WACHTELL, LIPTON, ROSEN & KATZ

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To Our Clients:

GOING PRIVATE

A California trial court in Jutkowitz v. Bourns, Cal. Super. Ct., LA. Co., NO. CA 000268, on November 19 held that a going private merger is not authorized by the California corporation law and that even a short-form going-private merger requires a valid business purpose other than merely going private. The following is an edited version of the full opinion:

Plaintiff on behalf of a class of minority shareholders requests a preliminary injunction to prevent a merger of Bourns, Inc. with Bourns Newco, and to prevent the forced buy-out of the minority shareholders in the merger. Plaintiff also wants to enjoin the sale until the price offered for the minority's stock is put at a higher level. Bourns, Inc. is a California corporation whose stock is presently owned by the public, as to approximately 10%, and the Bourns family, as to approximately 90%. The majority shareholders and the management want to "go private" by forcing the minority shareholders to sell their stock at fair market value. The method used, each individual step of which appears to be authorized by the Corporations Code, is as follows: (1) A new corporation is formed, appropriately named Bourns Newco. (2) The Bourns family transfers all of its Bourns, Inc. shares to Newco in exchange for shares of Newco. (3) Newco will then be merged into Bourns, Inc. with the terms of the merger agreement providing for the cancellation of Bourns stock owned by Newco, and that all stock of Bourns, Inc. not owned by the merged corporation, Newco, will be purchased for $10.00 a share. Thereafter, new shares of Bourns, Inc. will be exchanged for the shares in Newco. The result is that the Bourns family will own 100% of the stock of Bourns, Inc. Each individual step is authorized by the Code. The problem posed is that all of these steps have no purpose other than to buy out the minority public shareholders, a purpose which Bourns has taken great pains not to hide. Defendants explicitly state that the forced buy-out of the minority shareholders is the only purpose of the whole transaction. They contend that "going private" is a legitimate business aim, justified by the advantages which non-public corporations have in this era of expensive accountability to minority shareholders and burdensome regulation of publicly held companies. They assert that their willingness to pay fair market value, whether by acceptance of their offer or by appraisal proceedings pursuant to the merger statutes, is sufficient to protect the interests of the minority. The plaintiff aptly characterizes the plan as a "private condemnation" and says it is not authorized by statute.

The question which concerns the Court is whether those plaintiffs who do not desire to sell at all can be forced to do so. If defendant's theory is correct, the holders of sufficient stock to approve a merger have a permanent option to buy out an unwilling minority with corporate money, assuming they are willing that the corporation pay fair market value and willing to go to the trivial trouble of forming another corporation for this purpose but no other, followed by the appropriate amount of merger paperwork. The effect of the transaction is, of course, to treat shareholders owning the same class of stock differently; one portion of the shareholders is allowed to continue in the corporate business and one is required to sell out.

There is nothing explicit in the [Corporations] Code, therefore, which prohibits the result. But that is not the end of the inquiry. Plaintiff argues with cogency that Jones v. H. F. Ahmanson & Co. and its progeny, prohibit a majority from taking steps, however correct in form, by which the majority takes advantage of its position to harm minority interests. The court in Jones says that the fiduciary relationship of a majority to a minority prohibits the majority from using its power as such to harm minority interests. Defendant concedes the rule but denies its application. Defendant argues, in essence, that an investor in a publicly held company can only be interested in money, and a willingness to pay fair market value, or more, the $10.00 a share offered is about 25% more than the stock has recently sold for on the open market, is sufficient to protect the plaintiffs' legitimate interests. The Court does not follow defendant on the last argument. Money now may well satisfy some or most minority shareholders, but others may have differing investment goals, tax problems, a belief in the ability of Bourns' management to make them rich, or even a sentimental attachment to the stock which leads them to have a different judgment as to the desirability of selling out. Their interests, at least as they may perceive them, are not protected by fair market value, or more, paid now. Defendant's claim, in essence, is a claim that they may decide what is in plaintiff class' best interest. No reason is advanced as to why this question should not be determined by the individual whose interest is involved.

The matter may be viewed from another slightly different perspective. The mechanism used to accomplish the "private condemnation" is a merger, but no merger in any realistic sense is taking place. Two corporations are not combining their businesses with each other for business purposes. As a corporate entity separate from the majority stock interests, Newco is a sham, an ephemeral will-of-the-wisp

created for no purpose other than to create the formal appearance of a merger which does not exist in fact. Defendant does not deny this; it makes full disclosure of exactly why it is doing what it is doing, thus belying plaintiff's claim of fraud, but proving the claim of "private condemnation". The Court thinks that this is not what the merger sections of the Code were designed for. The transparent and ephemeral purpose and existence of Newco should be disregarded and the final picture examined. When that is done, it is seen that defendant's claim is that a majority of two-thirds or more has a permanent option to use corporate money to buy the stock of the minority at fair market value without any other corporate purpose. The easy answer to the proposition is that the Corporations Code does not so provide.

Defendant says that the public policy inherent in the [short-form merger] sections should be recognized to permit "going private" by a merger technique. The [short-form merger sections] do not do away with the idea that a "merger" in fact must take place, nor do the [short-form merger sections] purport to eliminate the fiduciary responsibilities of the majority to the minority set forth in Jones v. Ahmanson, supra.

At the core of the problem here is whether the elimination of a minority as the sole aim of a merger, at least a merger in form is a legitimate business purpose. The law carefully protects a shareholder's rights, and the elimination of the nuisance of the protective procedures seems an insufficient reason to abolish the shareholding itself -- at least one which the Court is reluctant to recognize.

M. Lipton