that were referred to in the testimony. (Perhaps this also had something to do with the decision of J. Paul Getty to keep the companies separate.)

In any event, final surface asset values were eventually agreed to by late October 1976. From the evidence, there appears no doubt but that Skelly got the better of this aspect of the matter. Even the plaintiff does not seriously dispute this. While he takes issue with a few of the values placed on various Getty assets, I take note, as Getty points out, that he makes no claim that any of Skelly's surface assets were undervalued.

An illustration of Skelly's domination in the surface asset negotiations is the success that it achieved in having many of its surface assets valued on the basis of a multiple of earnings when compared with the surface assets of Getty that were valued on the same basis. For purposes of the merger Skelly's property, plant and equipment assets were valued at $ 949,823,000. Of that total, $ 511,810,000 (or 53.9%) was based on multiple of earnings valuations of the petrochemical portion of its refinery, its natural gas liquid (NGL) plants, its chemical subsidiaries and the Osage and Texoma pipelines. By contrast, Getty's property, plant and equipment assets were valued at $ 705,215,000. Of that total, $ 33,530,000 (or 4.75%) was based on multiple of earnings valuations of the petrochemical potion of its refinery, its NGL plants and three small pipeline systems. This was in keeping with Skelly's objective of maximizing and taking advantage of the current record earnings that it was achieving in 1976.

The Getty people were not happy with the results of the surface asset comparisons and evaluations. But in view of the time constraints imposed by the merger deadline and the effort that had already been expended, there came a point when they they finally forced to concede that they had done about as well as they were going to do. As stated by Mr. Menzie, Getty's coordinator:

"[I]t was simply that we had negotiated almost non-stop for the better part of a month, and they were heated and long negotiations. And we got to the point where Skelly would not come down any further, and they wouldn't raise ours any higher."

By October 27, 1976, the parties reached agreement on the value of the surface assets of both companies that were to be used for the purpose of establishing the merger ratio.

**[\*378]** During the few days immediately preceding October 27 the two sides had also met with D & M in a final effort to resolve which of the several economic cases prepared by D & M should be used to value the ***oil***, gas and mineral reserves of the two companies. However, they were unable to reach agreement and it became apparent that this aspect of the valuation process could not be completed within any reasonable time frame -- if at all -- so long as things continued as they were. Accordingly, on October 27, 1976, both sides agreed that the only sensible thing to do was to turn the matter over to D & M and allow D & M independently to value the ***oil***, gas and mineral reserves.

D & M agreed to undertake this assignment. However, D & M agreed to do so only on the express condition that it would not disclose and Getty and Skelly would not inquire about the economic assumptions and methodology used by D & M in arriving at the valuation figures. Getty and Skelly acquiesced in this condition, the basis for which was the standing practice of D & M to protect its confidential processes and business reasonings from public disclosure to others when making appraisals of ***oil*** and gas properties. Subject to this informal understanding. Getty, Skelly and Mission executed a written agreement on October 27, 1976, in which they agreed that:

". . . the determination by D & M of prices, costs and discount factors to be applied shall be final and binding on each Constituent Corporation and that the evaluation of the ***oil*** and gas and mineral reserves of each Constituent Corporation as determined by D & M shall be final and accepted by each of the Constituent Corporations."

D & M immediately selected a Fair Market Value Committee from among the members of its senior management. This was D & M's normal procedure whenever it was asked to establish a fair market value for ***oil*** and gas properties. The committee was composed of seven members of D & M's senior management who averaged 36 years experience per person in the business of petroleum engineering. The committee immediately engaged in its task, which was culminated by a final computer run -- or economic use -- using the factors determined to be appropriate by D & M for arriving at a fair market value under the existing circumstances. This run was known as Case V. [[2]](#footnote-3)\* On **[\*379]** October 29, 1976, D & M delivered its opinion to the parties estimating the fair market value of the ***oil***, gas and mineral reserves.

With agreement having been reached on the surface assets, and with D & M having provided the values for the ***oil***, gas and mineral reserves, the asset values to be used for the merger were thus determined. The parties then turned their attention to negotiating a merger exchange ratio.

From the outset the parties had approached this task with the idea of establishing subratios based upon a comparison of the asset, market and earnings values between Skelly and Getty. These subratios were then to be weighted as part of the negotiating process so as to arrive at the ultimate exchange ratio. This was in keeping with practice long-established by Delaware case law in stock appraisal proceedings to determine a per share market value, asset value and earnings value for the corporation in question and then to weight these values according to the circumstances of the particular case so as to arrive at a per share appraisal value for the stock.

A comparison of the combined surface and subsurface asset values of the two corporations revealed a ratio of .525. For market value, the two-month period prior to the death of J. Paul Getty was used. This was thought to be appropriate because the news of his death gave rise in the marketplace to immediate speculation that a merger between Getty and Skelly would be imminent, thus having a distorting effect on the market price of the stocks of the two companies. On this basis, the market subratio became .427.

As ultimately utilized the earnings ratio was based upon a three-year weighted average of the earnings for the two companies for the years 1974 through 1976 (annualized). In other words a 3x weight was given to the annualized 1976 earnings, a 2x weight was given to 1975 earnings and a 1x weight to 1974 earnings. Achieving this computation again worked to Skelly's advantage since it was experiencing a record earnings year in 1976. Prior to that its highest record earnings had been in 1974. The subration derived from this approach was .667.

For the purpose of negotiating the final exchange ratio the negotiating teams of Getty and Skelly met at Skelly's offices in Tulsa, Oklahoma, on November 1, 1976. Getty came into this meeting believing that a fair exchange ratio would be in the range of .48 to .55. From the Skelly side, its negotiators did not feel realistically that there was any chance to obtain an exchange ratio as high as .7. A key member of its negotiating team projected a ratio of only .6 on a "best case" basis. SBHU, based upon its analysis of the transaction, was prepared **[\*380]** to give an opinion as to the fairness of any ratio equal to or higher than .55. However, SBHU did not disclose this to the Skelly personnel during the negotiations.

Nonetheless, John A. Morgan, senior vice president of SBHU, opened the negotiations on behalf of Skelly by proposing an exchange ratio of .7. According to Morgan, he knew that there was no way that this ratio could be accepted by Getty. However, he wanted to start high and work down, and he also hoped to shock and irritate the Getty team. It was his preconceived strategy to attempt to push the negotiations up to a point where anger and frustration would result in the best possible deal for the Skelly minority shareholders. He perceived that the best deal he could possibly get from Getty was the highest ratio Getty was willing to accept just before it was angered to the point of abandoning the merger. In this latter effort Morgan appears to have achieved some degree of success.

Without going into the details, the parties negotiated for the better part of the entire day on November 1, 1976. By the end of the day, Skelly had come down in its position to .61 while Getty had come up to .57, a ratio which the Getty side already felt to be too high. At this point the discussions became deadlocked and Getty proposed that the merger negotiations be terminated. A press release was drafted for the purpose of making an announcement to this effect. At this point James Hara, Skelly's president, made a plea that such action not be taken at that time in view of the enormous effort and expense to which the parties has been put in getting to that point. A meeting of Getty's board of directors was scheduled for November 5 and Hara asked Berg, Getty's president, to at least present the matter to Getty's board before the merger was called off. Berg agreed. Subsequently, between November 1 and November 5 Skelly forwarded papers to Getty indicating a willingness to accept a .6 ratio.

At the November 5 meeting of Getty's board it was the consensus among its members in attendance that a ratio higher than .58 simply could not be justified and, although no formal vote was taken, it was further the consensus that the merger discussions should be terminated. Berg immediately telephoned Hara and so advised him.

Hara made one last plea. He noted that a meeting of the American Petroleum Institute was scheduled for the following week in San Francisco. Since the key personnel of both Getty and Skelly would be attending that meeting anyway, Hara suggested that they attempt one final effort at agreeing upon an exchange ratio at that time. Again, Berg gave his agreement to this proposal.

The parties thus convened again on Sunday afternoon, November **[\*381]** 7, 1976, in San Francisco. Initially, they repeated the various arguments which had already been discussed. Hara then asked Getty to make its final and best offer of an exchange ratio. The two sides caucused.

Prior to the caucus, Skelly, which had been urging all along that greater weight should be given to earnings than to assets and market price, had come up with an alternate proposal, mentioned previously, that the parties focus on Skelly's last three years' earnings only and that they be considered on a weighted basis. (While I shall not go into it, there was arguably some justification for this.) The Getty personnel did some figuring with this suggestion and readjusted their thinking as to the weights to be assigned to the subratios. They came up with a final proposal of .5875.

The meeting was resumed and the final offer of .5875 was made. After some consultation with his people, Hara stated that he could recommend that ratio to the Skelly minority shareholders if SBHU was prepared to give an opinion that it was fair and equitable. On behalf of SBHU, Morgan indicated that his firm was prepared to give such an opinion. Stuart and Miller, the other members of the Skelly senior negotiating team, were in accord and the agreement on the merger exchange ratio was reached.

As finally agreed upon, the exchange ratio of .5875 was computed as follows:

|  | **Relative Per Share** | **Weighting** | **Weighted** |
| --- | --- | --- | --- |
|  | **Values -- Getty Shares** | **Factor** | **Value** |
| Skelly |  |  |  |
| Assets | .525 | 47.5% | .2494 |
| Earnings | .667 | 47.5% | .3168 |
| Market | .427 | .5% | .0213 |
|  | Ratio |  | .5875 |

On November 13, 1976, the boards of directors of all three constituent corporations met and, after a review of the materials and after hearing from their investment bankers, all three adopted resolutions approving the plan and agreement of merger, including the .5875 exchange ratio.

Thereafter, proxy materials were disseminated concerning the terms of the proposed merger, and on January 25, 1977, special meetings of the shareholders of Skelly, Getty and Mission were held for the purpose of voting on the merger. It was approved overhwelmingly by the minority shareholders of both Skelly and Mission. There were 2,368,274 minority shares of Skelly which were entitled to vote **[\*382]** on the proposal. Of this number 1,549,341 shares were voted. Of the shares voted, 1,385,406 were in favor of the merger while only 136,935 were opposed. Thus, the terms of the merger, including the .5875 exchange ratio, were approved by approximately 60% of all of the outstanding minority shares of Skelly that were entitled to vote and by approximately 90% of the minority shares that were actually voted.

II

[2] As indicated previously the parties disagree on which of them bears the burden of proof in this case. Plaintiff proceeds on the premise that a majority stockholder who stands on both sides of a merger transaction has the burden of proving the entire fairness of the transaction to the minority shareholders. Indeed, in Sterling v. Mayflower Hotel Corp., supra, at 93 A.2d 109 (1952) the Supreme Court stated as follows:

"Plaintiffs invoke the settled rule of law that Hilton as majority stockholder of Mayflower and the Hilton directors as its nominees occupy, in relation to the minority, a fiduciary position in dealing with Mayflower's property. Since they stand on both sides of the transaction, they bear the burden of establishing its entire fairness, and it must pass the test of careful scrutiny by the courts."

The decision in *Sterling* continues to be cited as good law. Singer v. Magnavox Co., Del.Supr., 380 A.2d 969 (1977). Most recently, in Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701, 710 (1983), a decision handed down while this case was in the briefing stage, the Supreme Court stated as follows:

"When directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain. Gottlieb v. Heyden Chemical Corp., Del.Supr., 91 A.2d 57, 57-58 (1952). The requirement of fairness is unflinching in its demand that where one stands on both sides of a transaction, he has the burden of establishing its entire fairness, sufficient to pass the test of careful scrutiny by the courts. Sterling v. Mayflower Hotel Corp., Del.Supr., 93 A.2d 107, 110 (1952);Bastian v. Bourns, Inc., Del.Ch., 256 A.2d 680, 681 (1969),*aff'd.*Del.Supr., 278 A.2d 467 (1970);David J. Greene & Co. v. Dunhill International, Inc., Del.Ch., 249 A.2d 427, 431 (1968)."

**[\*383]** Getty, on the other hand, takes the position that regardless of such general statements the cases show that the bare fact that a party stands on both sides of a transaction does not, standing alone, shift the burden of proof to that party to demonstrate the fairness of the transaction. Rather, Getty says, the burden of proof does not shift unless the plaintiff demonstrates in some fashion that the party standing on both sides of the transaction actually used its position of control to fix the terms of the transaction for its own benefit and to the detriment of the minority shareholders to whom it owes the fiduciary duty. Getty contends that in the absence of such a threshold showing by a plaintiff the party standing on both sides of the transaction is entitled to the benefit of the business judgment rule, thus imposing on the plaintiff the burden of proving the terms of the transaction to be so unfair as to amount to a fraud on the minority shareholders.

For decisions standing for this proposition Getty relies on Sinclair ***Oil*** Corp. v. Levien, Del.Supr., 280 A.2d 717 (1971);Gabelli & Co., Inc. Profit Sharing Plan v. Liggett Group, Inc., Del.Ch., 444 A.2d 261 (1982);Schreiber v. Pennzoil Co., Del.Ch., 419 A.2d 952 (1980);David J. Greene & Co. v. Dunnhill International, Inc., Del.Ch., 249 A.2d 427 (1968);Marks v. Wolfson, Del.Ch., 188 A.2d 680 (1963); and Bennett v. Breuil Petroleum Corp., Del.Ch., 99 A.2d 236 (1953). Moreover, Getty points out that in stating the rule in *Sterling* the Supreme Court explicitly relied on its previous decisions in Keenan v. Eshleman, Del.Supr., 2 A.2d 904 (1938) and Gottlieb v. Heyden Chemical Corp., Del.Supr., 90 A.2d 660 (1952), and that in both of those cases the Court premised its entire fairness test on a finding that the power of control had in fact been exercised by the party standing on both sides of the transaction. Thus Getty argues that the law is clear that it is not the potential for controlling the terms of the transaction that shifts the burden to the party standing on both sides of the transaction, but rather it is circumstances showing an actual exercise of the control position to that end.

Getty argues that there is no showing on the evidence here that it exercised its controlling shareholder status with Skelly so as to dictate or control the fixing of the merger ratio. To the contrary, Getty argues that the evidence shows that the exchange ratio was the product of hard bargaining between the two corporations during the course of which Skelly clearly got the better of the surface asset negotiations and in which the subsurface asset values were fixed by an independent third party appraisal. Moreover, Getty points out that in the final analysis Skelly achieved an exchange ratio considerably higher than Getty was prepared to accept from the outset. Thus, based upon these **[\*384]** factors, Getty contends that plaintiff has failed to show that Getty used its position of control to dictate the terms of the merger and that Getty is thus entitled to the benefit of the business judgment rule which places the burden on the plaintiff to demonstrate the unfairness of the exchange ratio to the Skelly minority shareholders.

Getty also relies on that fact that the merger was approved by a majority of Skelly's minority shareholders. Citing Michelson v. Duncan, Del.Ch., 386 A.2d 1144 (1978),*aff'd in part and rev'd in part,*Del.Supr., 407 A.2d 211 (1979) and Schreiber v. Pennzoil Co., supra, Getty argues that in an interested director situation, ratification by a majority of the minority shareholders, based upon an informed vote, shifts the burden to the party attacking the transaction to demonstrate its unfairness to the minority. See also, Gottlieb v. Heyden Chemical Corp., Del.Supr., 91 A.2d 57 (1952);Saxe v. Brady, Del. Ch., 184 A.2d 602 (1962);Lewis v. Hat Corp., Del.Ch., 150 A.2d 750 (1959).

Quite frankly, the decision in *Weinberger v. UOP, Inc.* has left me in a bit of a quandary as to what the current status of the law is concerning who has the burden of proof in a situation such as this. The statement in *Weinberger,* quoted previously, is, like the statement in *Sterling,* rather broad and all-encompassing. It says that one or both sides of a transaction has the burden of establishing its entire fairness. Yet the statement in *Weinberger,* like the statement in *Sterling,* cites as authority at least one case in which there was a clear finding that in addition to standing on both sides of the transaction the controlling shareholder also fixed its terms in the absence of any independent contribution from others. See, Bastian v. Bourns, Inc., Del.Ch., 256 A.2d 680 (1969).

As to the ratification argument, I note that none of the cases relied upon by Getty dealt with shareholder ratification of the terms of a corporate merger. All dealt in general with questions of alleged waste in the area of internal corporate business dealings. In a situation such as this, where the outcome of the merger vote was a foregone conclusion as of the time that the proxy materials were issued and where the incentive for minority shareholders to participate was thus reduced (unlike the situation in *Weinberger* where approval of the merger was made dependent on the favorable vote of the minority), one wonders if a ratification by a majority of the outstanding minority shares should relieve the party standing on both sides of the transaction from the burden of demonstrating its entire fairness where, as here, the plaintiff has come forth with evidence of alleged unfairness during the course of his case in chief.

I think, however, that postulating these concerns is sufficient for **[\*385]** present purposes. I say this because I think it clear that the evidence on which Getty relies for its burden of proof argument is the same evidence on which it relies to show that the exchange ratio utilized in the merger was entirely fair to the Skelly minority. Indeed, Getty presented its evidence with that purpose in mind. Because I am satisfied that Getty has demonstrated the fairness of the exchange ratio on the evidence that it has presented I shall simply proceed on the assumption that plaintiff's position on the burden of proof issue is the one that governs. In other words, since I am convinced on the evidence presented that Getty is entitled to prevail under either approach, I see no need to pursue the point further in a decision which, because of its inherent complexities, is already too long.

Chronologically, then, I turn to the specific contentions of the plaintiff which, in the procedural context in which I view the matter, I consider to be offered in an effort to persuade the Court that Getty's showing of entire fairness is insufficient.

III

In a transaction of this magnitude, involving among other things the valuation of each and every major asset as well as the future earnings capabilities of two major integrated ***oil*** companies, it is predictable that one in the plaintiff's position can find numerous individual points and value figures with which to take issue. In the main, however, having sat through 23 days of trial and having reviewed at length more than 800 pages of pre-trial and post-trial briefing by the parties, I view the plaintiff's case, in the final analysis, to break down into five areas of contention.

For one thing, plaintiff strongly contends, based upon factors which he says he did not discover until the trial itself, that the negotiating personnel of both Skelly and Getty proceeded on a misconception as to the future prospects of Skelly when compared against those of Getty, and that this misconception, in the plaintiff's word, "skewed" the merger ratio unjustifiably in favor of Getty. Plaintiff also contends that the delegation to D & M of the task of placing a value on the subsurface assets, and the agreement of Skelly and Getty to be bound by D & M's conclusions without questioning its metholdolgy, was illegal.

Third, plaintiff argues that even if this delegation was a proper one, the uninhibited role of D & M in fixing the subsurface asset values free from question by the parties to the merger was not adequately disclosed in the proxy materials, thus rendering the proxy materials false and misleading. Fourth, plaintiff takes issue with the accuracy **[\*386]** of various economic assumptions made by D & M in reaching its conclusions as to the value of the ***oil***, gas and mineral reserves.

Finally, plaintiff argues most strenuously that the .5875 merger ratio was unfair because it constituted at the time a 26% *pro forma* dilution in earnings and an 8% *pro forma* dilution in dividends to the Skelly minority. I find none of these contentions to be persuasive.

A.

As to the first point, plaintiff relies primarily on two things. One was a press release issued by Skelly on October 21, 1976. The other is two pages from a document of some 270 pages compiled by SBHU during its investigation into the merger ratio.

The news release reported on Skelly's financial results for the first nine months of 1976. It indicated that Skelly had experienced higher earnings -- by almost 40% -- in 1976 as compared to the same period in 1975. The release attributed this increase, in part, to "reduced exploration costs." The two-page document -- designated at trial as plaintiff's exhibit ME-10 -- was comprised of figures taken from the annual reports of the two companies. It purported to show that for the five-year period ending 1975 Getty had added 370 million barrels of ***oil*** and gas reserves while Skelly had added only 30 million barrels during the same period. This indicated on its face that Getty was outstripping Skelly by a 12 to 1 ratio in adding to reserves.

Plaintiff argues that both of these factors are erroneous. Yet he says that both the Skelly and the Getty teams placed significant reliance upon them in concluding, for the purpose of the merger discussions, that Skelly was achieving record earnings in 1976 due in large part to reduced expenditures for ***oil*** and gas exploration and due to an accompanying rapid depletion in its reserves. This, plaintiff argues, caused those negotiating the merger terms, including SBHU and BEDCO, to conclude that Getty had a much more aggressive exploration and development program than did Skelly and that its record of finding new ***oil*** and gas was far better than Skelly's. This, plaintiff says, led the principals to the ultimate error, namely, that the future for Getty looked far better than the future for Skelly, a misconception which pervaded the negotiation of the exchange ratio thereafter and which unfairly skewed the ratio in favor of Getty.

Plaintiff says that the comparison in ME-10 was wrong for three reasons. The fact that Getty's figures were taken from its 1975 annual report meant that the figures included 100% of Skelly as well as Mission in their computation. This is attributable to the fact that Getty controlled 80% of Skelly and owned 89.73% of Mission, and thus **[\*387]** had to include their figures along with its own for reporting purposes. Thus, plaintiff says, the comparison was not one strictly between Getty and Skelly. Second, plaintiff points out that the figures in the Skelly annual report specifically did not include those attributable to a large gas producing field of Skelly, the Heather field. Thus he says that Skelly did not get credit for this substantial reserve in the comparison. Third, plaintiff points out that the conversion of cubic feet of gas to equivalent barrels of ***oil*** in ME-10 was done on a 15,000 to 1 basis when the standard conversion ratio in the industry is 10,000 to 1. This too hurt Skelly since proportionately it had much more natural gas than did Getty. Plaintiff says that if these errors were corrected, it would show the ratio between Getty and Skelly in adding to reserves would have been only 5 to 1 rather than 12 to 1, a significant difference when it is considered that overall Getty was four times as large as Skelly.

As to the news release, plaintiff says that it conveyed the wrong impression. He says the fact that Skelly had reduced exploration costs did not mean that it had reduced its efforts to find new ***oil*** and gas as those involved in the negotiations were led to assume. He says that the reduced expenditures derived from the fact that in the 2 1/2 year period prior to the merger Skelly's exploration efforts had been eminently successful. He says that when an exploratory well proves to be successful, the costs relating to it cannot be immediately expensed but rather must be depreciated over the life of the well. Thus, the greater the success of an exploratory program the fewer the expenditures that will be reported for exploration in a given year.

Plaintiff points out that in the 2 1/2 year period from 1974 through June 30, 1976, Skelly had actually intensified its exploratory efforts (a fact that is not disputed) and that during that period it drilled 86 net exploratory wells to 85 net exploratory wells for Getty. He says that in 1976 alone Skelly's success rate in net exploratory wells was 38% in contrast to Getty's success rate of only 18%. Thus, he argues that it was wrong for the parties to proceed on the theory that Skelly was liquidating to a degree by reducing its exploration efforts and by correspondingly reducing its existing reserves at a rapid pace.

Plaintiff embellishes his argument on this point with various other figures and comparisons extracted from the mounds of financial and documentary material placed in evidence at the trial. However, I find myself in agreement with Getty that this exercise is nothing more than an artful diversion developed during the course of the trial in an effort to shore up what would appear from the outset to have been a marginal case at best.

**[\*388]** What plaintiff has done is to take two pages from a 270-page preliminary research document prepared by Skelly's investment banker and couple it with selected figures taken from a carefully selected period of time preceding the merger in an effort to persuade the Court that the presidents and senior management personnel of two major ***oil*** companies, their respective boards of directors, and the experienced professional representatives of two established investment banking firms, after four months of intensive research, investigation, discussion and negotiation, were all in error in proceeding on the premise that the future looked better for Getty than it did for Skelly. The evidence simply does not support such a radical proposition.

For instance, the evidence is clear that Skelly was taking and producing reserves from its major field in Sharjah at a comparatively rapid rate. This may not have been fully attributable to a decision on the part of Skelly to do so since others had interests in the same field. Nonetheless, the rate of production was a fact.

Moreover, the evidence indicates that in 1976 alone Getty spent 2 1/2 times as much as Skelly on exploration and production. Also, if one looks at the figures on exploration and development wells as opposed to just exploration wells, it will appear that during the three-year period of 1974 through 1976, Skelly drilled a total of 252 net exploratory and development wells while Getty drilled a total of 1,437 net exploratory and development wells -- nearly six times as many. The success or productive ratio for Skelly's 252 net wells was 70.63% while the success or productive ratio for Getty's 1,437 net wells was 93.25%.

The percentage replacement of production of total proved reserves provides another example of how the figures can be used depending on the viewpoint. It is true that if one takes the 2 1/2 year period of 1974 through June 30, 1976, Skelly exceeded Getty by 34.21%. However, if the 5 1/2 year period of 1971 through June 30, 1976 is used as the criteria, Getty exceeded Skelly by 30.84%. If 1972 is used as the starting point, then Getty exceeded Skelly by 18.56%. If 1973 is used, the figure is 26.75% in Getty's favor. From 1975 through June 30, 1976 Getty exceeded Skelly by 29% and for the six-month period ending June 30, 1976, Getty exceeded Skelly by 46.13%. Thus, it can be seen how the plaintiff's approach attempts to utilize the one and only time frame favorable to his position over the 5 1/2 year period preceding the merger in an effort to convince the Court that those involved in negotiating the merger ratio were not aware of the real situation at the time.

That the contrary is true is perhaps best reflected by the testimony of Robert N. Miller, one of the members of Skelly's senior negotiating **[\*389]** team. Miller had been sent to Skelly by Getty in 1973 for the express purpose of upgrading Skelly's sagging exploration and development program. There seems no doubt that Miller had done an excellent job and that during the period of 1974 through 1976 -- the "Miller Era" as plaintiff would call it -- Skelly's exploration and development efforts were on the rise. Yet Miller, who was in charge of Skelly's development program, had no problem about the status of things as of the time of the merger negotiations. In view of the fact that Skelly was achieving record earnings in 1976 and that it did not anticipate doing as well the following year, and in view of his knowledge of Getty's immediate production potential, he, as well as others at Skelly, felt that there would never be a better time for a merger with Getty from Skelly's standpoint. As stated by Mr. Miller:

"I knew that while we had some proven fields and some very good exploration opportunities in the future, Getty had two major fields, Claymore and Piper, that they had been spending a tremendous amount of money on in the mid-70's that were about to come on production. Knowing the type of fields these were plus the fact that they [Getty] were coming off of a moratorium at ***Kern*** River where they had been not allowed to put in the generators that they needed, I felt that if you look at the foreseeable future -- and I'm talking about five to seven years down the road -- I didn't see any possible way that Skelly could ever be better off from a current income standpoint than we were at that time."

As to the effect that the impending production of the Piper and Claymore fields by Getty would have on the comparison of the two companies, Miller stated as follows:

"If you quantify what I reasonably thought Claymore and Piper would mean net to Getty in current production, it was equivalent to 75 or 80% of Skelly's total production."

These views of Miller were made clear to the other Skelly personnel on November 7, 1976 in San Francisco just prior to the time that Skelly made the decision to accept Getty's final offer of a .5875 exchange ratio.

For the plaintiff to contend on all of the evidence that the Getty and Skelly sides were operating under an innocent misconception of the real situation in thinking that the future looked better for Getty than it did for Skelly, and that this erroneous assumption skewed the merger negotiations so as to cause the Skelly minority to receive less than **[\*390]** they should have for their stock under the terms of the merger, is, it seems to me, to be grasping at straws.

B.

Turning to what plaintiff contends was an improper delegation of authority to D & M, I again see no merit to the argument. Plaintiff contends that such a delegation, with its accompanying conditions of finality and secrecy as to the basis for D & M's computations, is without precedent in the context of a merger between two corporations. Plaintiff says that because the decision was made by Getty and Skelly to be bound by D & M's opinion of the fair market value of the ***oil***, gas and mineral reserves without knowing and without inquiring as to the economic factors, cost projections and discount rates utilized by D & M in reaching its opinion, it meant that D & M's value judgments became imbedded in the ultimate exchange ratio without any opportunity on the part of Skelly to disagree with D & M or to correct any mistaken factor relied upon by D & M.

Plaintiff points out that the Delaware General Corporation Law requires that the board of directors manage the business and affairs of the corporation unless the certificate of incorporation specifically relieves the directors of that duty. 8 *Del.C.* § 141(a). Skelly's certificate of incorporation contained no such provision. Therefore, since plaintiff views the fixing of a value on the assets of the company for merger purposes to be at the heart of managing the affairs of the corporation, he argues that the absolute delegation of that task to a third party was unlawful.

In support of this position plaintiff relies on the decisions in Chapin v. Benwood Foundation, Inc., Del.Ch., 402 A.2d 1205 (1979);Abercrombie v. Davies, Del.Ch., 123 A.2d 893 (1956)*rev'd on other grounds,*Del.Supr., 130 A.2d 338 (1957), and Field v. Carlisle Corporation, Del.Ch., 68 A.2d 817 (1949). Concededly, these cases stand for the proposition that directors cannot lawfully agree to surrender to others the duties of corporate management which the statutes impose upon them. As stated by the Chancellor in Abercrombie v. Davies at 123 A.2d 899:

"So long as the corporate form is used as presently provided by our statutes this Court cannot give legal sanction to agreements which have the effect of removing from directors in a very substantial way their duty to use their own best judgment on management matters."

While I have no quarrel with this general principle, I am inclined to agree with Getty that it has no application here. The cases cited **[\*391]** by the plaintiff illustrate the point. In *Chapin v. Benwood Foundation, Inc.* the question was whether the trustees of a charitable corporation could bind themselves by agreement to limit the total number of trustees irrespective of the corporate charter and bylaws and also bind themselves to agree in advance to the name of the persons who would become successor trustees upon vacancies occurring in the office. *Abercrombie v. Davies* involved an agreement whereby each director was bound to vote the wishes of the shareholder who named him to the board, regardless of his personal views on any given subject. In *Field v. Carlisle Corporation* the board had committed itself in advance to issue such number of shares in return for each share of another corporation as was to be determied by an independent appraiser. In each such case the directors had surrendered the ability to use their best judgment in the future on action to be taken in the named of the corporation. That was the flaw that made their actions unlawful as I read those cases. However, that is not the situation here as I see it.

Here, the decision to be made by the boards of the two companies -- and particularly the decision to be made by the Skelly board when viewed from the position of the plaintiff's argument -- was whether an agreement of merger should be entered into and, if so, on what terms. Moreover, D & M was not vested with the power to determine the value that Skelly was to receive in exchange for its subsurface assets. Rather D & M, as one of the leading authorities in the world on the subject, was simply asked to appraise the fair market value of Skelly's reserves, along with those of Getty, so as to provide value figures to be used as part of the information available to Skelly's board in determining and agreeing upon what a fair exchange ratio should be. The ultimate decision to be made by Skelly's board was to ascertain a fair exchange ratio for the amount of Getty stock to be received by Skelly's minority shareholders. The subsurface asset appraisal made by D & M did not bind it in any way insofar as that decision was concerned. Nor was that decision delegated to D & M.

[3] Stated another way, by assigning to D & M the task of valuing the subsurface assets and by agreeing that those values would be accepted as final for the purpose of the valuations to be used in the merger negotiations, Skelly's board did not thereby agree to weight that particular asset component, or the overall asset component, in any particular way in arriving at an exchange ratio. Likewise, it did not commit itself in advance to any particular exchange ratio, and, in fact, it did not commit itself to agree to merge at all. Therefore, I cannot find that it improperly delegated its duties and responsibilities under the statute insofar as they pertained to the establishment of the merger terms.

**[\*392]** Moreover, on the facts of this case it is hard to say that Getty and Skelly boards did not use their best judgment in finally agreeing to accept the independent appraisal of D & M. Time was a factor, and the Skelly and Getty negotiating teams appeared to have reached an impasse. It was not as through the parties had failed to make an effort to first reach some mutual agreement as to the subsurface asset values through arm's length bargaining. They had done so. Among other things, in addition to the Base Case economic run provided by D & M, the Base Case A and Case II projections were premised on factors submitted on behalf of Getty, the Case III and Case IV projections were premised on factors submitted on behalf of Skelly, and Base Case B was an alternative, although unacceptable, economic case developed between D & M, Skelly and Getty. D & M had also participated in the discussions of the parties over a period of weeks. As a result of this D & M, aside from its own expertise in the area, had the benefit of knowing fully the various contentions being made by both sides. And, as a result of its involvement with both companies over the years, D & M was thoroughly familiar with the assets in question. It is difficult to imagine who could have been in a better position or more qualified to break the impasse under the circumstances.

[4] The underlying, premise to plaintiff's argument on this point seems to be that Skelly's management had an absolute statutory obligation to have the final say in fixing a value on the ***oil***, gas and mineral reserves of Skelly for the purpose of negotiating the exchange of ratio. But in the context of the situation, Skelly could not have had the final say because Getty had a voice to be heard also. If the merger negotiations were to proceed Skelly could not finally fix a value on its assets unless Getty agreed to its figures, and vice versa. In other words, the procedure contemplated an understanding between the participants reached after intercorporate bargaining in a valuation area where exactitude is impossible. But where an honest impasse is reached in such a bargaining process, common sense would seem to indicate that the result does not have to be either successful arm's length bargaining or nothing.

As stated by former Chancellor Marvel in Abelow v. Symonds, Del.Ch., 184 A.2d 173, 178 (1962):

"While arms' length bargaining between a wiling buyer and seller is the time tested method of arriving at a fair selling price for corporate assets, an independent and honest appraisal is sometimes by necessity the only acceptable method of establishing fair value."

**[\*393]** And compare the facts in Sterling v. Mayflower Hotel Corp., supra, where no appraisal of assets was ever made prior to the approval of an exchange ratio by the directors. It was held in that case, in effect, that this was not fatal so long as the evidence offered at trial demonstrated the fairness of the transaction to the minority shareholders.

All factors considered, I find no impropriety in the agreement entered into between Getty, Skelly and Mission to have D & M fix a fair market value on the subsurface assets of the companies based on economic assumptions determined solely by D & M and their further agreement to use those values for the purpose of the merger negotiations.

C.

This brings us to the plaintiff's contention that the information in the proxy statement relating to the role of D & M was false and misleading. On this I think there is little that need be said.

Plaintiff basically takes issue with statements contained in the proxy materials which indicate that BEDCO and SBHU "examined" the "valuations" made by D & M in the process of formulating their respective opinions as to the fairness of the terms of the merger. This, says plaintiff, falsely implied that BEDCO and SBHU had knowledge of the assumptions and methodology employed by D & M in determining the subsurface asset values, thereby further falsely implying that BEDCO and SBHU viewed D & M's values to have been properly reached.

This argument is not persuasive here. In actual fact, the statements alluded to by the plaintiff were correct. BEDCO and SBHU did examine and consider the values placed by D & M on the ***oil***, gas and mineral reserves of both Getty and Skelly in the process of arriving at their fairness opinions. What the plaintiff is attempting to do is to take a correct statement, read something into it by implication, and prove by the facts that the implication is not true in an effort to show that the correct statement was misleading. For this approach to be successful, the wording of the correct statement, or the context in which it is found, must fairly give rise to the implication. Here, in my view, the statements in issue do not do this. Fairly read, I do not think they give rise to an impliation that BEDCO and SBHU, in effect, double-checked the accuracy of D & M's conclusions.

Plaintiff also charges that it was misleading for the proxy statement to fail to disclose the fact that Skelly, Getty and Mission had formally agreed to have D & M value the subsurface assets and to **[\*394]** be bound by D & M's conclusions without questioning or knowing the economic assumptions and methodology employed by D & M. In order words, plaintiff is charging that it was misleading to fail to disclose the conditions under which the fair market value of the subsurface assets were determined for the purpose of the merger negotiations.

I have previously found that it was not improper under the circumstances for the parties to ultimately have these assets valued in this manner. Also, as indicated hereafter, I am satisfied that the valuation of D & M was competently performed and that its opinion was fair and equitable to the Skelly minority.

[5] The requirement of full disclosures does not mean that a proxy statement must satisfy unreasonable or absolute standards. People naturally differ on what should or should not be included in a proxy statement. Kaplan v. Goldsamt, Del.Ch., 380 A.2d 556 (1977). The test is whether facts are germane in the sense that they are those which a reasonable shareholder would consider important in deciding whether to vote for or against the terms of the merger that have been presented to him. Lynch v. Vickers Energy Corp., Del.Supr., 338 A.2d 278 (1977).

I fail to see how a full and detailed disclosure of all the facts and circumstances that led up to the decision to have D & M fix the subsurface asset values for both corporations, most of which factors have been described at length herein, could have caused any reasonable shareholder to decide to vote against the merger based upon a question as to the fairness of the subsurface asset values. If anything, I think it would have had an opposite effect. Accordingly, I cannot find the proxy statement to have been misleading for failure to make this disclosure.

The other points urged by the plaintiff on the disclosure issue I also find to be without merit.

D.

The plaintiff also contends that certain of D & M's economic assumptions were unsupportable, and that overall its valuation of the underground reserves unfairly favored Getty over Skelly. This, too, does not warrant prolonged discussion. While plaintiff takes issue with many of the findings and economic premises utilized by D & M, he focuses mainly on the assumptions made by D & M as to future natural gas prices, the various discount rates used by D & M to establish the present worth of future net revenues, and the values given to Getty's Australian uranium deposits and its diatomite ***oil*** and ***oil*** shale reserves.

**[\*395]** The problem that the plaintiff has, of course, is that he was unable to offer any persuasive expert testimony in direct rebuttal to the opinions offered by D & M at trial. [[3]](#footnote-4)\* From the plaintiff's standpoint this is perhaps unfortunate and I fully appreciate his lament that in a case such as this it is difficult for a shareholder plaintiff to locate experienced petroleum experts who are willing to take on a company the size of Getty. (It occurs to me that this also may have something to do with the long-standing qualifications and reputation of D & M, the firm selected by Getty and Skelly to do the valuations for them.) Nonetheless, from the Court's standpoint I must work with what I have in the record. This means that I am left with only the plaintiff's counsel debating with D & M witnesses on cross-examination as to the reasonableness of approaching various valuation factors in the manner in which D & M approached them. In such a potential mismatch counsel likely has little chance no matter how valiant the effort. Such was the case here.

The D & M witnesses testified over a period of seven days concerning the procedures they use, the assumptions they made, the justification therefor, and the tests that they ran so as to confirm their conclusions concerning the values placed on the Getty and Skelly reserves on October 29, 1976. It would serve little purpose to attempt to review this mass of material.

Ernest T. Pitzer, Jr., senior vice president of D & M was the witness on the stand for the majority of this time. A goodly portion of his testimony was spent on cross-examination. His patience with counsel, and particularly with the Court, in a highly technical and complex area known well to him but somewhat difficult to grasp by others, can only be likened to that of Job.

Mr. Pitzer brought charts and graphs prepared especially for trial so as to aid the Court and counsel in understanding his testimony. It was indeed helpful that he did so. He conducted several mini-seminars on petroleum evaluation at the blackboard. He was obviously an excellent and qualified witness. His testimony, as well as that of the other D & M witnesses who actually participated in the valuation effort during October 1976, appeared to be genuine and sincere. It was certainly convincing. From the testimony and documentary evidence presented through the D & M witnesses I have no doubt that the fair market **[\*396]** value placed on the reserves of Getty and Skelly by D & M was the product of an honest, independent and economically defensible effort by qualified people to do justice to both sides. As trier of the facts and judge of the demeanor and credibility of the witnesses, this is my finding to make and I so make it.

To borrow from the words of former Chancellor Marvel in Abelow v. Symonds, supra, at 184 A.2d 177, the reputation of D & M as an appraiser of ***oil*** and gas properties is well recognized, and the plaintiff was not, in my opinion, successful at trial in breaking down its methods, reasoning, or the result of its work. In the face of such appraisal and its implications, plaintiff failed to introduce any evidence which seriously impugned D & M's competence or the accuracy and fairness of the appraisal itself. Accordingly, I find that there is no element of unfairness flowing to the former Skelly minority shareholders as a result of the fair market values for the subsurface assets of Getty and Skelly as determined by D & M and utilized by the parties in the process of negotiating the ultimate merger ratio.

E.

The last of the plaintiff's principle contentions of unfairness involves his charge that under the .5875 merger ratio the *pro forma* earnings of the Skelly minority shareholders suffered a 26% dilution and, on the same *pro forma* basis, their dividends suffered an 8% dilution. Through the expert financial analyst called by the plaintiff to testify on the subject, it is contended that such dissolution is unprecedented in the market place in any arm's length bargaining transaction. This alone, says plaintiff, constitutes prima facie evidence of unfairness.

While Getty does not necessarily dispute the mathematics employed by plaintiff in reaching his dilution percentages, it takes the position that when weighed in light of other relevant factors the point is hardly sufficient to carry the day for the plaintiff's case. On this I agree with Getty.

To begin with, there is now some doubt in my mind as to the propriety of relying on the plaintiff's *pro forma* percentage approach. In the intervening decision in Weinberger v. UOP Inc., supra, which came down while this case was in the post-trial briefing stage, the Supreme Court, at 457 A.2d 713, stated that:

". . . the determination of 'fair' value [must be] based upon 'all relevant factors.' Only the speculative elements of value that may arise from the 'accomplishment or expectation' of the merger are excluded. We take this to be a very narrow **[\*397]** exception to the appraisal process, *designed to eliminate use of pro forma data and projections of a speculative variety* relating to the completion of a merger." (Emphasis added.)

But even if it can be said that the *pro forma* data and projections of the plaintiff here are not of the speculative variety (and I make no attempt to resolve the point) other factors detract from the effect that the plaintiff would have the Court give to such figures.

As to the 8% *pro forma* dividend dilution, this prospect was considered by the parties during he negotiations. Mr. Morgan of SBHU, one of the chief negotiators for the Skelly side, broached this very subject with the Getty people. Getty appreciated this potential for a negative effect on the Skelly minority also, and viewed it as something to be avoided in an exchange-of-stock context. Getty's solution was to indicate that it would raise its dividend for 1977 so as to overcome any such dilution. Mr. Berg, Getty's president, gave this assurance to Morgan. While Morgan realized that Berg could not make that decision alone and that it would have to be made ultimately by Getty's board, he was satisfied tht it would be done since he, as well as others involved in the negotiations, were well aware that Getty had the capability to raise its dividend.

[6] In fact, this is what occurred. While such evidence of postmerger events would normally be inadmissible by a defendant such as Getty to prove out the fairness of its actions at the time of the merger, documentary evidence placed in the record by plaintiff indicates, among other things, that in 1977 Getty shareholders received dividends totalling $ 3.80 per share while in 1976 Skelly shareholders received dividends of $ 1.60 per share. Since the Skelly shareholders received .5875 of a share of Getty for each share of Skelly, the dividend received by the Skelly minority in 1977 attributable to their former Skelly stock was $ 2.23 per share ($ 3.80 X .5875 = $ 2.23). Rather than a dilution of 8%, this represents an increase of 39%. In considering whether the terms of the merger were fair to the Skelly minority, I fail to see how I can close my eyes to this evidence placed in the record by the plaintiff himself, ignore also the fact that a commitment, albeit non-binding, was given by Getty prior to the merger for the purpose of protecting the Skelly minority against the dividend dilution complained of by the plaintiff, and brand the merger unfair to the Skelly minority based on plaintiff's *pro forma* projections derived from facts existing on the date of the merger.

Similarly, I am not persuaded that plaintiff's 26% earnings dilution figure is convincing standing alone. For one thing, 1976 was an **[\*398]** all-time record earnings year for Skelly and even Skelly's management did not realistically anticipate equivalent earnings in 1977. In fact, there is evidence that it was projecting a 10% decrease in earnings for 1977. Thus, in proclaiming a *pro forma* 26% dilution in earnings plaintiff is relying on the best year in Skelly's history to support his argument. Because of this, the 26% figure can be viewed from a practical standpoint to be a distortion, at least to some degree.

Moreover, through its experts, Getty offered evidence of some 15 examples of arm's length merger transactions occurring between 1974 and 1980 in which *pro forma* dilution in earnings occurred. Eight of such transactions involved dilution of 20% or more. This was offered in opposition to the testimony of plaintiff's expert so as to demonstrate that owing to other compensating factors having appeal to shareholders there does occur occasionally in the marketplace transactions which do give rise at the time to a *pro forma* dilution in earnings.

Compare also the decision in Bastian v. Bourns, Inc., supra, *aff'd,* Del.Supr., 278 A.2d 467 (1970) in which the overall terms of a merger were found to be fair to minority shareholders even though a dilution of earnings on a *pro forma* basis was involved. To the same effect, see Levin v. Great Western Sugar Company, 3d Cir., 406 F.2d 1112 (1969), *cert. denied,* 396 U.S. 848 (1969).

[7] In David J. Greene & Co. v. Dunhill International, Inc., supra, relied upon by plaintiff, a severe *pro forma* dilution in both earnings and book value provided one of the elements which persuaded the Court to enjoin the proposed merger there in question. However, that was a decision at the preliminary injunction stage and thus it ws not a decision on a full record containing factors explanatory or in mitigation of the *pro forma* earnings dilution element. A contrary situation prevails here, as it did in *Bastian v. Bourns, Inc.,* since this decision is being made after trial and based upon a full record after the party standing on both sides of the transaction has come forward with evidence to establish the entire fairness of the transaction. Thus, the finding of the Court there as to the earnings dilution issue has no controlling precedential effect here.

All things considered, I do not find that the terms of the merger were unfair in this case due to an 8% dilution of dividends and a 26% dilution in earnings on a *pro forma* basis as of the date of the merger.

IV

In summary, I am satisfied that Getty has established the fairness of the .5875 exchange ratio to the minority shareholders of Skelly. **[\*399]** The task of establishing the exchange ratio was approached on the basis of the Delaware law as it then existed. The approach was to establish an asset value, an earnings value and a market value for each company, to establish a ratio for each of these value components, and to then weight them accordingly so as to achieve the overall exchange ratio.

The procedure adopted was for each side to value its own assets separately, exchange the results, and negotiate any differences of opinion through the bargaining process. On the evidence it appears that this was accomplished in a *bona fide* adversary atmosphere, and it further appears that if anything the Skelly side obtained the benefit of all doubts with regard to the surface assets of both companies. The fact that the Getty side ever agreed to the valuation approach of Skelly as to certain properties and assets is nothing short of astounding.

It is also of no small significance that a substantial error was committed by the Getty side in computing its net asset values. Specifically, through an oversight, certain taxes owed by Getty to the Saudi Arabian government were double-counted. The result of this error was that the value of Getty's Saudi Division was *understated by $ 213 million.* This error was not discovered until after the merger negotiations of November 1, 1976 had been concluded.When the negotiations were resumed in San Francisco on November 7, 1976, and the exchange ratio agreed upon, the same figures available on November 1 as to Getty's Saudi Division were used. In other words, the $ 213 million error was never corrected.

The effect of this error was that the asset value assigned to Getty's Saudi Division for purposes of the merger was a *negative* $ 142.5 million. Getty points out that if this error had been corrected, and if it was then applied to the end result reached between the parties, the net asset value ratio between Getty and Skelly would have been .5093 rather than .525, and for that reason alone the merger exchange ratio would have been lowered from .5875 to .5800.Nonetheless, on the basis of the figures used in determining the exchange ratio, this error was allowed to remain and to flow to the benefit of the Skelly minority.

As noted previously, the subsurface assets of both companies were valued by the independent appraisal of D & M, arguably the world's foremost authority in the area. The earnings component was computed on a weighted basis over the most recent three-year period which, in effect, gave a 50% emphasis to 1976, the best earnings year in Skelly's history. As to none of these matters can Getty be accused of using its majority position to the disadvantage of the Skelly minority.

**[\*400]** When the asset, earnings and market values were weighted through the bargaining process so as to achieve the exchange ratio, asset value was assigned a 47.5% weight. Since Getty's asset values were far higher than those of Skelly, this clearly worked to the advantage of Skelly. The same was true with the 47.5% weight assigned to earnings since it tended to emphasize the recent record earnings of Skelly. Market value, being assigned only a 5% weight, was relatively ignored.Since Getty was trading at a price considerably higher than was Skelly during the two-month period selected for the purpose of the merger negotiations, this was also favorable to Skelly.

The effect of the .5875 exchange ratio was to give the Skelly minority a 65% premium over the market price of their shares as it existed prior to the time of market speculation that there would be a merger because of the death of J. Paul Getty. And, as noted, by far the majority of the Skelly shareholders who chose to vote on the terms of the merger voted to approve the transaction.

[8] In the recent decision of Weinberger v. UOP, Inc., supra, the Supreme Court pointed out that entire fairness in a transaction such as the one presented here has two aspects, namely, fair dealing and fair price. I find that the evidence submitted by Getty, tested against the arguments and proof of the plaintiff, has satisfied both standards. Also, *Weinberger* holds that the venerable Delaware method of finding and weighting asset, market and earnings value is now out-moded and that the door is now thrown open to consideration of any and all methods of valuation that a party can conceive. At the same time, *Weinberger* did not throw out or condemn the method utilized by Getty and Skelly in 1976 in formulating the exchange ratio and, since the parties were scrupulous in attempting to adhere to the formula generally accepted under Delaware law at the time, it would be difficult to condemn them for eschewing other approaches to valuation in their efforts.

I note too that I have considered the testimony of the plaintiff's expert, Mr. Glick and, with all due respect to his ably expressed views, I am not persuaded by them over the traditional approach utilized by Getty and Skelly. For one thing, Mr. Glick was relatively inexperienced with the merger of ***oil*** and gas companies or with the sale of ***oil*** and gas properties. Moreover, the comparables used by him in support of his opinion involved the the acquisition of smaller ***oil*** and gas producing companies as opposed to a major integrated company such as Skelly.

I note further that at the heart of Mr. Glick's testimony, at least **[\*401]** as I understand it, was that fairness required the Skelly minority shareholders to receive Getty stock having a market value equal to the asset value of their Skelly stock. While perhaps couched in different terms, I believe that basically this is the same argument that was rejected in Sterling v. Mayflower Hotel Corp., supra. I also take note that while Mr. Glick repeatedly stressed the importance of assets in the acquisition of one ***oil*** company by another (on the basis that the acquiring company is in reality buying the ***oil*** and gas reserves of the other), his ultimate opinion as to the Getty-Skelly transaction was that asset values should have been weighted at only 20% with earnings weighted at 65%, a seeming inconsistency in his testimony which I find difficult to rationalize.

Finally, it is difficult to ignore the fact that Harold C. Stuart, a man of extensive business experience, an outside director of Skelly, the son-in-law of the founder of the company, a member of Skelly's senior negotiating team, and -- most significantly -- a member of the Skelly minority owning personally $ 13.5 million in Skelly stock, voted in favor of the merger and saw fit to testify as to the fairness of the .5875 exchange ratio to the Skelly minority. He participated in fixing the terms of the transaction, he had more at stake than any other minority shareholder, and he had no reservations as to either fair dealing on the part of Getty or the fairness of the price equating from the merger ratios.

Based upon the foregoing, it is may conclusion that judgment must be entered in favor of the defendant Getty ***Oil*** Company.An appropriate form of order may be submitted.

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**End of Document**

1. \*The merger involved Mission Corporation as well as Getty and Skelly. As a practical matter, however, the merger was between Skelly and Getty and it will be so treated herein except where reference to Mission Corporation is necessary for technical purposes. [↑](#footnote-ref-2)
2. \*The factors and methodology actually used by D & M in this Case V were not disclosed by D & M until the spring of 1982 during the course of discovery in preparation for the trial of this matter. [↑](#footnote-ref-3)
3. \*Plaintiff offered an expert for this purpose at trial. However, this witness revealed a relative lack of experience in the particular area in which he was asked to testify. His name was not mentioned by plaintiff in post trial briefing or argument. [↑](#footnote-ref-4)