Session 4: Market Power: Natural Monopoly and Standards Businesses

In our last session, we discussed the antitrust/competition policy approach to market power. In this session, we will look at situations where antitrust proper may not work very well given that the underlying production technology may give rise to just a few producers or even one. This is the case of natural monopoly and is historically the domain of regulated industries laws, such as those operating in railroads, telecommunications, electricity and natural gas. We continue to have statutes and regulations in those areas, but over the last twenty years, standard setting and platforms have become an important part of the regulatory conversation. Our reading will start with DVD patent pools and then we will look at the Department of Justice’s closing statement in Google’s 2012 purchase of Motorola Mobility. After that, we will turn to the issue of network neutrality or the open internet as the Federal Communications Commission would prefer.

DVD Joint Licensing of Patents Request Letter

July 29, 1998

Honorable Joel I. Klein, Esq.,
Assistant Attorney General,
Antitrust Division,
United States Department of Justice,
10th Street and Constitution Avenue, N.W.,
Washington, D.C. 20530.

Re: Request for Business Review Letter Regarding the Licensing of Patents Essential to DVD-Video and DVD-ROM

Dear Mr. Klein:

On behalf of Koninklijke Philips Electronics, N.V. ("Philips"), Sony Corporation of Japan ("Sony"), and Pioneer Electronic Corporation of Japan ("Pioneer") (and their affiliates which are involved in the patent licensing program described below) we submit this request for a Business Review pursuant to 28 C.F.R. § 50.6 regarding the proposed arrangement under which certain patents essential to the manufacture and use of DVD-Video and DVD-ROM will be licensed on reasonable and non-discriminating terms (the “Proposed Licensing Program”).

DVD (or Digital Versatile Discs) refers to a high density CD-sized optical disc in which signals are encoded and stored in digital form and are then read and reproduced by players using an optical read out beam. Relying on basic CD technology, the DVD discs and players allow for an increase of approximately sixty times the storage capacity of a typical CD or CD-ROM. DVD-Video and DVD-ROM are two formats relating to high density optical discs which have been described by Philips, Sony, Pioneer and several other companies in the DVD-Specification for Read Only Disc version 1.0 dated August 1996 and in several updates thereto (a copy of the specification is set forth in Exhibit A hereto).
A single DVD format for video and ROM was defined in an open process by participating companies over the course of several years at the request of various industries—particularly the computer industry—which asserted that multiple DVD formats would delay introduction of this new and beneficial product, increase costs, and much like the incompatible BETA and VHS formats, result in losses to consumers who purchased products based on a format which quickly became obsolete. In defining the DVD-Video and DVD-ROM formats, input was solicited and received from a variety of industries and an even wider variety of companies throughout the world.

As the format was developed and refined, it became clear that numerous independent companies had been granted patents which were relevant to DVD-Video and DVD-ROM. The three companies submitting this request actively sought to join the licensing of their patents with the patents of other companies which also claimed to have patents which are essential to DVD-Video and DVD-ROM. To date, those efforts have not resulted in any other companies joining the Proposed Licensing Program. Philips, Sony and Pioneer, however, remain willing to include others having essential patents in the licensing program described below.

The companies submitting this request firmly believe that, in the near future, DVD products will be widely marketed by a wide variety of companies. We are also convinced that, once these products are manufactured and distributed in volume, there will be great consumer demand for them. We anticipate that the producers and sellers of DVD discs and players will largely be the companies that currently manufacture and sell CDs and the equipment that plays CDs and CD ROMs. Thus, prospective licensees include manufacturers of consumer audio equipment and computer disc drives. Typically, licensees to manufacture DVD discs will be replicators, as is the case with CDs. In sum, the DVD licenses will be offered to the same classes of sophisticated licensees as are CD licenses, and there is every reason to expect that the transfer of this valuable DVD technology will have the same beneficial effects upon the relevant industries that CD licenses had upon the recorded music industry 15 years ago.

In one respect, licensors of DVD technology face risks and uncertainties that were not faced 15 years ago by the creators of CD technology. During the past year, several different formats have been announced that will compete with various applications of DVD for the favor of consumers. For example, Circuit City and others have developed Digital Video Express (DIVX), a pay-per-play system that allows consumers who have purchased a DIVX-compliant player to purchase a disc at a lower price and to play that disc for a limited period of time without having to return the disc when finished. The disc may later be “re-activated” for additional plays upon payment of additional fees. Various companies have announced that they will offer DIVX discs, including Twentieth Century Fox, the Walt Disney Company, Paramount Pictures, Universal Studios and Dream Works. It is our understanding that DIVX discs will not play on non-DIVX DVD players. In addition, NEC, one of Japan’s largest electronics manufacturers, has announced its intention to introduce Multimedia Video File (MMDF), an optical disc format which is expected to compete directly with certain applications of DVD technology. Other new announced products include...
TeraStor’s Near Field Recording (NFR) technology and Advanced Storage Magneto-Optical (ASMO). In short, this is an area in which several well-financed suppliers are prepared to compete aggressively with DVD products. Obviously, there also will be competition among those selling DVD products.

Offering a patent license for all essential patents of the three companies under the Proposed Licensing Program will provide several pro-competitive benefits, including (1) reducing the uncertainty of the availability of patent licenses so that those who require a license to manufacture or use a DVD-Video or DVD-ROM product are aware that a license from the three companies easily can be obtained; (2) reducing the royalties that likely would be payable if the three companies licensed their essential patents on their own; (3) reducing the cost for each prospective licensee of determining on its own the identities of owners of essential patents and the entities from which licenses which must be obtained; (4) reducing other transaction costs of licensees having to negotiate and execute separate licenses; (5) reducing the transaction costs of essential patent holders offering separate licenses thereby allowing for a reduction in the price of the license; and (6) offering the same royalty rate and other conditions to all interested licensees so that no entity manufacturing or selling a DVD-Video or DVD-ROM product will have a price advantage over any other such entity as a result of entering into a license for the essential patents of Philips, Sony and Pioneer.

The Proposed Licensing Program will be structured to avoid any countervailing aspects that may be deemed anticompetitive. For example, each patent holder will retain the right to license its patents outside the Proposed Licensing Program under whatever terms and conditions it reaches with any prospective licensee, and each prospective licensee will be informed in writing of its option to negotiate such an individual license under reasonable terms and conditions. The Philips personnel who are responsible for the Proposed Licensing Program will play no role in the marketing of DVD products. An independent expert in the art has been retained to insure that the portfolio of patents that will be licensed under the Program includes only those patents which are essential to DVD-Video and DVD-ROM products. Although Philips, Sony and Pioneer have not been successful in having other companies join their licensing program, they remain willing to include any others having essential patents who wish to join. There will be no royalty payable by the licensee unless a licensed patent would be infringed but for the license, information which the licensee may be required to disclose to monitor infringement and royalty payments will not be disclosed to any of the licensors, but only to a third party expert retained by the licensors, patents included in the licenses will be specifically identified in appendices to the license, and Philips, Sony and Pioneer will commit to licensing to any licensee any essential patent rights they may acquire subsequent to the date specified in the license.

Set forth below is a fuller description of the proposed licensing terms and the agreements among the licensors.

The Proposed Patent License

Two licenses (Appended hereto as Exhibits B and C) will be offered, both in substantially the same form. One is for DVD players, the other for DVD discs. A three page “Agreement” sets
forth a few basic terms of the license and also specifically incorporates the “Conditions” of the license which are appended to the Agreement.

On the first page of the Agreement, it is specifically noted that Philips, Sony and Pioneer are each willing to license their respective patent rights for optical disc or player manufacturing whether within or outside the standard DVD specifications on reasonable terms and conditions. Thus, any prospective licensee who is dissatisfied with the terms of the Proposed Licensing Program is assured of this alternative.

Article 2 of the Conditions sets forth the terms of the license grant, and provides for a license under Licensed Patents which are defined in Article 1.07 as all patent rights pertinent to DVD discs or players which Philips has acquired the right to license, which have or are entitled to a priority date prior to January 1, 1997, and which are essential to DVD discs or players. Article 1.07 goes on to define as “essential” those patents which are necessary as a practical matter for compliance with the DVD-Video or DVD-ROM specifications. The license, therefore, includes not only all patents technically necessary to manufacture a product to the standard specifications, but also those which a typical licensee is likely to require. For example, it may be theoretically possible to design around a particular patent at significant additional cost (and without additional benefit), but few, if any, licensees who pay the standard royalty rate for other essential patents would want such patent excluded from the license. Indeed, it is fair to say that most, if not all, licensees would want such patents included.

Article 2.07 describes the method by which patents are selected for the portfolio license. The prospective licensee is specifically informed that Philips has appointed an independent patent expert to evaluate the patents of the three licensors for “essentiality” and that the portfolio included in the license may be amended from time to time based on the results of that evaluation.1

In Article 2.03, each licensor agrees to grant a license to each licensee under any essential patent which Philips, Sony or Pioneer acquire the right to license in the future. Thus, to the extent any of the licensors are issued essential patents in the future or other companies join the proposed licensing program, all licensees are guaranteed a license under any such essential patent.

Articles 2.05 and 2.06 set forth the terms of the licensees’ grant of patent rights. For the identical term of the license granted by Philips, Sony and Pioneer, the licensee agrees to grant to the licensors and other licensees (who also agree to the terms of the grant back) a royalty bearing license on essential patents. Thus, the scope of the grant back is virtually identical to the scope of the license itself. The grant back would not create any disincentive to innovate as it specifically allows the licensee to charge a royalty for its grant of a license.

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1 Philips has appointed Kenneth Rubenstein, a member of Proskauer Rose LLP of New York, to determine which patents are essential and should be included in the license. Dr. Rubenstein received his Ph.D in plasma physics from the Massachusetts Institute of Technology in 1975 and his J.D. cum laude from New York Law School in 1982. Dr. Rubenstein previously performed a similar function for the licensing of patents essential to MPEG-2 technology and he continues this work.
and would only prevent a particular patent holder from deciding to use its after-acquired patent position to completely block others from competing in a business in which they already have invested substantial resources.

Article 4 sets forth the royalty payments to be made by licensees. The license provides for a $10,000 payment upon execution of the license ($5,000 of which may be credited to royalty payments) and a running royalty of $.05 per disc or 3.5% of the net selling price of a player, with a minimum player payment of $7.00 until January 1, 2000 and a minimum of $5.00 thereafter.2

Article 4 makes plain that no royalties are due unless “a Licensed Patent is utilized” and, therefore, there are no royalty paying obligations regardless of whether the 10-year license is in effect if the licensee has adopted new or different technology that does not utilize any of the patents in the portfolio.

Articles 4.09 and 4.10 provide that licensees must maintain and furnish certain information relevant to issues of infringement and appropriate royalty payments, but specify that such information shall be provided to independent experts rather than to any licensor itself.

The licenses provide for “most favorable nations” terms under which each licensee is assured of receiving the most favorable royalty rate granted any other portfolio licensee under the conditions specified in Article 5. Thus, no similarly situated licensee is given a competitive advantage by the license over any other such licensee.

Article 10.05 gives each licensor the right to withdraw its own patents from the portfolio license with respect to any licensee which both (1) brings a lawsuit against the licensor for infringement of an essential DVD patent and (2) refuses to license such patents to the licensor on fair and reasonable terms. This provision is necessary to prevent portfolio licensees from taking unreasonable and unfair advantage of the fact that each portfolio licensor already has agreed to license its patent on the open, fair and non-discriminatory terms provided in the portfolio license at royalty rates that are likely considerably lower than what would be payable if patents were licensed individually outside the portfolio license.

Without the provisions of Article 10.05, a portfolio licensee could, while enjoying the considerable benefits of the portfolio license, attempt to extract unreasonable terms for licensing its patents as a result of already being licensed under the portfolio license. Article 10.05 merely “evens the playing field,” returns the parties to the bargaining position each would have been in but for the portfolio license, and creates no competitive issues. This is particularly so in light of each portfolio licensors’ undertaking to license its patents outside the portfolio license. Thus, a licensee who subjects itself to the provision of Article 10.05 by filing suit and refusing to grant a license on fair and reasonable terms is not denied the right to a license for essential patents, just to a license for essential patents on the favorable terms of the portfolio license.

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2 Widespread public reports have suggested that the typical disc will retail for approximately $20-25. The per disc royalty thus amounts to approximately .22% of the retail price of discs, although the royalty typically will be payable by the disc replicator.
Finally, Article 11.04 provides that any disputes involving the license shall be submitted to arbitration in New York and resolved under New York law. This provides for a certain and cost effective method to resolve disputes.

Agreement Among Licensors

The agreements among Philips, Sony and Pioneer relating to the Proposed Licensing Program are set forth in two bilateral Agreements and Amendment No. 1 thereto, one between Sony and Philips and one identical agreement between Pioneer and Philips. The Agreements and Amendments are appended hereto as Exhibit D.

The Agreements basically set forth the terms under which Philips shall license the three companies’ essential patents and set out many of the same terms which are incorporated in the licenses itself and are discussed above. The Agreements make plain that the Proposed Licensing Program does not in any way impede the companies’ ability to license their patents on their own under any conditions they may negotiate.

Article 2.01 of the Agreement provides that Philips shall offer the portfolio license to “all interested third parties.” Article 5 of Amendment No. 1 further specifies that Philips shall grant licenses “to all interested parties and shall not discriminate against or among potential licensees” although Philips is entitled to seek financial guarantees on royalty payments when required. The Agreements also set out various terms for the collection and distribution of royalties. Although Article 4.03 provides that each party may consult with the others in the event of a good faith belief that an act of infringement has occurred, Article 4.04 provides that each party retains the right to enforce its patents as it sees fit.

Article 7 of Amendment No. 1 sets forth the details of the procedure by which Philips shall retain an independent expert to assure that all patents in the portfolio are essential, and provides the procedure under which patents may be added to the Proposed Licensing Program.

Conclusion

It is anticipated that DVD-Video and DVD-ROM applications will gain widespread acceptance among consumers in the United States and throughout the world. Intellectual property rights granted by the United States and other sovereign nations to numerous unrelated entities could seriously delay if not block the introduction of this new and significant technology. The Proposed Licensing Program described above eliminates one potential impediment to the implementation of DVD-Video and DVD-ROM by allowing all essential patents of Philips, Sony and Pioneer to be offered in a single, non-discriminatory, fair and cost effective licensing program. The Proposed Licensing Program has been carefully crafted in an effort to avoid any competition concerns which may arise from the combining of patents belonging to independent entities within a single license. We respectfully submit that the Proposed Licensing Program has successfully addressed any competition concerns, and that the pro-competitive aspects of the program far outweigh any potential competition issues which may remain.

We will be available at your convenience to provide any further information you may require. We very much appreciate the Division’s attention to this matter.
Respectfully,

Garrard R. Beeney
for Koninklijke Philips Electronics, N.V.; Sony Corporation of Japan and Pioneer Electronic Corporation of Japan

DVD Business Review Letter Response

December 16, 1998

VIA FAX

Garrard R. Beeney, Esq.
Sullivan & Cromwell
125 Broad Street
New York, New York 10004-2498

Dear Mr. Beeney:

This letter is in response to your request on behalf of Koninklijke Philips Electronics, N.V. (“Philips”), Sony Corporation of Japan (“Sony”) and Pioneer Electronic Corporation of Japan (“Pioneer”) for the issuance of a business review letter pursuant to the Department of Justice’s Business Review Procedure, 28 C.F.R. § 50.6. You have requested a statement of the Department of Justice’s antitrust enforcement intentions with respect to a proposed arrangement pursuant to which Philips will assemble and offer a package license under the patents of Philips, Sony and Pioneer (collectively, the “Licensors”) that are “essential,” as defined below, to manufacturing Digital Versatile Discs (DVDs) and players in compliance with the DVD-ROM and DVD-Video formats, and will distribute royalty income among the Licensors.

I. The DVD-ROM and DVD-Video Formats

The Standard Specifications for the DVD-ROM and DVD-Video formats describe the physical and technical parameters for DVDs for read-only-memory and video applications, respectively, and “rules, conditions and mechanisms” for player units for the two formats.1 In either format, the DVD offers storage capacity more than seven times that of a compact disc; a single-layer, single-sided DVD, for example, can store 4.7 billion bytes (4.38 GB) of information including audio, video, text, and data. Employing compression technology, a DVD-Video disc can hold a 135-minute feature film on a single side.

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1 DVD Specifications for Read-Only Disc (the “Standard Specifications”), Part 3: Video Specifications, Version 1.1 (December 1997), § 3.3.1. You have attached the Standard Specifications as Exhibit A to your letter. DVD-Video, which is described in Part 3 of the Standard Specifications, appears to be a subunit of the DVD-ROM format. The DVD-Video specifications indicate that DVD-Video discs shall comply with Parts 1 and 2 of the Standard Specifications, which describe the disc’s physical and file-system characteristics, respectively. Id., § 1.1.
The Licensors, along with a number of other producers of consumer electronics hardware, software, or both, established the Standard Specifications. These Standard Specifications appear to implicate the intellectual property rights of numerous firms.

II. The Proposed Arrangement

The proposed arrangement is embodied in two pairs of licenses: two separate but substantially identical licenses to Philips from Sony and Pioneer (the “DVD-Video and DVD-ROM Agreement”); and a pair of standard licenses from Philips to DVD makers (the “Disc License”) and player manufacturers (the “Player License”). Through these two sets of licenses, Philips aggregates the Licensors’ patents and will disseminate them to users of the DVD-ROM and DVD-Video formats.

A. The patents to be licensed

Under the proposed arrangement, Philips is licensing from the other Licensors those patents that: (i) they owned or controlled as of specific dates in 1997; (ii) are entitled to a priority date before December 31, 1996; and (iii) are “essential,” which is defined as “necessary (as a practical matter) for compliance with the DVD Video or DVD-ROM Standard Specifications.” In turn, Philips will sublicense those patents, along with its own patents that meet the same criteria, in the Portfolio Licenses for use in making discs or players, respectively, that comply with either of those formats.

Initially, each Licensor has designated its “essential” patents for inclusion in the Portfolio Licenses; there are 115 patents in all for the manufacture of DVD players, and 95 for the manufacture of the discs themselves. However, the Licensors have retained a patent expert to review the designated United States patents and make an independent determination as to their “essentiality.” His determination, reflecting his “best independent judgment,” is to be based on information he obtains from the Licensors, others in the industry, and the advice of technical experts he may retain. The review, which is already underway, will not entail an

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3 In addition to the Licensors, the publishers of the DVD-ROM Specifications are: Hitachi, Ltd.; Matsushita Electric Industrial Co., Ltd.; Mitsubishi Electric Corporation; Thomson Multimedia; Time Warner Inc.; Toshiba Corp.; and Victor Company of Japan, Ltd. While your letter includes information concerning the process by which these formats were established, you have not requested, and this letter does not offer, an opinion on any competitive issues presented by the development of these formats or any other DVD-related format.

5 You have attached the Player License as Exhibit B to your letter, and the Disc License as Exhibit C. I will refer to the Disc and Player Licenses collectively as the “Portfolio Licenses.”

7 DVD-Video and DVD-ROM Agreement, Arts. 1.06-1.07. You have confirmed that the term “priority date” means, for any given patent in the Portfolio License, the first date on which the application for that patent, or for a patent on the same invention in another country, was filed. See 35 U.S.C. § 119.

8 We understand this definition to encompass patents which are technically essential—i.e., inevitably infringed by compliance with the specifications—and those for which existing alternatives are economically unfeasible. As discussed below, a less concrete definition of the term “as a practical matter” could give rise to difficult competitive issues. Neither Sony’s and Pioneer’s licenses to Philips nor the Portfolio Licenses convey rights to patents that are “essential” by virtue of the DVD formats’ incorporation of MPEG-2 video compression technology.
examination of validity. Should the expert determine that a patent initially designated as “essential” is not, Philips will exclude it from the Portfolio Licenses. However, licensees that have already taken the Disc or Player License shall have the option to retain their licenses to the newly excluded patent.

While one of the license documents indicates that the patent expert is to be “appointed” by Philips, the letters that the Licensors will send to the expert state that all of them are retaining him. Further, the letters state that the expert’s conclusions will have no bearing on either his compensation or any Licensor’s future retention of him or his law firm.

As noted above, the DVD-Video and DVD-ROM Agreements ensure only that the Licensors’ “essential” patents with filing dates before December 31, 1996, and which were owned or controlled by the Licensors as of November 24, 1997 (or, in Pioneer’s case, October 1, 1997) will be part of the Portfolio Licenses. You have stated to us that, as of December 1, 1998, no Licensor has indicated that it owns or controls an “essential” patent that falls outside these bounds. Should such a patent emerge, however, the DVD-Video and DVD-ROM Agreements commit the Licensors to licensing it, “at fair and reasonable conditions,” to any licensee under the Portfolio Licenses, either through Philips or individually.

B. The joint licensing arrangement

1. The licenses from Sony and Pioneer to Philips

Sony and Pioneer have granted Philips nonexclusive, sublicensable licenses on their “essential” patents to enable Philips to grant licenses “to all interested parties . . . to manufacture, have made, have manufactured components of, use and sell or otherwise dispose of” discs and players that conform to the Standard Specifications. The licenses obligate Philips to grant licenses on the “essential” patents for use in conformity with the specifications nondiscriminatorily to all interested third-parties. All three Licensors, however, remain free to license their “essential” patents independently of the Portfolio Licenses, including for uses outside the DVD-ROM and DVD-Video formats.

The licenses from Sony and Pioneer also establish the Portfolio Licenses’ royalty rates. The Player License per-unit royalty is to be 3.5% of the net selling price for each player sold, subject to a minimum fee of $7 per unit, which drops to $5 as of January 1, 2000. The Disc License royalty is to be $.042 per disc sold. In addition, each Portfolio License requires a $10,000 initial payment, half of which is creditable against the per-unit royalties. Philips’ licenses from Sony and Pioneer separately set the latter two firms’ share of these royalties, again on a per-unit basis. The allocation of royalties among the Licensors is not a function of the number of patents contributed to the pool. To ensure the receipt of their agreed royalties, Sony’s and Pioneer’s independent auditors may audit Philips’ books and records up to once a year.

While each of the Licensors retains sole discretion to pursue infringers, the licenses from Sony and Pioneer require each Licensor to notify the others before initiating any enforcement action and provide for sharing of joint infringement litigation expenses.
2. The Portfolio Licenses
As authorized by its licenses from Sony and Pioneer, Philips’ licenses to disc and player manufacturers will be for use in conformity with the Standard Specifications. However, the Portfolio Licenses will notify potential licensees that all the Licensors are “willing to license their respective patent rights for optical disc manufacturing, whether within or outside of the DVD-Video and DVD-ROM Standard Specifications . . . on reasonable terms and conditions.” They will warn potential licensees that licenses from other intellectual property owners may be necessary for compliance with the formats. A “Most Favourable Conditions” clause will entitle the licensee to the benefit of any lower royalty rate Philips grants to another licensee under “otherwise similar and substantially the same conditions.”

Each Portfolio License will have a term of ten years from the license’s effective date, subject to termination for a limited number of reasons.37 To verify royalties owed and paid, Philips may appoint an independent accountant to audit its licensees’ books and records up to once a year and may require licensees to provide the accountant with additional information for that purpose. The Portfolio Licenses also require licensees to provide, on request, information for review by a patent expert to determine whether a particular product infringes any of the licensed patents and, thus, triggers royalty obligations. The licensees’ obligation to provide information to the independent accountant and patent expert extends only to the information necessary to determine the amount of royalties owed or whether they are owed at all.

One of the grounds on which Philips may terminate a license relates to the licensees’ grantback obligation: Portfolio licensees must grant the Licensors and fellow licensees a license, “on reasonable, non-discriminatory conditions comparable to those set forth herein,” on any patents they own or control that are “essential” to either disc or player manufacture in conformity with the Standard Specifications. As noted above, this obligation is reinforced by Philips’ right to terminate without notice the license of any licensee that, after having refused to grant a Licensor a license on an “essential” patent it owns, sues that Licensor for infringement of that patent.

III. Analysis
As with any aggregation of patent rights for the purpose of joint package licensing, commonly known as a patent pool, an antitrust analysis of this proposed licensing program must examine both the pool’s expected competitive benefits and its potential competitive hazards. In particular, one expects that a patent pool “may provide competitive benefits by integrating complementary technologies, reducing transaction costs, clearing blocking positions, and avoiding costly infringement litigation.”44 At the same time, “some patent pools can restrict

37 Philips or its licensee may terminate the license on 30 days’ notice for the other party’s default. Philips also may terminate for licensee bankruptcy, failure to pay royalties, and without notice in response to a licensee’s lawsuit against any Licensor for infringement of an “essential” patent that licensee owns or controls, after the licensee has refused that Licensor’s request for a license.

44 Department of Justice-Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual
competition, whether among intellectual property rights within the pool or downstream products incorporating the pooled patents or in innovation among parties to the pool.”45 Accordingly, the following analysis addresses (i) whether the proposed licensing program is likely to integrate complementary patent rights and (ii), if so, whether the resulting competitive benefits are likely to be outweighed by competitive harm posed by other aspects of the program.

A fundamental premise of the following analysis is that the patents to be licensed are valid. This is a legitimate presumption with any patent. On the other hand, persuasive evidence to the contrary would undermine virtually any licensing arrangement: “A licensing scheme premised on invalid or expired intellectual property rights will not withstand antitrust scrutiny.”47 Unaccompanied by legitimate intellectual property rights, restrictions on licensors or licensees are highly likely to be anticompetitive. None of the information that you have provided us warrants abandonment of the presumption of validity as to any of the patents to be licensed. Should the Department subsequently receive information that undercuts this presumption, its enforcement intentions as to the proposed arrangement might be very different.

A. Integration of Complementary Patent Rights

If the Licensors owned patent rights that could be licensed and used in competition with each other, they might have an economic incentive to utilize a patent pool to eliminate competition among them. A pool that served that purpose “would raise serious competitive concerns.”49 In combining such substitute patents, the pool could serve as a price-fixing mechanism, ultimately raising the price of products and services that utilize the pooled patents. If, on the other hand, the pool were to bring together complementary patent rights, it could be “an efficient and procompetitive method of disseminating those rights to would-be users.”50

By reducing what would otherwise be three licensing transactions to one, the pool would reduce transactions costs for Licensors and licensees alike. By ensuring that each Licensors patents will not be blocked by those of the other two, the pool would enhance the value of all three Licensors patents.

One way to ensure that the proposed pool will integrate only complementary patent rights is to limit the pool to patents that are essential to compliance with the Standard Specifications. Essential patents by definition have no substitutes; one needs licenses to each of them in order to comply with the standard. At the same time, they are complementary to each

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50 Id.
A broader inclusion criterion than essentiality carries with it two anticompetitive risks, both arising from the possibility that there may be substitutes for patents included in the pool. Consider, for example, a situation where there are several patented methods for placing DVD-ROMs into packaging—each a useful complement to DVD-ROM manufacturing technology, but not essential to the standard. A DVD-ROM maker needs to license only one of them; they are substitutes for each other. Inclusion in the pool of two or more of those patents would risk turning the pool into a price-fixing mechanism. Inclusion in the pool of one of the patents, which the pool would convey along with the essential patents, could in certain cases unreasonably foreclose the competing patents from use by manufacturers; because the manufacturers would obtain a license to the one patent with the pool, they might choose not to license any of the competing patents, even if they otherwise would regard the competitive patents as superior. Limiting a pool to essential patents ensures that neither of these concerns will arise; rivalry is foreclosed neither among patents within the pool nor between patents in the pool and patents outside it.

If our understanding of the criterion “necessary (as a practical matter)” is correct, then it appears that the Licensors intend to license through the pool only complementary patents for which there are no substitutes for the purposes of compliance with the Standard Specifications. Some uncertainty arises from this definition’s imprecision: Unlike the MPEG-2 pool, which required actual technical essentiality for eligibility, this pool introduces the concept of necessity “as a practical matter.” On its face, this latter standard is inherently more susceptible to subjective interpretation. An excessively liberal interpretation of it could lead to the inclusion of patent rights for which there were viable substitutes. In that event, the pool could injure competition by foreclosing such substitutes.

Based on what you have told us, however, the definition of “necessary (as a practical matter)” that the expert will be employing is sufficiently clear and demanding that the portfolio is unlikely to contain patents for which there are economically viable substitutes. Thus, so long as the patent expert applies this criterion scrupulously and independently, it is reasonable to expect that the Portfolio will combine complementary patent rights while not limiting competition between them and other patent rights for purposes of the licensed applications. The structure of this pool, however, creates some concern about the expert’s ability to apply this criterion entirely independent of the Licensors. While you have stated that the patent expert will be “independent” and demonstrated that his independence is a term of the licenses from Sony and Pioneer to Philips, the expert is being retained directly by the Licensors, who have an incentive to combine in the pool any of their competing DVD-related patents and to foreclose others’ competing patents. Without more, there would be justifiable skep-

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56 Because the royalty allocation is unaffected by each Licensor’s share of the patents in the Portfolio License, the Licensors have no financial incentive to exclude each other’s non-essential patents. In the MPEG-2 pool, in contrast, the joint licensor, which retained the expert, was an entity separate from the patent owners with no intellectual property of its own at stake. Moreover, the pool members themselves had a strong incentive to ex-
ticism that this structure would ensure a disinterested review of the “essentiality” of the patent rights put forward.

However, in furtherance of the provision for independence in the licenses from Sony and Pioneer to Philips, each Licensor has assured the U.S. expert in writing that the expert’s compensation and future retention will not be affected by his determinations as to essentiality; the same assurance will go to the Japanese patent expert as well. These assurances, of course, are no guarantee. Their continuing fulfillment is necessary to the expert’s independence and, consequently, to the likelihood that the portfolio will contain only complementary patents without foreclosing competition. Whether they will be sufficient as well as necessary remains to be seen.

Although the patent-expert mechanism is flawed, the Department is willing to base its present enforcement intentions on your representation that the combination of the Licensors’ contractual commitment to independence and their written assurances to the expert will insulate him from their interests sufficiently to ensure that the Portfolio Licenses will contain only those patent rights of the Licensors that all DVD-Video and DVD-ROM licensees will need. In that case, the proposed arrangement would serve the procompetitive purpose of combining complementary technologies into a package that will be likely to lower costs to makers of DVD-Video and DVD-ROM discs and players. If, nevertheless, these assurances prove insufficient either to ensure the expert’s ability to function independently and objectively or to ensure that the pool will contain only essential patents, the Department’s enforcement intentions as to the proposed arrangement might be very different.

B. Foreclosure of Competition in Related Markets

As mentioned above, the Licensors are competitors in markets vertically related to the licensed technology—not only in “downstream” markets such as the manufacture of DVD discs and players, but also in the creation of content, such as feature-length films, that is incorporated in DVD discs. Consequently, the question arises whether this pool is likely to impede competition in any of those markets, not only between any given Licensor and licensees, but also among the Licensors themselves.

Based upon what you have told us, the proposed licensing program does not appear to have any such anticompetitive potential in the markets in which the licensed technology will be used. First, the agreed royalty is sufficiently small relative to the total costs of manufacture that it is unlikely to enable collusion among sellers of DVD players or discs. Second, the proposed program should enhance rather than limit access to the Licensors’ “essential” patents. Because Philips must license on a non-discriminatory basis to all interested parties, it cannot impose disadvantageous terms on competitors, let alone refuse to license them altogether. Should the agreed pool royalty prove economically unrealistic, each Licensor’s ability to grant licenses on its own to users of the Standard Specifications provides a backstop. Third, the extent of Philips’ ability to audit licensees, through independent accountants, is include non-essential patents, since their share of the royalties was a direct function of the number of essential patents they held.
unlikely to afford it anticompetitive access to competitively sensitive proprietary information, such as cost data. Sony’s and Pioneer’s similarly limited right to an annual audit of Philips’ conduct as joint licensor should not create any greater likelihood of collusion. Nor does there seem to be any facet of the proposed program that would facilitate collusion or dampen competition among the Licensors in the creation of content for software.

C. Effect on Innovation

Because only already-filed “essential” patents and patent applications are required for inclusion in the Portfolio, the program does not discourage the Licensors from continuing research and development that may relate to the standard. Further, the Licensors are free to license their “essential” patents for purposes that compete with the DVD-Video and DVD-ROM standards.

Ordinarily, patent license grantback provisions might be expected to raise the question whether, by reducing licensees’ incentives to innovate, they threaten competitive harm that outweighs their procompetitive effects. Here, however, the proposed grantback provisions are so narrow that they are unlikely to raise significant issues. Their scope is commensurate with that of the Licenses: They cover only “essential” patents. A licensee’s non-“essential” improvements remain its own and may be licensed or not, as the licensee wishes. Thus, the grantback obligation seems unlikely to apply to further innovation within the DVD-ROM and DVD-Video formats. Instead, it is far more likely to force cross-licenses, on “reasonable, non-discriminatory conditions comparable to those” of the Portfolio Licenses, from owners of already extant “essential” patents. In requiring licensees to offer the Licensors and fellow licensees access, on reasonable terms, to whatever “essential” patents they own or control, the Portfolio Licenses ensure that no licensee may take advantage of the benefits of the pool while exploiting its own market power over users of the Standard Specifications. The grantback provision is likely simply to bring other “essential” patents into the Portfolio, thereby limiting holdouts’ ability to exact a supracompetitive toll from Portfolio licensees and further lowering licensees’ costs in assembling the patent rights essential to their compliance with the Standard Specifications. While easing, though not altogether eliminating, the holdout problem, the grantback should not create any disincentive among licensees to innovate.

In the current circumstances, the proposed ten-year term of the license does not pose significant concerns. The Portfolio Licenses authorize only a limited field of use for the licensed technology—the manufacture and sale of products that comply with the Standard Specifications; they do not limit licensees’ other options. Licensees may seek presently unknown methods of complying with these standards, or they may support altogether different product standards. The absence of any renewal clause puts potential licensees on notice that they will be facing a new market-based negotiation for access to the technology on the expiration of the Portfolio Licenses ten years hence. The uncertainty of market conditions at that time makes it impossible to speculate on the degree of power, if any, the Licensors will hold over any future technology licensing market.
IV. Conclusion

Based on the information and assurances that you have provided us, it appears that the proposed arrangement is likely to combine complementary patent rights, thereby lowering the costs of manufacturers that need access to them in order to produce discs and players in conformity with the DVD-Video and DVD-ROM formats. Your assurances and information indicate that the proposed arrangement is not likely to impede competition, either in the licensing or development of technology for use in making DVDs, players, or products that conform to alternative formats, or in the markets in which DVDs and players compete.

For these reasons, the Department is not presently inclined to initiate antitrust enforcement action against the conduct you have described. This letter, however, expresses the Department’s current enforcement intention. In accordance with our normal practices, the Department reserves the right to bring an enforcement action in the future if the actual operation of the proposed conduct proves to be anticompetitive in purpose or effect.

This statement is made in accordance with the Department’s Business Review Procedure, 28 C.F.R. § 50.6. Pursuant to its terms, your business review request and this letter will be made publicly available immediately, and any supporting data will be made publicly available within 30 days of the date of this letter, unless you request that part of the material be withheld in accordance with Paragraph 10(c) of the Business Review Procedure.

Sincerely,

/s/ Joel I. Klein

Statement of the Department of Justice’s Antitrust Division on Its Decision to Close Its Investigations of Google Inc.’s Acquisition of Motorola Mobility Holdings Inc. and the Acquisitions of Certain Patents by Apple Inc., Microsoft Corp. and Research in Motion Ltd.

Department of Justice, Office of Public Affairs, February 13, 2012

WASHINGTON – The Department of Justice’s Antitrust Division issued the following statement today after announcing the closing of its investigations into Google Inc.’s acquisition of Motorola Mobility Holdings Inc., the acquisitions by Apple Inc., Microsoft Corp. and Research in Motion Ltd. (RIM) of certain Nortel Networks Corporation patents, and the acquisition by Apple of certain Novell Inc. patents:

“After a thorough review of the proposed transactions, the Antitrust Division has determined that each acquisition is unlikely to substantially lessen competition and has closed these three investigations. In all of the transactions, the division conducted an in-depth analysis into the potential ability and incentives of the acquiring firms to use the patents they proposed acquiring to foreclose competitors. In particular, the division focused on standard essential patents (SEPs) that Motorola Mobility and Nortel had committed to license to industry participants through their participation in standard-setting organizations (SSOs). The
division’s investigations focused on whether the acquiring firms could use these patents to raise rivals’ costs or foreclose competition.

“The division concluded that the specific transactions at issue are not likely to significantly change existing market dynamics.

“During the course of the division’s investigation, several of the principal competitors, including Google, Apple and Microsoft, made commitments concerning their SEP licensing policies. The division’s concerns about the potential anticompetitive use of SEPs was lessened by the clear commitments by Apple and Microsoft to license SEPs on fair, reasonable and non-discriminatory terms, as well as their commitments not to seek injunctions in disputes involving SEPs. Google’s commitments were more ambiguous and do not provide the same direct confirmation of its SEP licensing policies.

“In light of the importance of this industry to consumers and the complex issues raised by the intersection of the intellectual property rights and antitrust law at issue here, as well as uncertainty as to the exercise of the acquired rights, the division continues to monitor the use of SEPs in the wireless device industry, particularly in the smartphone and computer tablet markets. The division will not hesitate to take appropriate enforcement action to stop any anticompetitive use of SEP rights.”

BACKGROUND

Google/ Motorola Mobility

On Aug. 25, 2011, Google entered into an agreement to acquire Motorola Mobility, a manufacturer of smartphones and computer tablets and the holder of a portfolio of approximately 17,000 issued patents and 6,800 applications, including hundreds of SEPs relevant to wireless devices that Motorola Mobility committed to license through its participation in SSOs.

Rockstar Bidco

Rockstar Bidco, a partnership that includes, among others, RIM, Microsoft and Apple, was formed to acquire patents at the June 2011 Nortel bankruptcy auction, and to license and distribute them to certain partners. Nortel’s portfolio of approximately 6,000 patents and patent applications includes many SEPs that Nortel committed to license through its participation in SSOs and that are relevant to wireless devices (the Nortel SEPs).

Apple/Novell

Apple also proposes to acquire patents held by CPTN Holdings LLC, formerly owned by Novell, following CPTN’s acquisition in April 2011 of those patents on behalf of Apple, Oracle Corporation and EMC Corporation. As a member of the Open Invention Network (OIN), Novell committed to cross-license its patents on a royalty-free basis for use in the open source “Linux system,” a defined term in the OIN.
Competitive Landscape

Google, Apple, Microsoft and RIM have each developed mobile operating systems for smartphones and tablets. Apple and RIM manufacture and sell the smartphones and tablets that run on their proprietary mobile operating systems. In contrast, Microsoft licenses its proprietary mobile operating systems, Windows Phone 7 and Windows Mobile, to non-affiliated wireless handset original equipment manufacturers (OEMs). Google, in turn, sponsors Android, a mobile operating system that it distributes to OEMs without monetary charge under an open source license. These operating systems provide platforms for a variety of products and services offered by competing handset and tablet manufacturers, as well as, application developers.

At the end of 2011, Google’s Android accounted for approximately 46 percent of the U.S. smartphone operating system platform subscribers and Apple’s iOS was used by about 30 percent of subscribers. RIM and Microsoft accounted for approximately 15 percent and 6 percent of the share of smartphone subscribers, respectively.

Apple’s iPad is the leading tablet in the market, although the recently introduced Android-based tablets are rapidly gaining share. Thus far, tablets running RIM’s and Microsoft’s operating systems have a minimal presence in the marketplace.

The Importance of Standard Setting in the Wireless Industry

Today’s wireless device industry, which includes smartphones and tablets, relies on complex operating systems that allow seamless interaction with wireless communications technologies while providing audio, video and computer functionalities.

To facilitate seamless interoperability, industry participants work through SSOs collectively to develop technical standards that establish precise specifications for essential components of the technology. For example, wireless devices typically implement a significant number of telecommunication and computer standards, including cellular air interface standards (e.g., 3G and 4G LTE standards), wireless broadband technologies (e.g., WiFi and WiMax) and video compression technologies (e.g., H.264). As with other industries, these standards facilitate compatibility among products and provide consumers with a wider range of products and capabilities than would otherwise be available.

Often, many technologies adopted by the SSOs fall within the scope of existing patents or patent applications. Once a patent is included in a standard, it becomes essential to the implementation of that standard, thus the term “Standard Essential Patent.” After industry participants make complementary investments, abandoning the standard can be extremely costly. Thus, after the standard is set, the patent holder could seek to extract a higher payment than was attributable to the value of the patented technology before the standard was set. Such behavior can distort innovation and raise prices to consumers. A comparable harm may also arise in situations outside of the SSO context where a patent holder’s prior actions, such as open source commitments, lead others to make complementary investments (See U.S. Department of Justice and Federal Trade Commission, Antitrust Enforcement & Intellectual Property Rights: Promoting Innovation and Competition, April 17, 2007 at 35-6).
Most SSOs therefore require the owners of patents essential to the proposed standard that are participating in the SSO’s standard-setting activities to make disclosure and licensing commitments with respect to their essential patents. These commitments are intended to reduce the subsequent inappropriate use of the patent rights at issue, and thus prevent disputes that can inhibit innovation and competition. One common licensing requirement is to require SSO members to commit to license patented technologies essential to a standard on reasonable and nondiscriminatory (RAND) terms (for SSOs based in the United States) or on fair, reasonable and nondiscriminatory (FRAND) terms (for SSOs based outside the United States) (collectively F/RAND). In practice, however, SSO F/RAND requirements have not prevented significant disputes from arising in connection with the licensing of SEPs, including actions by patent holders seeking injunctive or exclusionary relief that could alter competitive market outcomes.

ANALYSIS

The division’s investigations regarding the acquisitions of the Motorola Mobility and Nortel SEPs focused on whether the acquiring firms would have the incentive and ability to exploit ambiguities in the SSOs’ F/RAND licensing commitments to hold up rivals, thus preventing or inhibiting innovation and competition (The division’s analysis was limited to SEPs encumbered by F/RAND commitments). Such hold up could include raising the costs to rivals by demanding supracompetitive licensing rates, compelling prospective licensees to grant the SEP holder the right to use the licensee’s differentiating intellectual property, charging licensees the entire portfolio royalty rate when licensing only a small subset of the patent holder’s SEPs in its portfolio, or seeking to prevent or exclude products practicing those SEPs from the market altogether. In this analysis, the critical issue is whether the patent holder has the incentive and ability to hold up its competitors, particularly through the threat of an injunction or exclusion order. The division’s analysis focused on how the proposed transactions might change that incentive and ability to do so.

The division concluded that each of the transactions was unlikely to substantially lessen competition for wireless devices. With respect to RIM’s and Microsoft’s acquisition of Nortel patents, their low market shares in mobile platforms would likely make a strategy to harm rivals either through injunctions or supracompetitive royalties based on the acquired Nortel SEPs unprofitable. Because of their low market shares, they are unlikely to attract a sufficient number of new customers to their mobile platforms to compensate for the lost patent royalty revenues. Moreover, Microsoft has cross-license agreements in place with the majority of its Android-based OEM competitors, making such a strategy even less plausible for it.

Apple’s and Google’s substantial share of mobile platforms makes it more likely that as the owners of additional SEPs they could hold up rivals, thus harming competition and innovation. For example, Apple would likely benefit significantly through increased sales of its devices if it could exclude Android-based phones from the market or raise the costs of such phones through IP-licenses or patent litigation. Google could similarly benefit by raising the costs of, or excluding, Apple devices because of the revenues it derives from Android-based devices.
The specific transactions at issue, however, are not likely to substantially lessen competition. The evidence shows that Motorola Mobility has had a long and aggressive history of seeking to capitalize on its intellectual property and has been engaged in extended disputes with Apple, Microsoft and others. As Google’s acquisition of Motorola Mobility is unlikely to materially alter that policy, the division concluded that transferring ownership of the patents would not substantially alter current market dynamics. This conclusion is limited to the transfer of ownership rights and not the exercise of those transferred rights.

With respect to Apple/Novell, the division concluded that the acquisition of the patents from CPTN, formerly owned by Novell, is unlikely to harm competition. While the patents Apple would acquire are important to the open source community and to Linux-based software in particular, the OIN, to which Novell belonged, requires its participating patent holders to offer a perpetual, royalty-free license for use in the “Linux-system.” The division investigated whether the change in ownership would permit Apple to avoid OIN commitments and seek royalties from Linux users. The division concluded it would not, a conclusion made easier by Apple’s commitment to honor Novell’s OIN licensing commitments.

In its analysis of the transactions, the division took into account the fact that during the pendency of these investigations, Apple, Google and Microsoft each made public statements explaining their respective SEP licensing practices. Both Apple and Microsoft made clear that they will not seek to prevent or exclude rivals’ products from the market in exercising their SEP rights.

Apple outlined its view of F/RAND in a letter to the European Telecommunications Standards Institute (ETSI) on Nov. 11, 2011, stating among other things:

“A party who made a FRAND commitment to license its cellular standards essential patents or otherwise acquired assets/rights from a party who made the FRAND commitment must not seek injunctive relief on such patents. Seeking an injunction would be a violation of the party’s commitment to FRAND licensing.” (emphasis supplied)

Microsoft stated publicly on Feb. 8, 2012, among other things:

“This means that Microsoft will not seek an injunction or exclusion order against any firm on the basis of those essential patents.”

If adhered to in practice, these positions could significantly reduce the possibility of a hold up or use of an injunction as a threat to inhibit or preclude innovation and competition.

Google’s commitments have been less clear. In particular, Google has stated to the IEEE and others on Feb. 8, 2012, that its policy is to refrain from seeking injunctive relief for the infringement of SEPs against a counter-party, but apparently only for disputes involving future license revenues, and only if the counterparty forgoes certain defenses such as challenging the validity of the patent; pays the full disputed amount into escrow; and agrees to a reciprocal process regarding injunctions. Google’s statement therefore does not directly provide the same assurance as the other companies’ statements concerning the exercise of its newly acquired patent rights. Nonetheless, the division determined that the acquisition of the patents by Google did not substantially lessen competition, but how Google may exercise its patents in the future remains a significant concern.
For these reasons the division continues to have concerns about the potential inappropriate use of SEPs to disrupt competition and will continue to monitor the use of SEPs in the wireless device industry, particularly as they relate to smartphones and computer tablets. The division’s continued monitoring of how competitors are exercising their patent rights will ensure that competition and innovation are unfettered in this important industry.

All three of the transactions highlight the complex intersection of intellectual property rights and antitrust law and the need to determine the correct balance between the rightful exercise of patent rights and a patent holder’s incentive and ability to harm competition through the anticompetitive use of those rights.

Agency Cooperation

During the course of its investigation of the Google/Motorola Mobility transaction, the Department of Justice cooperated closely with the European Commission. In addition, the Department of Justice had discussions with the Australian Competition and Consumer Commission, Canadian Competition Bureau, Israeli Antitrust Authority and the Korean Fair Trade Commission. In connection with the investigations relating to the Nortel patent assets, the division worked closely with states of New York and California and with the Canadian Competition Bureau.

The Antitrust Division’s Closing Statement Policy

The division provides this statement under its policy of issuing statements concerning the closing of investigations in appropriate cases. This statement is limited by the division’s obligation to protect the confidentiality of certain information obtained in its investigations. As in most of its investigations, the division’s evaluation has been highly fact-specific, and many of the relevant underlying facts are not public. Consequently, readers should not draw overly broad conclusions regarding how the division is likely in the future to analyze other collaborations or activities, or transactions involving particular firms. Enforcement decisions are made on a case-by-case basis, and the analysis and conclusions discussed in this statement do not bind the division in any future enforcement actions. Guidance on the division’s policy regarding closing statements is available at: www.usdoj.gov/atr/public/guidelines/201888.htm.
Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of

Restoring Internet Freedom

WC Docket No. 17-108

NOTICE OF PROPOSED RULEMAKING

Adopted: May 18, 2017
Released: May 23, 2017

Comment Date: July 17, 2017
Reply Comment Date: August 16, 2017

By the Commission: Chairman Pai and Commissioner O’Rielly issuing separate statements; Commissioner Clyburn dissenting and issuing a statement.

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APPENDIX A – Proposed Rules
APPENDIX B – Initial Regulatory Flexibility Act
I. INTRODUCTION

1. Americans cherish a free and open Internet. And for almost twenty years, the Internet flourished under a light-touch regulatory approach. It was a framework that our nation’s elected leaders put in place on a bipartisan basis. President Clinton and a Republican Congress passed the Telecommunications Act of 1996, which established the policy of the United States “to preserve the vibrant and competitive free market that presently exists for the Internet . . . unfettered by Federal or State regulation.”

2. During this time, the Internet underwent rapid, and unprecedented, growth. Internet service providers (ISPs) invested over $1.5 trillion in the Internet ecosystem and American consumers enthusiastically responded. Businesses developed in ways that the policy makers could not have fathomed even a decade ago. Google, Facebook, Netflix, and countless other online businesses launched in this country and became worldwide success stories. The Internet became an ever-increasing part of the American economy, offering new and innovative changes in how we work, learn, receive medical care, and entertain ourselves.

3. But two years ago, the FCC changed course. It decided to apply utility-style regulation to the Internet. This decision represented a massive and unprecedented shift in favor of government control of the Internet.

4. The Commission’s Title II Order has put at risk online investment and innovation, threatening the very open Internet it purported to preserve. Investment in broadband networks declined. Internet service providers have pulled back on plans to deploy new and upgraded infrastructure and services to consumers. This is particularly true of the smallest Internet service providers that serve consumers in rural, low-income, and other underserved communities. Many good-paying jobs were lost as the result of these pull backs. And the order has weakened Americans’ online privacy by stripping the Federal Trade Commission—the nation’s premier consumer protection agency—of its jurisdiction over ISPs’ privacy and data security practices.

5. Today, we take a much-needed first step toward returning to the successful bipartisan framework that created the free and open Internet and, for almost twenty years, saw it flourish. By proposing to end the utility-style regulatory approach that gives government control of the Internet, we aim to restore the market-based policies necessary to preserve the future of Internet Freedom, and to reverse the decline in infrastructure investment, innovation, and options for consumers put into motion by the FCC in 2015. Our actions today continue our critical work to promote broadband deployment to rural

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2 See, e.g., Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in A Reasonable & Timely Fashion, & Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996, As Amended by the Broadband Data Improvement Act, 2015 Broadband Progress Report and Notice of Inquiry on Immediate Action to Accelerate Deployment, 30 FCC Rcd 1375, 1383, para. 15 (2015) (2015 Broadband Progress Report) (noting that broadband providers recognized “both the value of and the need for continued investment to develop a robust broadband network that will meet consumers’ demands,” and that between 2012 and 2013, broadband providers had increased their investments by approximately 10 percent, to $75 billion).
II. BACKGROUND

6. Long before the commercialization of the Internet, federal law drew a line between the heavily regulated common carrier services and more lightly regulated services that went beyond mere transmission. Starting in 1966, the Commission initiated the Computer Inquiries, which created a dichotomy between basic and enhanced services. Basic services offered “pure transmission capability over a communications path that is virtually transparent in terms of its interaction with customer supplied information” and were “regulated under Title II of the [Communications] Act.” Enhanced services were “any offering over the telecommunications network which is more than a basic transmission service. In an enhanced service, for example, computer processing applications are used to act on the content, code, protocol, and other aspects of the subscriber’s information.” Unlike basic services, the Commission found that “enhanced services should not be regulated under the Act.”

7. Just two years later, the federal courts would draw a similar line in resolving the government’s antitrust case against AT&T. The Modification of Final Judgment (MFJ) of 1982 distinguished between “telecommunications services,” which Bell Operating Companies could offer when “actually regulated by tariff,” and “information services,” including “data processing and other computer-related services” and “electronic publishing services,” which Bell Operating Companies were prohibited from offering entirely.

8. In the Telecommunications Act of 1996, intended to “promote competition and reduce regulation,” President Clinton and Congress drew a line between lightly regulated “information services” and more heavily regulated “telecommunications services.” They also found that the “Internet and other interactive computer services have flourished, to the benefit of all Americans, with a minimum

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5 We note that since this docket was opened on April 27, 2017, this matter has generated significant public interest. The public will continue to have opportunities to participate in this important proceeding following adoption and release of the text of this Notice through a robust comment and reply comment period. Moreover, presentations made by the public before or after the Sunshine Agenda period will be made a part of the formal record of the proceeding.


7 Amendment of Section 64.702 of the Commission’s Rules and Regulations (Second Computer Inquiry), Docket No. 20828, Final Decision, 77 FCC 2d 384, 420, para. 97 (1980).

8 Id. at 420, para. 96.

9 Id. at 428, para. 114.

10 Id. at 420, para. 97.

11 Id. at 428, para. 114.


13 Id. at 179.

14 Id. at 180.

15 Id. at 228.


of government regulation”\textsuperscript{18} and declared it the policy of the United States to “promote the continued development of the Internet and other interactive computer services and other interactive media” and “to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation.”\textsuperscript{19} The 1996 Act went on to define “interactive computer service” to include “any information service, system, or access software provider that provides or enables computer access by multiple users to a computer server, including specifically a service or system that provides access to the Internet . . . .”\textsuperscript{20}

9. Congress weighed in again two years later. Five Senators—John Ashcroft, Wendell Ford, John F. Kerry, Spencer Abraham, and Ron Wyden—wrote the Commission that “[n]othing in the 1996 Act or its legislative history suggests that Congress intended to alter the current classification of Internet and other information services or to expand traditional telephone regulation to new and advanced services.”\textsuperscript{21} These five members further warned that if the Commission “subject[ed] some or all information service providers to telephone regulation, it seriously would chill the growth and development of advanced services to the detriment of our economic and educational well-being.”\textsuperscript{22}

10. For the next 16 years, the Commission repeatedly followed their advice, opting for a light-touch approach to the Internet that favored discrete and targeted actions over traditional pre-emptive, sweeping regulation of Internet service providers. In the 1998 \textit{Stevens Report}, the Commission comprehensively reviewed the Act’s definitions as they applied to the emerging technology of the Internet and concluded that Internet access service was properly classified as an information service.\textsuperscript{23} The \textit{Stevens Report} exhaustively reviewed the text and legislative history of the Telecommunications Act, along with the agency’s own administrative precedent and the courts’ administration of antitrust law.\textsuperscript{24} Looking to the Act’s text, the Commission concluded that “Internet access providers do not offer a pure transmission path; they combine computer processing, information provision, and other computer-mediated offerings with data transport,”\textsuperscript{25} and it “recognize[d] the unique qualities of the Internet, and [did] not presume that legacy regulatory frameworks are appropriately applied to it.”\textsuperscript{26} Further, even “address[ing] the classification of Internet access service \textit{de novo}” the \textit{Stevens Report} reached the same conclusion: Internet access service is an information service according to the statute.\textsuperscript{27} The \textit{Stevens Report} also found that subjecting Internet service providers and other information service providers to “the broad range of Title II constraints,” would “seriously curtail the regulatory freedom that the

\textsuperscript{18} \textit{47} U.S.C. § 230(a)(4).
\textsuperscript{19} \textit{47} U.S.C. § 230(b)(1), (2).
\textsuperscript{22} \textit{Id}.
\textsuperscript{24} See, e.g., \textit{id}., 13 FCC Rcd at 11513-14, 11520, 11536–37, paras. 27, 39, 74–75. The \textit{Stevens Report} also noted that “[s]ince \textit{Computer II}, we have made it clear that offerings by non-facilities-based providers combining communications and computing components should always be deemed enhanced,” while “the matter is more complicated when it comes to offerings by facilities-based providers.” \textit{Id}. at 11530, para. 60.
\textsuperscript{25} \textit{Id}. at 11536, para. 73.
\textsuperscript{26} \textit{Id}. at 11540, para. 82.
\textsuperscript{27} See, e.g., \textit{id}. 

4
Commission concluded in Computer II was important to the healthy and competitive development of the enhanced-services industry.²²₈

11. In the 2002 Cable Modem Order, the Commission classified broadband Internet access service over cable systems as an “interstate information service.”²²₉ The Commission did so based on the “functions that cable modem service makes available to its end users,”³₀ on the fact that the “telecommunications component is not, however, separable from the data-processing capabilities of the service,”³¹ and is an information service “regardless of whether subscribers use all of the functions provided as part of the service, such as e-mail or web-hosting, and regardless of whether every cable modem service provider offers each function that could be included in the service.”³² The Commission was also guided by its belief that “broadband services should exist in a minimal regulatory environment that promotes investment and innovation in a competitive market,”³³ and the knowledge that regulatory uncertainty “may discourage investment and innovation.”³⁴

12. In June 2005, the Supreme Court decisively upheld the Commission’s 2002 classification of broadband Internet access service over cable systems as a lightly-regulated Title I information service.³⁵

13. In 2004, then-FCC Chairman Michael Powell announced four principles for Internet freedom to further ensure that the Internet would remain a place for free and open innovation with minimal regulation.³⁶ These four “Internet freedoms” include the freedom to access lawful content, the freedom to use applications, the freedom to attach personal devices to the network, and the freedom to obtain service plan information.³⁷

14. In the 2005 Wireline Broadband Classification Order, the Commission classified broadband Internet access service over wireline facilities as an information service.³⁸ In reaching this conclusion, the Commission relied on the plain text of the Act, finding that “providers of wireline broadband Internet access service offer subscribers the ability to run a variety of applications that fit under the characteristics stated in the information service definition,”³⁹ and that users of wireline

²²₈ Id. at 11524, para. 46.
²²₉ See Inquiry Concerning High-Speed Access to the Internet Over Cable & Other Facilities; Internet Over Cable Declaratory Ruling; Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4802, para. 7 (2002) (Cable Modem Order).
³₀ Id. at 4821, para. 35.
³₁ Id. at 4823, para. 39.
³² Id. at 4822–23, para. 38 (footnote omitted).
³³ Id. at 4802, para. 5.
³⁴ Id.
³⁷ Id at 5.
³⁹ Id. at 14860, para. 9.
broadband Internet access service were provided “more than [a] pure transmission” path whenever they accessed the Internet.\footnote{14864, para. 15.}

15. In 2005, the Commission also unanimously endorsed the four Internet freedoms in the Internet Policy Statement.\footnote{Appropriate Framework for Broadband Access to the Internet over Wireline Facilities et al., GN Docket No. 00-185, CC Docket Nos. 02-33, 01-33, 98-10, 95-20, CS Docket No. 02-52, Policy Statement, 20 FCC Rcd 14986 (2005) (Internet Policy Statement).} The Internet Policy Statement announced the Commission’s intent to “incorporate [these] principles into its ongoing policymaking activities” in order to “foster creation, adoption and use of Internet broadband content, applications, services and attachments, and to ensure consumers benefit from the innovation that comes from competition.”\footnote{Internet Policy Statement, 20 FCC Rcd at 14988, para 5. The Commission did this, for example, by incorporating such principles in its rules governing certain wireless spectrum. See Service Rules For the 698-746, 747-762 and 777-792 MHz Bands et al., WT Docket No. 06-150 et al., Second Report and Order, 22 FCC Rcd. 15289, 15361, 15365, paras. 194, 206 (2007).}

16. In the 2006 BPL-Enabled Broadband Order, the Commission concluded that broadband Internet access service over power lines was properly classified as an information service.\footnote{See United Power Line Council’s Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service, WC Docket No. 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281 (2006) (BPL-Enabled Broadband Order).} This decision established “a minimal regulatory environment” which promoted “ubiquitous availability of broadband to all Americans.”\footnote{Id. at 13281, para. 2.} The Commission noted that broadband-powerline-enabled Internet access service “combines computer processing, information provision, and computer interactivity with data transport, [which] enable[es] end users to run a variety of applications,”\footnote{Id. at 13826, para. 9.} and concluded that classification as an information service “encourage[es] the deployment of broadband Internet access services.”\footnote{Id. at 13827, para. 10.}

17. In the 2007 Wireless Broadband Internet Access Order, the Commission classified wireless broadband Internet access service as an information service, again recognizing the “minimal regulatory environment” that promoted the “ubiquitous availability of broadband to all Americans.”\footnote{See Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks, Declaratory Ruling, 22 FCC Rcd 5901, 5902, para. 2 (2007) (Wireless Broadband Internet Access Order).} Consistent with its prior interpretations, the Commission concluded that “wireless broadband Internet access service offers a single, integrated service to end users, Internet access, that inextricably combines the transmission of data with computer processing, information provision, and computer interactivity, for the purpose of enabling end users to run a variety of applications.”\footnote{Id. at 5911, para. 26.} The Commission also found that “mobile wireless broadband Internet access service is not a ‘commercial mobile radio service’ as that term is defined in the Act and implemented in the Commission’s rules.”\footnote{Id. at 5916, para. 41.}

18. In the 2008 Comcast-BitTorrent Order, the Commission sought to directly enforce federal Internet policy consistent with the Internet Policy Statement, finding Comcast’s actions “contravene[d] . . . federal policy” by “significantly impeding consumers’ ability to access the content
and use the applications of their choice." In 2010, the U.S. Court of Appeals for the D.C. Circuit rejected the Commission’s action, holding that the Commission had not justified its action as a valid exercise of ancillary authority.

19. In response, the Commission adopted the 2010 Open Internet Order, where once again the Commission specifically rejected more heavy-handed regulation of broadband Internet access service. Instead, the Open Internet Order relied on, among other things, newly-claimed regulatory authority under section 706 of the Telecommunications Act to establish no-blocking and no-unreasonable-discrimination rules as well as a requirement that broadband Internet access service providers “publicly disclose accurate information regarding the network management practices, performance, and commercial terms of its broadband Internet access services.” In doing so, the Commission distinguished between fixed and mobile broadband Internet access services, reasoning that the latter “presents special considerations that suggest differences in how and when open Internet protections should apply.”

20. In 2014, the D.C. Circuit vacated the no-blocking and no-unreasonable-discrimination rules adopted in the Open Internet Order, finding that the rules impermissibly regulated broadband Internet access service providers as common carriers, in conflict with the Commission’s prior determination that broadband Internet access service was not a telecommunications service and that mobile broadband Internet access service was not a commercial mobile service. The D.C. Circuit nonetheless upheld the transparency rule, claimed the Commission had authority to regulate broadband Internet access service providers under section 706 of the Telecommunications Act, and suggested that no-blocking and no-unreasonable-discrimination rules might be permissible if Internet service providers could engage in individualized bargaining.


51 Comcast Corp. v. FCC, 600 F.3d 642 (D.C. Cir. 2010) (Comcast). Among other things, the court held that section 706 of the 1996 Act could not serve as the source of direct authority to which the Commission’s action was ancillary because the Commission was bound in Comcast by a prior Commission determination that section 706 did not constitute a direct grant of authority. Id. at 658–59.


53 Id. at 17992 (Appendix A).

54 Id. at 17956, para. 94.

55 Verizon v. FCC, 740 F.3d 623, 655–58 (D.C. Cir. 2014) (Verizon) (vacating the Commission’s rule prohibiting “unreasonable discrimination” by fixed broadband providers on the theory that it “so limited broadband providers’ control over edge providers’ transmissions that [it] constitute[d] common carriage per se” and finding that the no-blocking rules “would appear on their face” to impose common carrier obligations on fixed and mobile broadband providers).

56 Id. at 650.

57 Id. at 635–42.

58 See, e.g., id. at 657 (quoting Cellco Partnership v. FCC, 700 F.3d 534, 549 (D.C. Cir. 2012)).
21. Later that year, the Commission embarked yet again down the path of rulemaking, proposing to rely on section 706 of the Telecommunications Act to adopt enforceable rules using the court’s “roadmap.”

22. In November 2014, then-President Obama called on the FCC to “reclassify consumer broadband service under Title II of the Telecommunications Act.” Three months later, the Commission adopted the *Title II Order*, reclassifying broadband Internet access services from information services to telecommunications services. In doing so, the Commission found it necessary to forbear from enforcing the “vast majority of rules adopted under Title II,” including “30 statutory provisions[,]” and to render “over 700 codified rules inapplicable.” The Commission adopted no-blocking, no-throttling, and no-paid-prioritization rules, as well as a general Internet conduct standard and “enhancements” to the transparency rule. In 2016, a divided panel of the D.C. Circuit Court of Appeals upheld the *Title II Order* in *United States Telecom Ass’n v. FCC*, with the D.C. Circuit denying petitions for rehearing of the case *en banc*.

### III. ENDING PUBLIC-UTILITY REGULATION OF THE INTERNET

23. Between enactment of the Telecommunications Act and the 2015 adoption of the *Title II Order*, the free and open Internet flourished: Providers invested over $1.5 trillion to construct networks; high-speed Internet access proliferated at affordable rates; and consumers were able to enjoy all that the Internet had to offer. In 2015, the Commission abruptly departed from its prior posture and classified broadband Internet access service as a telecommunications service subject to public-utility regulations under Title II.

24. Today, we propose to reinstate the information service classification of broadband Internet access service and return to the light-touch regulatory framework first established on a bipartisan basis during the Clinton Administration. We also propose to reinstate the determination that mobile broadband Internet access service is not a commercial mobile service.

#### A. Reinstating the Information Service Classification of Broadband Internet Access Service

25. Our proposal to classify broadband Internet access service as an information service is based on a number of factors. First, we examine the text, structure, and history of the Communications Act and the Telecommunications Act, combined with the technical details of how the Internet works. Second, we examine Commission precedent. Third, we examine public policy and our goal of benefiting consumers through greater innovation, investment, and competition. We seek comment on our proposals and these analyses.

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62 *Id.* at 5616, para. 51.

63 *Id.* at 5607-09, paras. 15–24.

64 *United States Telecom Ass’n v. FCC*, 825 F.3d 674 (D.C. Cir 2016) (*USTelecom*), *reh’g en banc denied*, No. 15-1063, 2017 WL 1541517, at *1 (D.C. Cir. May 1, 2017) (stating that “[e]n banc review would be particularly unwarranted at this point in light of the uncertainty surrounding the fate of the FCC’s Order”).
Clicks and More

The European Union approved Google’s purchase of Motorola Mobility on February 13, 2012. The DVD letters above arose as part of the U.S. Department of Justice’s business review process. This is a way for concerned parties to get some advance antitrust guidance before undertaking a new arrangement. We tend to see these requests in contexts like the one above, where a number of otherwise competing participants in an industry believe that there is good reason for them to be cooperating. Other business review letters can be here.
Session 5: Entity Law and the Duties of Officers and Directors; Information Disclosure and Securities Markets

We will spend a session talking through issues that arise in the choice of legal entities as well as the duties of directors and officers. We will also do a brief overview of securities markets. We will start our discussion with a corporate law classic: a rare case in which directors are found to have violated the business judgment rule in the context of a sale of the company. We will then turn some materials on allegations against the CEO of Hewlett-Packard.

Smith v. Van Gorkom

488 A.2d 858 (Del. 1985)

HORSEY, Justice (for the majority): This appeal from the Court of Chancery involves a class action brought by shareholders of the defendant Trans Union Corporation (“Trans Union” or “the Company”), originally seeking rescission of a cash-out merger of Trans Union into the defendant New T Company (“New T”), a wholly-owned subsidiary of the defendant, Marmon Group, Inc. (“Marmon”). Alternate relief in the form of damages is sought against the defendant members of the Board of Directors of Trans Union, New T, and Jay A. Pritzker and Robert A. Pritzker, owners of Marmon.

Following trial, the former Chancellor granted judgment for the defendant directors by unreported letter opinion dated July 6, 1982. Judgment was based on two findings: (1) that the Board of Directors had acted in an informed manner so as to be entitled to protection of the business judgment rule in approving the cash-out merger; and (2) that the shareholder vote approving the merger should not be set aside because the stockholders had been “fairly informed” by the Board of Directors before voting thereon. The plaintiffs appeal.

Speaking for the majority of the Court, we conclude that both rulings of the Court of Chancery are clearly erroneous. Therefore, we reverse and direct that judgment be entered in favor of the plaintiffs and against the defendant directors for the fair value of the plaintiffs’ stockholdings in Trans Union, in accordance with Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701 (1983).

We hold: (1) that the Board’s decision, reached September 20, 1980, to approve the proposed cash-out merger was not the product of an informed business judgment; (2) that the Board’s subsequent efforts to amend the Merger Agreement and take other curative action were ineffectual, both legally and factually; and (3) that the Board did not deal with complete candor with the stockholders by failing to disclose all material facts, which they knew or should have known, before securing the stockholders’ approval of the merger.

I.

The nature of this case requires a detailed factual statement. The following facts are essentially uncontradicted:
-A-
Trans Union was a publicly-traded, diversified holding company, the principal earnings of which were generated by its railcar leasing business. During the period here involved, the Company had a cash flow of hundreds of millions of dollars annually. However, the Company had difficulty in generating sufficient taxable income to offset increasingly large investment tax credits (ITCs).

-B-
On August 27, 1980, Van Gorkom met with Senior Management of Trans Union. Van Gorkom reported on his lobbying efforts in Washington and his desire to find a solution to the tax credit problem more permanent than a continued program of acquisitions. Various alternatives were suggested and discussed preliminarily, including the sale of Trans Union to a company with a large amount of taxable income.

Donald Romans, Chief Financial Officer of Trans Union, stated that his department had done a “very brief bit of work on the possibility of a leveraged buy-out.” This work had been prompted by a media article which Romans had seen regarding a leveraged buy-out by management. The work consisted of a “preliminary study” of the cash which could be generated by the Company if it participated in a leveraged buy-out. As Romans stated, this analysis “was very first and rough cut at seeing whether a cash flow would support what might be considered a high price for this type of transaction.”

On September 5, at another Senior Management meeting which Van Gorkom attended, Romans again brought up the idea of a leveraged buy-out as a “possible strategic alternative” to the Company’s acquisition program. Romans and Bruce S. Chelberg, President and Chief Operating Officer of Trans Union, had been working on the matter in preparation for the meeting. According to Romans: They did not “come up” with a price for the Company. They merely “ran the numbers” at $50 a share and at $60 a share with the “rough form” of their cash figures at the time. Their “figures indicated that $50 would be very easy to do but $60 would be very difficult to do under those figures.” This work did not purport to establish a fair price for either the Company or 100% of the stock. It was intended to determine the cash flow needed to service the debt that would “probably” be incurred in a leveraged buy-out, based on “rough calculations” without “any benefit of experts to identify what the limits were to that, and so forth.” These computations were not considered extensive and no conclusion was reached.

At this meeting, Van Gorkom stated that he would be willing to take $55 per share for his own 75,000 shares. He vetoed the suggestion of a leveraged buy-out by Management, however, as involving a potential conflict of interest for Management. Van Gorkom, a certified public accountant and lawyer, had been an officer of Trans Union for 24 years, its Chief Executive Officer for more than 17 years, and Chairman of its Board for 2 years. It is noteworthy in this connection that he was then approaching 65 years of age and mandatory retirement.

For several days following the September 5 meeting, Van Gorkom pondered the idea of a sale. He had participated in many acquisitions as a manager and director of Trans Union and
as a director of other companies. He was familiar with acquisition procedures, valuation methods, and negotiations; and he privately considered the pros and cons of whether Trans Union should seek a privately or publicly-held purchaser.

Van Gorkom decided to meet with Jay A. Pritzker, a well-known corporate takeover specialist and a social acquaintance. However, rather than approaching Pritzker simply to determine his interest in acquiring Trans Union, Van Gorkom assembled a proposed per share price for sale of the Company and a financing structure by which to accomplish the sale. Van Gorkom did so without consulting either his Board or any members of Senior Management except one: Carl Peterson, Trans Union’s Controller. Telling Peterson that he wanted no other person on his staff to know what he was doing, but without telling him why, Van Gorkom directed Peterson to calculate the feasibility of a leveraged buy-out at an assumed price per share of $55. Apart from the Company’s historic stock market price, 5 and Van Gorkom’s long association with Trans Union, the record is devoid of any competent evidence that $55 represented the per share intrinsic value of the Company.

Having thus chosen the $55 figure, based solely on the availability of a leveraged buy-out, Van Gorkom multiplied the price per share by the number of shares outstanding to reach a total value of the Company of $690 million. Van Gorkom told Peterson to use this $690 million figure and to assume a $200 million equity contribution by the buyer. Based on these assumptions, Van Gorkom directed Peterson to determine whether the debt portion of the purchase price could be paid off in five years or less if financed by Trans Union’s cash flow as projected in the Five Year Forecast, and by the sale of certain weaker divisions identified in a study done for Trans Union by the Boston Consulting Group (“BCG study”). Peterson reported that, of the purchase price, approximately $50-80 million would remain outstanding after five years. Van Gorkom was disappointed, but decided to meet with Pritzker nevertheless.

Van Gorkom arranged a meeting with Pritzker at the latter’s home on Saturday, September 13, 1980. Van Gorkom prefaced his presentation by stating to Pritzker: “Now as far as you are concerned, I can, I think, show how you can pay a substantial premium over the present stock price and pay off most of the loan in the first five years. * * * If you could pay $55 for this Company, here is a way in which I think it can be financed.”

Van Gorkom then reviewed with Pritzker his calculations based upon his proposed price of $55 per share. Although Pritzker mentioned $50 as a more attractive figure, no other price was mentioned. However, Van Gorkom stated that to be sure that $55 was the best price obtainable, Trans Union should be free to accept any better offer. Pritzker demurred, stating that his organization would serve as a “stalking horse” for an “auction contest” only if Trans Union would permit Pritzker to buy 1,750,000 shares of Trans Union stock at market price

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5 The common stock of Trans Union was traded on the New York Stock Exchange. Over the five year period from 1975 through 1979, Trans Union’s stock had traded within a range of a high of $39 1/2 and a low of $24 1/4. Its high and low range for 1980 through September 19 (the last trading day before announcement of the merger) was $38 1/4 - $29 1/2.
which Pritzker could then sell to any higher bidder. After further discussion on this point, Pritzker told Van Gorkom that he would give him a more definite reaction soon.

On Monday, September 15, Pritzker advised Van Gorkom that he was interested in the $55 cash-out merger proposal and requested more information on Trans Union. Van Gorkom agreed to meet privately with Pritzker, accompanied by Peterson, Chelberg, and Michael Carpenter, Trans Union’s consultant from the Boston Consulting Group. The meetings took place on September 16 and 17. Van Gorkom was “astounded that events were moving with such amazing rapidity.”

On Thursday, September 18, Van Gorkom met again with Pritzker. At that time, Van Gorkom knew that Pritzker intended to make a cash-out merger offer at Van Gorkom’s proposed $55 per share. Pritzker instructed his attorney, a merger and acquisition specialist, to begin drafting merger documents. There was no further discussion of the $55 price. However, the number of shares of Trans Union’s treasury stock to be offered to Pritzker was negotiated down to one million shares; the price was set at $38—75 cents above the per share price at the close of the market on September 19. At this point, Pritzker insisted that the Trans Union Board act on his merger proposal within the next three days, stating to Van Gorkom: “We have to have a decision by no later than Sunday [evening, September 21] before the opening of the English stock exchange on Monday morning.” Pritzker’s lawyer was then instructed to draft the merger documents, to be reviewed by Van Gorkom’s lawyer, “sometimes with discussion and sometimes not, in the haste to get it finished.”

On Friday, September 19, Van Gorkom, Chelberg, and Pritzker consulted with Trans Union’s lead bank regarding the financing of Pritzker’s purchase of Trans Union. The bank indicated that it could form a syndicate of banks that would finance the transaction. On the same day, Van Gorkom retained James Brennan, Esquire, to advise Trans Union on the legal aspects of the merger. Van Gorkom did not consult with William Browder, a Vice-President and director of Trans Union and former head of its legal department, or with William Moore, then the head of Trans Union’s legal staff.

On Friday, September 19, Van Gorkom called a special meeting of the Trans Union Board for noon the following day. He also called a meeting of the Company’s Senior Management to convene at 11:00 a.m., prior to the meeting of the Board. No one, except Chelberg and Peterson, was told the purpose of the meetings. Van Gorkom did not invite Trans Union’s investment banker, Salomon Brothers or its Chicago-based partner, to attend.

Of those present at the Senior Management meeting on September 20, only Chelberg and Peterson had prior knowledge of Pritzker’s offer. Van Gorkom disclosed the offer and described its terms, but he furnished no copies of the proposed Merger Agreement. Romans announced that his department had done a second study which showed that, for a leveraged buy-out, the price range for Trans Union stock was between $55 and $65 per share. Van Gorkom neither saw the study nor asked Romans to make it available for the Board meeting.

Senior Management’s reaction to the Pritzker proposal was completely negative. No member of Management, except Chelberg and Peterson, supported the proposal. Romans objected to the price as being too low; he was critical of the timing and suggested that considera-
tion should be given to the adverse tax consequences of an all-cash deal for low-basis shareholders; and he took the position that the agreement to sell Pritzker one million newly-issued shares at market price would inhibit other offers, as would the prohibitions against soliciting bids and furnishing inside information to other bidders. Romans argued that the Pritzker proposal was a “lock up” and amounted to “an agreed merger as opposed to an offer.” Nevertheless, Van Gorkom proceeded to the Board meeting as scheduled without further delay.

Ten directors served on the Trans Union Board, five inside (defendants Bonser, O’Boyle, Browder, Chelberg, and Van Gorkom) and five outside (defendants Wallis, Johnson, Lanternman, Morgan and Reneker). All directors were present at the meeting, except O’Boyle who was ill. Of the outside directors, four were corporate chief executive officers and one was the former Dean of the University of Chicago Business School. None was an investment banker or trained financial analyst. All members of the Board were well informed about the Company and its operations as a going concern. They were familiar with the current financial condition of the Company, as well as operating and earnings projections reported in the recent Five Year Forecast. The Board generally received regular and detailed reports and was kept abreast of the accumulated investment tax credit and accelerated depreciation problem.

Van Gorkom began the Special Meeting of the Board with a twenty-minute oral presentation. Copies of the proposed Merger Agreement were delivered too late for study before or during the meeting. He reviewed the Company’s ITC and depreciation problems and the efforts theretofore made to solve them. He discussed his initial meeting with Pritzker and his motivation in arranging that meeting. Van Gorkom did not disclose to the Board, however, the methodology by which he alone had arrived at the $55 figure, or the fact that he first proposed the $55 price in his negotiations with Pritzker.

Van Gorkom outlined the terms of the Pritzker offer as follows: Pritzker would pay $55 in cash for all outstanding shares of Trans Union stock upon completion of which Trans Union would be merged into New T Company, a subsidiary wholly-owned by Pritzker and formed to implement the merger; for a period of 90 days, Trans Union could receive, but could not actively solicit, competing offers; the offer had to be acted on by the next evening, Sunday, September 21; Trans Union could only furnish to competing bidders published information, and not proprietary information; the offer was subject to Pritzker obtaining the necessary financing by October 10, 1980; if the financing contingency were met or waived by Pritzker, Trans Union was required to sell to Pritzker one million newly-issued shares of Trans Union at $38 per share.

Van Gorkom took the position that putting Trans Union “up for auction” through a 90-day market test would validate a decision by the Board that $55 was a fair price. He told the Board that the “free market will have an opportunity to judge whether $55 is a fair price.” Van Gorkom framed the decision before the Board not as whether $55 per share was the highest price that could be obtained, but as whether the $55 price was a fair price that the stockholders should be given the opportunity to accept or reject.

Attorney Brennan advised the members of the Board that they might be sued if they failed to accept the offer and that a fairness opinion was not required as a matter of law.
Romans attended the meeting as chief financial officer of the Company. He told the Board that he had not been involved in the negotiations with Pritzker and knew nothing about the merger proposal until the morning of the meeting; that his studies did not indicate either a fair price for the stock or a valuation of the Company; that he did not see his role as directly addressing the fairness issue; and that he and his people “were trying to search for ways to justify a price in connection with such a [leveraged buy-out] transaction, rather than to say what the shares are worth.” Romans testified:

I told the Board that the study ran the numbers at 50 and 60, and then the subsequent study at 55 and 65, and that was not the same thing as saying that I have a valuation of the company at X dollars. But it was a way—a first step towards reaching that conclusion.

Romans told the Board that, in his opinion, $55 was “in the range of a fair price,” but “at the beginning of the range.”

Chelberg, Trans Union’s President, supported Van Gorkom’s presentation and representations. He testified that he “participated to make sure that the Board members collectively were clear on the details of the agreement or offer from Pritzker;” that he “participated in the discussion with Mr. Brennan, inquiring of him about the necessity for valuation opinions in spite of the way in which this particular offer was couched;” and that he was otherwise actively involved in supporting the positions being taken by Van Gorkom before the Board about “the necessity to act immediately on this offer,” and about “the adequacy of the $55 and the question of how that would be tested.”

The Board meeting of September 20 lasted about two hours. Based solely upon Van Gorkom’s oral presentation, Chelberg’s supporting representations, Romans’ oral statement, Brennan’s legal advice, and their knowledge of the market history of the Company’s stock,9 the directors approved the proposed Merger Agreement. However, the Board later claimed to have attached two conditions to its acceptance: (1) that Trans Union reserved the right to accept any better offer that was made during the market test period; and (2) that Trans Union could share its proprietary information with any other potential bidders. While the Board now claims to have reserved the right to accept any better offer received after the announcement of the Pritzker agreement (even though the minutes of the meeting do not reflect this), it is undisputed that the Board did not reserve the right to actively solicit alternate offers.

The Merger Agreement was executed by Van Gorkom during the evening of September 20 at a formal social event that he hosted for the opening of the Chicago Lyric Opera. Neither he nor any other director read the agreement prior to its signing and delivery to Pritzker.

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9 The Trial Court stated the premium relationship of the $55 price to the market history of the Company’s stock as follows: * * * the merger price offered to the stockholders of Trans Union represented a premium of 62% over the average of the high and low prices at which Trans Union stock had traded in 1980, a premium of 48% over the last closing price, and a premium of 39% over the highest price at which the stock of Trans Union had traded any time during the prior six years.
On Monday, September 22, the Company issued a press release announcing that Trans Union had entered into a “definitive” Merger Agreement with an affiliate of the Marmon Group, Inc., a Pritzker holding company. Within 10 days of the public announcement, dissent among Senior Management over the merger had become widespread. Faced with threatened resignations of key officers, Van Gorkom met with Pritzker who agreed to several modifications of the Agreement. Pritzker was willing to do so provided that Van Gorkom could persuade the dissidents to remain on the Company payroll for at least six months after consummation of the merger.

Van Gorkom reconvened the Board on October 8 and secured the directors’ approval of the proposed amendments—sight unseen. The Board also authorized the employment of Salomon Brothers, its investment banker, to solicit other offers for Trans Union during the proposed “market test” period.

The next day, October 9, Trans Union issued a press release announcing: (1) that Pritzker had obtained “the financing commitments necessary to consummate” the merger with Trans Union; (2) that Pritzker had acquired one million shares of Trans Union common stock at $38 per share; (3) that Trans Union was now permitted to actively seek other offers and had retained Salomon Brothers for that purpose; and (4) that if a more favorable offer were not received before February 1, 1981, Trans Union’s shareholders would thereafter meet to vote on the Pritzker proposal.

It was not until the following day, October 10, that the actual amendments to the Merger Agreement were prepared by Pritzker and delivered to Van Gorkom for execution. As will be seen, the amendments were considerably at variance with Van Gorkom’s representations of the amendments to the Board on October 8; and the amendments placed serious constraints on Trans Union’s ability to negotiate a better deal and withdraw from the Pritzker agreement. Nevertheless, Van Gorkom proceeded to execute what became the October 10 amendments to the Merger Agreement without conferring further with the Board members and apparently without comprehending the actual implications of the amendments.

Salomon Brothers’ efforts over a three-month period from October 21 to January 21 produced only one serious suitor for Trans Union—General Electric Credit Corporation (“GE Credit”), a subsidiary of the General Electric Company. However, GE Credit was unwilling to make an offer for Trans Union unless Trans Union first rescinded its Merger Agreement with Pritzker. When Pritzker refused, GE Credit terminated further discussions with Trans Union in early January.

In the meantime, in early December, the investment firm of Kohlberg, Kravis, Roberts & Co. (“KKR”), the only other concern to make a firm offer for Trans Union, withdrew its offer under circumstances hereinafter detailed.

On December 19, this litigation was commenced and, within four weeks, the plaintiffs had deposed eight of the ten directors of Trans Union, including Van Gorkom, Chelberg and Romans, its Chief Financial Officer. On January 21, Management’s Proxy Statement for the
February 10 shareholder meeting was mailed to Trans Union’s stockholders. On January 26, Trans Union’s Board met and, after a lengthy meeting, voted to proceed with the Pritzker merger. The Board also approved for mailing, “on or about January 27,” a Supplement to its Proxy Statement. The Supplement purportedly set forth all information relevant to the Pritzker Merger Agreement, which had not been divulged in the first Proxy Statement.

* * *  

On February 10, the stockholders of Trans Union approved the Pritzker merger proposal. Of the outstanding shares, 69.9% were voted in favor of the merger; 7.25% were voted against the merger; and 22.85% were not voted.

II.

We turn to the issue of the application of the business judgment rule to the September 20 meeting of the Board.

The Court of Chancery concluded from the evidence that the Board of Directors’ approval of the Pritzker merger proposal fell within the protection of the business judgment rule. *** [W]e conclude that the Court’s ultimate finding that the Board’s conduct was not “reckless or imprudent” is contrary to the record and not the product of a logical and deductive reasoning process.

* * * Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in 8 Del.C. § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors. 11 Aronson v. Lewis, Del. Supr., 473 A.2d 805, 811 (1984). In carrying out their managerial roles, directors are charged with an unyielding fiduciary duty to the corporation and its shareholders. The business judgment rule exists to protect and promote the full and free exercise of the managerial power granted to Delaware directors. The rule itself “is a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” Aronson, supra at 812. Thus, the party attacking a board decision as uninformed must rebut the presumption that its business judgment was an informed one.

The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves “prior to making a business decision, of all material information reasonably available to them.” Id.

Under the business judgment rule there is no protection for directors who have made “an unintelligent or unadvised judgment.” Mitchell v. Highland-Western Glass, Del. Ch., 167 A. 831, 833 (1933). A director’s duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders. Since a

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11 8 Del.C. § 141 provides, in pertinent part: (a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by such person or persons as shall be provided in the certificate of incorporation.
director is vested with the responsibility for the management of the affairs of the corporation, he must execute that duty with the recognition that he acts on behalf of others. Such obligation does not tolerate faithlessness or self-dealing. But fulfillment of the fiduciary function requires more than the mere absence of bad faith or fraud. Representation of the financial interests of others imposes on a director an affirmative duty to protect those interests and to proceed with a critical eye in assessing information of the type and under the circumstances present here.

Thus, a director’s duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty. Here, there were no allegations of fraud, bad faith, or self-dealing, or proof thereof. Hence, it is presumed that the directors reached their business judgment in good faith and considerations of motive are irrelevant to the issue before us.

The standard of care applicable to a director’s duty of care has also been recently restated by this Court. In Aronson, supra, we stated:

While the Delaware cases use a variety of terms to describe the applicable standard of care, our analysis satisfies us that under the business judgment rule director liability is predicated upon concepts of gross negligence. (footnote omitted)

473 A.2d at 812.

We again confirm that view. We think the concept of gross negligence is also the proper standard for determining whether a business judgment reached by a board of directors was an informed one.

In the specific context of a proposed merger of domestic corporations, a director has a duty under 8 Del.C. § 251(b), along with his fellow directors, to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders. Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement. Only an agreement of merger satisfying the requirements of 8 Del.C. § 251(b) may be submitted to the shareholders under § 251(c).

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14 8 Del.C. § 251(b) provides in pertinent part: (b) The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation. The agreement shall state: (1) the terms and conditions of the merger or consolidation; (2) the mode of carrying the same into effect; (3) such amendments or changes in the certificate of incorporation of the surviving corporation as are desired to be effected by the merger or consolidation, or, if no such amendments or changes are desired, a statement that the certificate of incorporation of one of the constituent corporations shall be the certificate of incorporation of the surviving or resulting corporation; (4) the manner of converting the shares of each of the constituent corporations ... and (5) such other details or provisions as are deemed desirable.... The agreement so adopted shall be executed in accordance with section 103 of this title. Any of the terms of the agreement of merger or consolidation may be made dependent upon facts ascertainable outside of such agreement, provided that the manner in which such facts shall operate upon the terms of the agreement is clearly and expressly set forth in the agreement of merger or consolidation. (underlining added for emphasis)
It is against those standards that the conduct of the directors of Trans Union must be tested, as a matter of law and as a matter of fact, regarding their exercise of an informed business judgment in voting to approve the Pritzker merger proposal.

III.

*** On the record before us, we must conclude that the Board of Directors did not reach an informed business judgment on September 20, 1980 in voting to “sell” the Company for $55 per share pursuant to the Pritzker cash-out merger proposal. Our reasons, in summary, are as follows:

The directors (1) did not adequately inform themselves as to Van Gorkom’s role in forcing the “sale” of the Company and in establishing the per share purchase price; (2) were uninformed as to the intrinsic value of the Company; and (3) given these circumstances, at a minimum, were grossly negligent in approving the “sale” of the Company upon two hours’ consideration, without prior notice, and without the exigency of a crisis or emergency.

As has been noted, the Board based its September 20 decision to approve the cash-out merger primarily on Van Gorkom’s representations. None of the directors, other than Van Gorkom and Chelberg, had any prior knowledge that the purpose of the meeting was to propose a cash-out merger of Trans Union. No members of Senior Management were present, other than Chelberg, Romans and Peterson; and the latter two had only learned of the proposed sale an hour earlier. Both general counsel Moore and former general counsel Browder attended the meeting, but were equally uninformed as to the purpose of the meeting and the documents to be acted upon.

Without any documents before them concerning the proposed transaction, the members of the Board were required to rely entirely upon Van Gorkom’s 20-minute oral presentation of the proposal. No written summary of the terms of the merger was presented; the directors were given no documentation to support the adequacy of $55 price per share for sale of the Company; and the Board had before it nothing more than Van Gorkom’s statement of his understanding of the substance of an agreement which he admittedly had never read, nor which any member of the Board had ever seen.

Under 8 Del.C. § 141(e),15 “directors are fully protected in relying in good faith on reports made by officers.” Michelson v. Duncan, Del. Ch., 386 A.2d 1144, 1156 (1978); aff’d in part and rev’d in part on other grounds, Del. Supr., 407 A.2d 211 (1979). The term “report” has been liberally construed to include reports of informal personal investigations by corporate officers, Cheff v. Mathes, Del. Supr., 199 A.2d 548, 556 (1964). However, there is no evidence that any “report,” as defined under § 141(e), concerning the Pritzker proposal, was presented to the Board on September 20. Van Gorkom’s oral presentation of his understanding of the terms of the proposed Merger Agreement, which he had not seen, and Romans’ brief oral statement of his preliminary study regarding the feasibility of a leveraged buy-out

15 Section 141(e) provides in pertinent part: A member of the board of directors ... shall, in the performance of his duties, be fully protected in relying in good faith upon the books of accounts or reports made to the corporation by any of its officers, or by an independent certified public accountant, or by an appraiser selected with reasonable care by the board of directors ..., or in relying in good faith upon other records of the corporation.
of Trans Union do not qualify as § 141(e) “reports” for these reasons: The former lacked substance because Van Gorkom was basically uninformed as to the essential provisions of the very document about which he was talking. Romans’ statement was irrelevant to the issues before the Board since it did not purport to be a valuation study. ***

The defendants rely on the following factors to sustain the Trial Court’s finding that the Board’s decision was an informed one: (1) the magnitude of the premium or spread between the $55 Pritzker offering price and Trans Union’s current market price of $38 per share; (2) the amendment of the Agreement as submitted on September 20 to permit the Board to accept any better offer during the “market test” period; (3) the collective experience and expertise of the Board’s “inside” and “outside” directors; and (4) their reliance on Brennan’s legal advice that the directors might be sued if they rejected the Pritzker proposal. We discuss each of these grounds seriatim:

(1)

A substantial premium may provide one reason to recommend a merger, but in the absence of other sound valuation information, the fact of a premium alone does not provide an adequate basis upon which to assess the fairness of an offering price. Here, the judgment reached as to the adequacy of the premium was based on a comparison between the historically depressed Trans Union market price and the amount of the Pritzker offer. Using market price as a basis for concluding that the premium adequately reflected the true value of the Company was a clearly faulty, indeed fallacious, premise, as the defendants’ own evidence demonstrates.

The record is clear that before September 20, Van Gorkom and other members of Trans Union’s Board knew that the market had consistently undervalued the worth of Trans Union’s stock, despite steady increases in the Company’s operating income in the seven years preceding the merger. The Board related this occurrence in large part to Trans Union’s inability to use its ITCs as previously noted. Van Gorkom testified that he did not believe the market price accurately reflected Trans Union’s true worth; and several of the directors testified that, as a general rule, most chief executives think that the market undervalues their companies’ stock. Yet, on September 20, Trans Union’s Board apparently believed that the market stock price accurately reflected the value of the Company for the purpose of determining the adequacy of the premium for its sale.

In the Proxy Statement, however, the directors reversed their position. There, they stated that, although the earnings prospects for Trans Union were “excellent,” they found no basis for believing that this would be reflected in future stock prices. With regard to past trading, the Board stated that the prices at which the Company’s common stock had traded in recent years did not reflect the “inherent” value of the Company. But having referred to the “inherent” value of Trans Union, the directors ascribed no number to it. Moreover, nowhere did they disclose that they had no basis on which to fix “inherent” worth beyond an impressionistic reaction to the premium over market and an unsubstantiated belief that the value of the assets was “significantly greater” than book value. By their own admission they could not rely on the stock price as an accurate measure of value. Yet, also by their own admission, the
Board members assumed that Trans Union’s market price was adequate to serve as a basis upon which to assess the adequacy of the premium for purposes of the September 20 meeting.

The parties do not dispute that a publicly-traded stock price is solely a measure of the value of a minority position and, thus, market price represents only the value of a single share. Nevertheless, on September 20, the Board assessed the adequacy of the premium over market, offered by Pritzker, solely by comparing it with Trans Union’s current and historical stock price.

Indeed, as of September 20, the Board had no other information on which to base a determination of the intrinsic value of Trans Union as a going concern. As of September 20, the Board had made no evaluation of the Company designed to value the entire enterprise, nor had the Board ever previously considered selling the Company or consenting to a buy-out merger. Thus, the adequacy of a premium is indeterminate unless it is assessed in terms of other competent and sound valuation information that reflects the value of the particular business.

Despite the foregoing facts and circumstances, there was no call by the Board, either on September 20 or thereafter, for any valuation study or documentation of the $55 price per share as a measure of the fair value of the Company in a cash-out context. It is undisputed that the major asset of Trans Union was its cash flow. Yet, at no time did the Board call for a valuation study taking into account that highly significant element of the Company’s assets.

We do not imply that an outside valuation study is essential to support an informed business judgment; nor do we state that fairness opinions by independent investment bankers are required as a matter of law. Often insiders familiar with the business of a going concern are in a better position than are outsiders to gather relevant information; and under appropriate circumstances, such directors may be fully protected in relying in good faith upon the valuation reports of their management.

Here, the record establishes that the Board did not request its Chief Financial Officer, Romans, to make any valuation study or review of the proposal to determine the adequacy of $55 per share for sale of the Company. On the record before us: The Board rested on Romans’ elicited response that the $55 figure was within a “fair price range” within the context of a leveraged buy-out. No director sought any further information from Romans. No director asked him why he put $55 at the bottom of his range. ***

The record also establishes that the Board accepted without scrutiny Van Gorkom’s representation as to the fairness of the $55 price per share for sale of the Company—a subject that the Board had never previously considered. The Board thereby failed to discover that Van Gorkom had suggested the $55 price to Pritzker and, most crucially, that Van Gorkom had arrived at the $55 figure based on calculations designed solely to determine the feasibility of a leveraged buy-out. No questions were raised either as to the tax implications of a cash-out merger or how the price for the one million share option granted Pritzker was calculated.

19 As of September 20 the directors did not know: that Van Gorkom had arrived at the $55 figure alone, and
We do not say that the Board of Directors was not entitled to give some credence to Van Gorkom’s representation that $55 was an adequate or fair price. Under § 141(e), the directors were entitled to rely upon their chairman’s opinion of value and adequacy, provided that such opinion was reached on a sound basis. Here, the issue is whether the directors informed themselves as to all information that was reasonably available to them. Had they done so, they would have learned of the source and derivation of the $55 price and could not reasonably have relied thereupon in good faith.

None of the directors, Management or outside, were investment bankers or financial analysts. Yet the Board did not consider recessing the meeting until a later hour that day (or requesting an extension of Pritzker’s Sunday evening deadline) to give it time to elicit more information as to the sufficiency of the offer, either from inside Management (in particular Romans) or from Trans Union’s own investment banker, Salomon Brothers, whose Chicago specialist in merger and acquisitions was known to the Board and familiar with Trans Union’s affairs.

Thus, the record compels the conclusion that on September 20 the Board lacked valuation information adequate to reach an informed business judgment as to the fairness of $55 per share for sale of the Company.

(2)

This brings us to the post-September 20 “market test” upon which the defendants ultimately rely to confirm the reasonableness of their September 20 decision to accept the Pritzker proposal. In this connection, the directors present a two-part argument: (a) that by making a “market test” of Pritzker’s $55 per share offer a condition of their September 20 decision to accept his offer, they cannot be found to have acted impulsively or in an uninformed manner on September 20; and (b) that the adequacy of the $17 premium for sale of the Company was conclusively established over the following 90 to 120 days by the most reliable evidence available—the marketplace. Thus, the defendants impliedly contend that the “market test” eliminated the need for the Board to perform any other form of fairness test either on September 20, or thereafter.

Again, the facts of record do not support the defendants’ argument. There is no evidence: (a) that the Merger Agreement was effectively amended to give the Board freedom to put Trans Union up for auction sale to the highest bidder; or (b) that a public auction was in fact permitted to occur. The minutes of the Board meeting make no reference to any of this. Indeed, the record compels the conclusion that the directors had no rational basis for expecting that a market test was attainable, given the terms of the Agreement as executed during the

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subjectively, as the figure to be used by Controller Peterson in creating a feasible structure for a leveraged buy-out by a prospective purchaser; that Van Gorkom had not sought advice, information or assistance from either inside or outside Trans Union directors as to the value of the Company as an entity or the fair price per share for 100% of its stock; that Van Gorkom had not consulted with the Company’s investment bankers or other financial analysts; that Van Gorkom had not consulted with or confided in any officer or director of the Company except Chelberg; and that Van Gorkom had deliberately chosen to ignore the advice and opinion of the members of his Senior Management group regarding the adequacy of the $55 price.
evening of September 20. We rely upon the following facts which are essentially uncontra-
dicted:

The Merger Agreement, specifically identified as that originally presented to the Board on
September 20, has never been produced by the defendants, notwithstanding the plaintiffs’
several demands for production before as well as during trial. No acceptable explanation of
this failure to produce documents has been given to either the Trial Court or this Court.
Significantly, neither the defendants nor their counsel have made the affirmative representa-
tion that this critical document has been produced. Thus, the Court is deprived of the best
evidence on which to judge the merits of the defendants’ position as to the care and attention
which they gave to the terms of the Agreement on September 20.

Van Gorkom states that the Agreement as submitted incorporated the ingredients for a
market test by authorizing Trans Union to receive competing offers over the next 90-day
period. However, he concedes that the Agreement barred Trans Union from actively solicit-
ing such offers and from furnishing to interested parties any information about the Compa-
ny other than that already in the public domain. Whether the original Agreement of Sep-
tember 20 went so far as to authorize Trans Union to receive competitive proposals is argua-
ble. The defendants’ unexplained failure to produce and identify the original Merger Agree-
ment permits the logical inference that the instrument would not support their assertions in
this regard. It is a well established principle that the production of weak evidence when
strong is, or should have been, available can lead only to the conclusion that the strong
would have been adverse. Van Gorkom, conceding that he never read the Agreement, stated
that he was relying upon his understanding that, under corporate law, directors always have
an inherent right, as well as a fiduciary duty, to accept a better offer notwithstanding an ex-
isting contractual commitment by the Board.

The defendant directors assert that they “insisted” upon including two amendments to the
Agreement, thereby permitting a market test: (1) to give Trans Union the right to accept a
better offer; and (2) to reserve to Trans Union the right to distribute proprietary information
on the Company to alternative bidders. Yet, the defendants concede that they did not seek to
amend the Agreement to permit Trans Union to solicit competing offers. ***

Thus, notwithstanding what several of the outside directors later claimed to have
“thought” occurred at the meeting, the record compels the conclusion that Trans Union’s
Board had no rational basis to conclude on September 20 or in the days immediately follow-
ing, that the Board’s acceptance of Pritzker’s offer was conditioned on (1) a “market test” of
the offer; and (2) the Board’s right to withdraw from the Pritzker Agreement and accept any
higher offer received before the shareholder meeting. ***

(4)

Part of the defense is based on a claim that the directors relied on legal advice rendered at the
September 20 meeting by James Brennan, Esquire, who was present at Van Gorkom’s re-
quest. Unfortunately, Brennan did not appear and testify at trial even though his firm partic-
ipated in the defense of this action. *** Several defendants testified that Brennan advised
them that Delaware law did not require a fairness opinion or an outside valuation of the
Company before the Board could act on the Pritzker proposal. If given, the advice was correct. However, that did not end the matter. Unless the directors had before them adequate information regarding the intrinsic value of the Company, upon which a proper exercise of business judgment could be made, mere advice of this type is meaningless; and, given this record of the defendants’ failures, it constitutes no defense here.\textsuperscript{22}

\* \* \* 

We conclude that Trans Union’s Board was grossly negligent in that it failed to act with informed reasonable deliberation in agreeing to the Pritzker merger proposal on September 20; and we further conclude that the Trial Court erred as a matter of law in failing to address that question before determining whether the directors’ later conduct was sufficient to cure its initial error. \* \* \* 

-B-

We now examine the Board’s post-September 20 conduct for the purpose of determining first, whether it was informed and not grossly negligent; and second, if informed, whether it was sufficient to legally rectify and cure the Board’s derelictions of September 20.

(1)

First, as to the Board meeting of October 8: Its purpose arose in the aftermath of the September 20 meeting: (1) the September 22 press release announcing that Trans Union “had entered into definitive agreements to merge with an affiliate of Marmon Group, Inc.;” and (2) Senior Management’s ensuing revolt.

Trans Union’s press release stated:

\textbf{FOR IMMEDIATE RELEASE:}

\textit{CHICAGO, IL—Trans Union Corporation announced today that it had entered into definitive agreements to merge with an affiliate of The Marmon Group, Inc. in a transaction whereby Trans Union stockholders would receive $55 per share in cash for each Trans Union share held. The Marmon Group, Inc. is controlled by the Pritzker family of Chicago. The merger is subject to approval by the stockholders of Trans Union at a special meeting expected to be held sometime during December or early January. Until October 10, 1980, the purchaser has the right to terminate the merger if financing that is satisfactory to the purchaser has not been obtained, but after that date there is no such right. In a related transaction, Trans Union has agreed to sell to a designee of the purchaser one million newly-issued shares of Trans Union common stock at a cash price of $38 per share. Such shares will be issued only if the merger financing has been committed for no later than October 10, 1980, or if the purchaser elects to waive the...}
merger financing condition. In addition, the New York Stock Exchange will be asked to approve the listing of the new shares pursuant to a listing application which Trans Union intends to file shortly. 

Completing of the transaction is also subject to the preparation of a definitive proxy statement and making various filings and obtaining the approvals or consents of government agencies.

The press release made no reference to provisions allegedly reserving to the Board the rights to perform a “market test” and to withdraw from the Pritzker Agreement if Trans Union received a better offer before the shareholder meeting. The defendants also concede that Trans Union never made a subsequent public announcement stating that it had in fact reserved the right to accept alternate offers, the Agreement notwithstanding.

The public announcement of the Pritzker merger resulted in an “en masse” revolt of Trans Union’s Senior Management. The head of Trans Union’s tank car operations (its most profitable division) informed Van Gorkom that unless the merger were called off, fifteen key personnel would resign.

Instead of reconvening the Board, Van Gorkom again privately met with Pritzker, informed him of the developments, and sought his advice. Pritzker then made the following suggestions for overcoming Management’s dissatisfaction: (1) that the Agreement be amended to permit Trans Union to solicit, as well as receive, higher offers; and (2) that the shareholder meeting be postponed from early January to February 10, 1981. In return, Pritzker asked Van Gorkom to obtain a commitment from Senior Management to remain at Trans Union for at least six months after the merger was consummated.

Van Gorkom then advised Senior Management that the Agreement would be amended to give Trans Union the right to solicit competing offers through January, 1981, if they would agree to remain with Trans Union. Senior Management was temporarily mollified; and Van Gorkom then called a special meeting of Trans Union’s Board for October 8.

Thus, the primary purpose of the October 8 Board meeting was to amend the Merger Agreement, in a manner agreeable to Pritzker, to permit Trans Union to conduct a “market test.” Van Gorkom understood that the proposed amendments were intended to give the Company an unfettered “right to openly solicit offers down through January 31.” Van Gorkom presumably so represented the amendments to Trans Union’s Board members on October 8. In a brief session, the directors approved Van Gorkom’s oral presentation of the substance of the proposed amendments, the terms of which were not reduced to writing until October 10. But rather than waiting to review the amendments, the Board again approved them sight unseen and adjourned, giving Van Gorkom authority to execute the papers when he received them.25

25 We do not suggest that a board must read in haece verba every contract or legal document which it approves, but if it is to successfully absolve itself from charges of the type made here, there must be some credible contemporary evidence demonstrating that the directors knew what they were doing, and ensured that their purported action was given effect. That is the consistent failure which cast this Board upon its unredeemable course.
Thus, the Court of Chancery’s finding that the October 8 Board meeting was convened to reconsider the Pritzker “proposal” is clearly erroneous. Further, the consequence of the Board’s faulty conduct on October 8, in approving amendments to the Agreement which had not even been drafted, will become apparent when the actual amendments to the Agreement are hereafter examined.

The next day, October 9, and before the Agreement was amended, Pritzker moved swiftly to off-set the proposed market test amendment. First, Pritzker informed Trans Union that he had completed arrangements for financing its acquisition and that the parties were thereby mutually bound to a firm purchase and sale arrangement. Second, Pritzker announced the exercise of his option to purchase one million shares of Trans Union’s treasury stock at $38 per share—75 cents above the current market price. Trans Union’s Management responded the same day by issuing a press release announcing: (1) that all financing arrangements for Pritzker’s acquisition of Trans Union had been completed; and (2) Pritzker’s purchase of one million shares of Trans Union’s treasury stock at $38 per share.

The next day, October 10, Pritzker delivered to Trans Union the proposed amendments to the September 20 Merger Agreement. Van Gorkom promptly proceeded to countersign all the instruments on behalf of Trans Union without reviewing the instruments to determine if they were consistent with the authority previously granted him by the Board. The amending documents were apparently not approved by Trans Union’s Board until a much later date, December 2. The record does not affirmatively establish that Trans Union’s directors ever read the October 10 amendments.

The October 10 amendments to the Merger Agreement did authorize Trans Union to solicit competing offers, but the amendments had more far-reaching effects. The most significant change was in the definition of the third-party “offer” available to Trans Union as a possible basis for withdrawal from its Merger Agreement with Pritzker. Under the October 10 amendments, a better offer was no longer sufficient to permit Trans Union’s withdrawal. Trans Union was now permitted to terminate the Pritzker Agreement and abandon the merger only if, prior to February 10, 1981, Trans Union had either consummated a merger (or sale of assets) with a third party or had entered into a “definitive” merger agreement more favorable than Pritzker’s and for a greater consideration—subject only to stockholder approval. Further, the “extension” of the market test period to February 10, 1981 was circumscribed by other amendments which required Trans Union to file its preliminary proxy statement on the Pritzker merger proposal by December 5, 1980 and use its best efforts to mail the statement to its shareholders by January 5, 1981. Thus, the market test period was effectively reduced, not extended.

In our view, the record compels the conclusion that the directors’ conduct on October 8 exhibited the same deficiencies as did their conduct on September 20. ***

We conclude that the Board acted in a grossly negligent manner on October 8; and that Van Gorkom’s representations on which the Board based its actions do not constitute “reports” under § 141(e) on which the directors could reasonably have relied. Further, the amended Merger Agreement imposed on Trans Union’s acceptance of a third party offer
conditions more onerous than those imposed on Trans Union’s acceptance of Pritzker’s offer on September 20. After October 10, Trans Union could accept from a third party a better offer only if it were incorporated in a definitive agreement between the parties, and not conditioned on financing or on any other contingency.

The October 9 press release, coupled with the October 10 amendments, had the clear effect of locking Trans Union’s Board into the Pritzker Agreement. Pritzker had thereby foreclosed Trans Union’s Board from negotiating any better “definitive” agreement over the remaining eight weeks before Trans Union was required to clear the Proxy Statement submitting the Pritzker proposal to its shareholders.

(2)

Next, as to the “curative” effects of the Board’s post-September 20 conduct, we review in more detail the reaction of Van Gorkom to the KKR proposal and the results of the Board-sponsored “market test.”

The KKR proposal was the first and only offer received subsequent to the Pritzker Merger Agreement. The offer resulted primarily from the efforts of Romans and other senior officers to propose an alternative to Pritzker’s acquisition of Trans Union. In late September, Romans’ group contacted KKR about the possibility of a leveraged buy-out by all members of Management, except Van Gorkom. By early October, Henry R. Kravis of KKR gave Romans written notice of KKR’s “interest in making an offer to purchase 100%” of Trans Union’s common stock.

Thereafter, and until early December, Romans’ group worked with KKR to develop a proposal. It did so with Van Gorkom’s knowledge and apparently grudging consent. On December 2, Kravis and Romans hand-delivered to Van Gorkom a formal letter-offer to purchase all of Trans Union’s assets and to assume all of its liabilities for an aggregate cash consideration equivalent to $60 per share. The offer was contingent upon completing equity and bank financing of $650 million, which Kravis represented as 80% complete. The KKR letter made reference to discussions with major banks regarding the loan portion of the buy-out cost and stated that KKR was “confident that commitments for the bank financing * * * can be obtained within two or three weeks.” The purchasing group was to include certain named key members of Trans Union’s Senior Management, excluding Van Gorkom, and a major Canadian company. Kravis stated that they were willing to enter into a “definitive agreement” under terms and conditions “substantially the same” as those contained in Trans Union’s agreement with Pritzker. The offer was addressed to Trans Union’s Board of Directors and a meeting with the Board, scheduled for that afternoon, was requested.

Van Gorkom’s reaction to the KKR proposal was completely negative; he did not view the offer as being firm because of its financing condition. It was pointed out, to no avail, that Pritzker’s offer had not only been similarly conditioned, but accepted on an expedited basis. Van Gorkom refused Kravis’ request that Trans Union issue a press release announcing KKR’s offer, on the ground that it might “chill” any other offer. Romans and Kravis left with the understanding that their proposal would be presented to Trans Union’s Board that afternoon.
Within a matter of hours and shortly before the scheduled Board meeting, Kravis withdrew his letter-offer. He gave as his reason a sudden decision by the Chief Officer of Trans Union’s rail car leasing operation to withdraw from the KKR purchasing group. Van Gorkom had spoken to that officer about his participation in the KKR proposal immediately after his meeting with Romans and Kravis. However, Van Gorkom denied any responsibility for the officer’s change of mind.

At the Board meeting later that afternoon, Van Gorkom did not inform the directors of the KKR proposal because he considered it “dead.” Van Gorkom did not contact KKR again until January 20, when faced with the realities of this lawsuit, he then attempted to reopen negotiations. KKR declined due to the imminence of the February 10 stockholder meeting.

GE Credit Corporation’s interest in Trans Union did not develop until November; and it made no written proposal until mid-January. Even then, its proposal was not in the form of an offer. Had there been time to do so, GE Credit was prepared to offer between $2 and $5 per share above the $55 per share price which Pritzker offered. But GE Credit needed an additional 60 to 90 days; and it was unwilling to make a formal offer without a concession from Pritzker extending the February 10 “deadline” for Trans Union’s stockholder meeting. As previously stated, Pritzker refused to grant such extension; and on January 21, GE Credit terminated further negotiations with Trans Union. Its stated reasons, among others, were its “unwillingness to become involved in a bidding contest with Pritzker in the absence of the willingness of [the Pritzker interests] to terminate the proposed $55 cash merger.”

* * *

In the absence of any explicit finding by the Trial Court as to the reasonableness of Trans Union’s directors’ reliance on a market test and its feasibility, we may make our own findings based on the record. Our review of the record compels a finding that confirmation of the appropriateness of the Pritzker offer by an unfettered or free market test was virtually meaningless in the face of the terms and time limitations of Trans Union’s Merger Agreement with Pritzker as amended October 10, 1980.

Finally, we turn to the Board’s meeting of January 26, 1981. The defendant directors rely upon the action there taken to refute the contention that they did not reach an informed business judgment in approving the Pritzker merger. The defendants contend that the Trial Court correctly concluded that Trans Union’s directors were, in effect, as “free to turn down the Pritzker proposal” on January 26, as they were on September 20.

* * * We conclude that the Trial Court’s finding in this regard is neither supported by the record nor the product of an orderly and logical deductive process. Without disagreeing with the principle that a business decision by an originally uninformed board of directors may, under appropriate circumstances, be timely cured so as to become informed and deliberate, we find that the record does not permit the defendants to invoke that principle in this case. *** We find the Trial Court to have erred, both as a matter of fact and as a matter of law, in relying on the action on January 26 to bring the defendants’ conduct within the protection of the business judgment rule.
Johnson’s testimony and the Board Minutes of January 26 are remarkably consistent. Both clearly indicate recognition that the question of the alternative courses of action, available to the Board on January 26 with respect to the Pritzker merger, was a legal question, presenting to the Board (after its review of the full record developed through pre-trial discovery) three options: (1) to “continue to recommend” the Pritzker merger; (2) to “recommend that the stockholders vote against” the Pritzker merger; or (3) to take a noncommittal position on the merger and “simply leave the decision to [the] shareholders.”

We must conclude from the foregoing that the Board was mistaken as a matter of law regarding its available courses of action on January 26, 1981. Options (2) and (3) were not viable or legally available to the Board under 8 Del.C. § 251(b). The Board could not remain committed to the Pritzker merger and yet recommend that its stockholders vote it down; nor could it take a neutral position and delegate to the stockholders the unadvised decision as to whether to accept or reject the merger. Under § 251(b), the Board had but two options: (1) to proceed with the merger and the stockholder meeting, with the Board’s recommendation of approval; or (2) to rescind its agreement with Pritzker, withdraw its approval of the merger, and notify its stockholders that the proposed shareholder meeting was cancelled. There is no evidence that the Board gave any consideration to these, its only legally viable alternative courses of action.

But the second course of action would have clearly involved a substantial risk—that the Board would be faced with suit by Pritzker for breach of contract based on its September 20 agreement as amended October 10. As previously noted, under the terms of the October 10 amendment, the Board’s only ground for release from its agreement with Pritzker was its entry into a more favorable definitive agreement to sell the Company to a third party. Thus, in reality, the Board was not “free to turn down the Pritzker proposal” as the Trial Court found. Indeed, short of negotiating a better agreement with a third party, the Board’s only basis for release from the Pritzker Agreement without liability would have been to establish fundamental wrongdoing by Pritzker. Clearly, the Board was not “free” to withdraw from its agreement with Pritzker on January 26 by simply relying on its self-induced failure to have reached an informed business judgment at the time of its original agreement.

Therefore, the Trial Court’s conclusion that the Board reached an informed business judgment on January 26 in determining whether to turn down the Pritzker “proposal” on that day cannot be sustained. The Court’s conclusion is not supported by the record; it is contrary to the provisions of § 251(b) and basic principles of contract law; and it is not the product of a logical and deductive reasoning process.

* * *

Upon the basis of the foregoing, we hold that the defendants’ post-September conduct did not cure the deficiencies of their September 20 conduct; and that, accordingly, the Trial Court erred in according to the defendants the benefits of the business judgment rule.

*** V.

The defendants ultimately rely on the stockholder vote of February 10 for exoneration. The defendants contend that the stockholders’ “overwhelming” vote approving the Pritzker Mer-
ger Agreement had the legal effect of curing any failure of the Board to reach an informed business judgment in its approval of the merger.

The settled rule in Delaware is that “where a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail.” Gerlach v. Gillam, Del. Ch., 139 A.2d 591, 593 (1958). The question of whether shareholders have been fully informed such that their vote can be said to ratify director action, “turns on the fairness and completeness of the proxy materials submitted by the management to the ... shareholders.” Michelson v. Duncan, supra at 220.

Applying this standard to the record before us, we find that Trans Union’s stockholders were not fully informed of all facts material to their vote on the Pritzker Merger and that the Trial Court’s ruling to the contrary is clearly erroneous. We list the material deficiencies in the proxy materials:

(1) The fact that the Board had no reasonably adequate information indicative of the intrinsic value of the Company, other than a concededly depressed market price, was without question material to the shareholders voting on the merger.

Accordingly, the Board’s lack of valuation information should have been disclosed. Instead, the directors cloaked the absence of such information in both the Proxy Statement and the Supplemental Proxy Statement. Through artful drafting, noticeably absent at the September 20 meeting, both documents create the impression that the Board knew the intrinsic worth of the Company. In particular, the Original Proxy Statement contained the following:

> although the Board of Directors regards the intrinsic value of the Company’s assets to be significantly greater than their book value ..., systematic liquidation of such a large and complex entity as Trans Union is simply not regarded as a feasible method of realizing its inherent value. Therefore, a business combination such as the merger would seem to be the only practicable way in which the stockholders could realize the value of the Company.

The Proxy stated further that “[i]n the view of the Board of Directors ..., the prices at which the Company’s common stock has traded in recent years have not reflected the inherent value of the Company.” What the Board failed to disclose to its stockholders was that the Board had not made any study of the intrinsic or inherent worth of the Company; nor had the Board even discussed the inherent value of the Company prior to approving the merger on September 20, or at either of the subsequent meetings on October 8 or January 26.

We find misleading the Board’s references to the “substantial” premium offered. The Board gave as their primary reason in support of the merger the “substantial premium” shareholders would receive. But the Board did not disclose its failure to assess the premium offered in terms of other relevant valuation techniques, thereby rendering questionable its determination as to the substantiability of the premium over an admittedly depressed stock market price.

(5) The Board’s Supplemental Proxy Statement, mailed on or after January 27, added significant new matter, material to the proposal to be voted on February 10, which was not contained in the Original Proxy Statement. Some of this new matter was information which
had only been disclosed to the Board on January 26; much was information known or rea-
sonably available before January 21 but not revealed in the Original Proxy Statement. Yet,
the stockholders were not informed of these facts.

*** In this case, the Board’s ultimate disclosure as contained in the Supplemental Proxy
Statement related either to information readily accessible to all of the directors if they had
asked the right questions, or was information already at their disposal. In short, the infor-
mation disclosed by the Supplemental Proxy Statement was information which the defend-
ant directors knew or should have known at the time the first Proxy Statement was issued.
The defendants simply failed in their original duty of knowing, sharing, and disclosing in-
formation that was material and reasonably available for their discovery. They compounded
that failure by their continued lack of candor in the Supplemental Proxy Statement. While
we need not decide the issue here, we are satisfied that, in an appropriate case, a completely
candid but belated disclosure of information long known or readily available to a board
could raise serious issues of inequitable conduct.

The burden must fall on defendants who claim ratification based on shareholder vote to es-
tablish that the shareholder approval resulted from a fully informed electorate. On the record
before us, it is clear that the Board failed to meet that burden.

* * *

For the foregoing reasons, we conclude that the director defendants breached their fiduciary
duty of candor by their failure to make true and correct disclosures of all information they
had, or should have had, material to the transaction submitted for stockholder approval.

VI.

To summarize: we hold that the directors of Trans Union breached their fiduciary duty to
their stockholders (1) by their failure to inform themselves of all information reasonably
available to them and relevant to their decision to recommend the Pritzker merger; and (2)
by their failure to disclose all material information such as a reasonable stockholder would
consider important in deciding whether to approve the Pritzker offer.

We hold, therefore, that the Trial Court committed reversible error in applying the busi-
ness judgment rule in favor of the director defendants in this case.

On remand, the Court of Chancery shall conduct an evidentiary hearing to determine the
fair value of the shares represented by the plaintiffs’ class, based on the intrinsic value of
Trans Union on September 20, 1980. * * * Thereafter, an award of damages may be entered
to the extent that the fair value of Trans Union exceeds $55 per share.

* * *

REVERSED and REMANDED for proceedings consistent herewith.
June 24, 2010

Via Personal Messenger

PERSONAL & CONFIDENTIAL

Mark Hurd, CEO
HEWLETT PACKARD COMPANY
3000 Hanover Street
Palo Alto, CA 94304

Re: Jodie Fisher v. Hewlett Packard/Mark Hurd

Dear Mr. Hurd:

Please be advised that we represent Ms. Jodie Fisher regarding her claims under Cal. Govt. Code §12940 (j)(1) and the Unruh Act §51.9 against Hewlett Packard ("HP") and you, Mr. Mark Hurd, as an individual. Ms. Fisher has retained our firm to attempt resolution of her claims confidentially prelitigation as it is our policy to do so at this juncture before the nature of protracted litigation sets in.

After careful review of the facts and circumstances regarding her claims, we believe Ms. Fisher has a significant case for sexual harassment. In that this matter is currently at the prelitigation stage and neither formal discovery nor further investigation has occurred, we hereby reserve the right to supplement these facts as formal investigation may dictate. Further, this communication is subject to California Evidence Code Sec. 1152 and therefore is not admissible for any reason.

By way of background, in August, 2007 Ms. Fisher was contacted by her publicist, Nadine Jolson of Jolson Creative. She had been contacted regarding Ms. Fisher’s availability to host a series of executive summit events for HP. You had seen Ms. Fisher on the NBC television show “Age of Love” that she had appeared on in May/June of 2007 and were quite taken with her. You hand-picked her to technically hostess various HP events, but more accurately, to be with you and accompany you when you were out of town at numerous various HP events.

Looking at what ensued over the next two (2) years, it is clear you had designs to make her your lover from the onset using your status and authority as CEO of HP and HP monies expecting her to be with you. It is appalling that you would use HP revenues for the purpose of
procuring female companionship and romance under the guise of HP business.

After Ms. Jolson was contacted, a meeting was set up for Ms. Fisher to meet with Caprice Fimbres and you at the Miramar Hotel in Santa Monica, CA in late August 2007. Ms. Fisher met with Ms. Fimbres very briefly, approximately five minutes, who then directed her to meet with you to talk with you. You both had drinks in the hotel lobby for about 45 minutes. Ms. Fisher thought it odd that you talked of mainly personal things - like the fact that you both went to Southwest Conference schools – you went to Baylor, she to Texas Tech in the early 1980's. She was somewhat baffled as to why you wanted to meet with her and why you flew down from Palo Alto to do so but was of course pleased to be considered for whatever job you had in mind.

In September 2007 Ms. Fisher’s publicist called her regarding another meeting. You wanted to meet with Ms. Fisher for a second interview in Denver, Colorado. Again, Ms. Fimbres played intermediary and you all met at the Brown Hotel. Ms. Fisher spoke to Ms. Fimbres briefly and then was shuttled over to you for drinks and dinner. Ms. Fisher knew she was being considered for a job but this time the meeting felt more like a date.

Again, you talked about college days and your personal lives. You told Ms. Fisher that you were married with two daughters. You asked Ms. Fisher if there was anything that she needed to disclose that, if it were to come to light while Ms. Fisher was working for HP, would cause a problem. Ms. Fisher disclosed that she had posed for Playboy Magazine while at Texas Tech. Ms. Fisher also told you that she had two DUI’s in her early 20’s and that she was now clean and sober and had been for 20 years.

You later told Ms. Fisher that you were very impressed with her candor on that particular evening. You were drinking at this dinner excessively and seemed to get more friendly and personal the more you drank. You were always looking around decidedly aware of the fact that someone might recognize you because you are so well known. You were obviously trying to impress Ms. Fisher. Ms. Fisher left this dinner feeling good about her chances for getting the job but again was uncomfortable with some of the conversation and the date-like feel of the evening.

In October 2007, Ms. Fisher was offered her first contract with HP to host a series of six executive summit events and flew to Atlanta for the first event. Ms. Fisher was paid $30,000 for these six events upfront. She was really just observing this first event so that she could see what was involved. Ms. Fimbres, acting as intermediary as usual, directed Ms. Fisher to join you for dinner after the event.
You went to dinner across the street from the Ritz Carlton where you were staying. You talked briefly about the event and how it went. You told Ms. Fisher that you were flying to China to meet Madame Wu Yi, the Chinese Vice-Premier, in a couple of days. As you were walking back to the Ritz, you invited Ms. Fisher to come up to your room. You said there were some documents that you wanted to show her pertaining to Madame Wu Yi.

She did not want to go. Ms. Fisher first went to her room and called her sponsor in AA, Diane Rogers. Ms. Fisher reported to her what the situation was and asked for her advice. She agreed that Ms. Fisher “had” to go but that Ms. Fisher should remember who she was and that she did not ever have to do anything that compromised her integrity. So, shored up by Ms. Roger’s supportive words, Ms. Fisher went to your suite. You told her that they needed to be quiet because you had body guards in a room right next door.

Ms. Fisher was scared. She was a nervous wreck but attempted to appear relaxed. She sat down on one of two love seats in the sitting room. She was worried when you came over and sat directly next to her and put your arm on the back of the love seat. As you did so, your hand brushed across her breast. The first time Ms. Fisher thought it was a mistake. It happened a second time and Ms. Fisher said “you do know that you are touching my breast, right?” You said “oh, sorry, sorry” and then laughed it off.

You both chatted for a bit and then you looked at Ms. Fisher and said, “So, you’ll stay the night, right? You’ll stay?” Ms. Fisher was horrified as everything she feared was coming to pass. Ms. Fisher said “Absolutely not. I barely know you and you are my boss.” You told her that she worked for Ms. Fimbres, not you, that she should not worry about that. You tried to persuade her to spend the night with you. This went on painfully for another hour.

Ms. Fisher finally gathered her courage and said that she needed to go. You told her that no one had ever rejected you before and were clearly miffed. Ms. Fisher tried to be low key about the whole situation but it was difficult. Ms. Fisher certainly didn’t want to lose her job but she was deeply upset. She felt deceived and confused at the same time.

As she left your suite, you asked Ms. Fisher to at least give you a hug. Then you said she needed to be very careful leaving your room so the body guards wouldn’t hear. This was the beginning of an uncomfortable dance that went on for almost two years. At times you would behave professionally seemingly “getting” that she was not going to have sex with you. At other times, not, and you would relentlessly attempt to cajole her into having sex with you.

The next day, Ms. Fimbres “invited” Ms. Fisher to have dinner with you again. Ms. Fisher did not feel like she could say no. Ms. Fisher met you for dinner and you admitted that
you “didn’t handle that right” the night prior. Ms. Fisher knew that if she shamed you or made you feel worse, she would jeopardize her job. She kept rationalizing to herself, “I can handle this. I can just be polite”. You had been telling her about many different women that were crazy about you...including Sheryl Crow. You were indicating that she was the lucky one... that you found her desirable and wanted to spend your extremely valuable time with her. However, Ms. Fisher did not feel lucky at all - she felt manipulated.

Ms. Fisher flew home to Los Angeles, First Class, as this was part of her contract with HP. She felt tired, irritated and depressed, sad and mad with the growing unbending realization that her great new job had some major strings attached. Ms. Fisher had survived a very high stress situation but at what cost? She dreaded the next encounter. She told her mother about the entire episode who was absolutely flabbergasted that you, CEO of one of the largest corporations in the world, were manipulating her daughter, expecting sex in exchange for work. She was outraged.

In December 2007 an event was added to her contract. Ms. Fisher headed to St. Louis. It was more of the same, except this time she had been booked in a suite instead of a room at the Ritz. Ms. Fimbres again directed Ms. Fisher to have dinner with you. You went to Morton’s steakhouse where you expressed your frustration that you were doing “all the work” in this relationship.

Ms. Fisher told you that she was definitely not interested in you romantically. After dinner that night, you walked Ms. Fisher to her room and came into the sitting area. She was starting to panic. You abruptly walked up to her, put your arms around her, looked her in the eye and looked like you were going to kiss her. Ms. Fisher did not want to kiss you and was incredibly uncomfortable making efforts to dissuade the situation. You quickly kissed Ms. Fisher on the lips and she reacted by just squirming away quickly. You directed her to meet for coffee in the morning at 7 AM. The next morning you walked over to Starbucks. You both sat at Starbucks and talked for about an hour.

You came to her room the next morning and wanted to say good bye to Ms. Fisher before you left. It was very early and Ms. Fisher was in her robe. You came in and hugged her good bye. Ms. Fisher felt horribly uncomfortable, trying to keep her distance and quickly disengaged your continuing embrace. It was as if you thought there was a relationship that was romantic in nature. She continued to ponder day and night out how she could turn this whole thing around and still keep her job. She didn’t know what to do.

In January 2008, Ms. Fisher was next scheduled for the Toronto event. As Ms. Fisher
was walking down the ramp to board her plane, she got a call from Ms. Fimbres saying, “Don’t come. They are cancelling the event. Don’t get on the plane.” Ms. Fisher still does not know what happened but knows the event was held in Toronto and was not really cancelled. She believes that you may have had another woman there that would sleep with you. Later she was told by you at the Peninsula Hotel, in the pool area, that you regularly sleep with one woman in New York and that you sleep with another woman in San Francisco. At one point the New York woman wanted to come to San Francisco. You laughed while explaining that this would never work out to Ms. Fisher. It may have been that the New York woman was flying up to Toronto unexpectedly and that is why you had to cancel Ms. Fisher. It is clear that you had various women in various places utilizing HP monies, expensing hotels, airfare and dinners while using your status and clear ability to enjoy female companionship and intimacy.

In February 2008, Ms. Fisher was invited to attend an event in Rancho Bernardo, CA. Once again, Ms. Fimbres directed her to join you for dinner at the Rancho Bernardo Inn where you were staying. Ms. Fisher was scared that you were going to try to come back to her room. You did. And once again, Ms. Fisher made up excuses so that you couldn’t stay. On these occasions, you would then call her from your hotel room and want to chat about different movies that you liked and different sports teams.

At this point, her publicist was trying to negotiate more money due to the fact that she was being asked...on her own time...to attend these dinners, etc. with you which were clearly not HP “events”. Her publicist felt she should receive compensation and was aware of the situation and of your advances. You were outraged and felt insulted by her and by Ms. Fisher. Ms. Fisher tried to explain that her publicist was only looking out for her interests and doing only what she felt was right and proper. Ms. Fisher had to “fire” her publicist if she wanted to keep her job. She did so, but thereafter felt completely alone.

In March, 2008 in Madrid, Spain, you and Ms. Fisher stayed at the Ritz. Ms. Fimbres asked Ms. Fisher if she was available for dinner with you. Ms. Fimbres always set up the dinners and paid in advance with her credit card. The reservations would always be under her name. You went in a town car from the hotel to Combarro Restaurant in Madrid. Anytime Ms. Fisher was in a town car with you when there was a driver present, you would always “shush” Ms. Fisher as if to say, “don’t say anything personal.”

The next day, Ms. Fimbres called Ms. Fisher and directed her to immediately meet you in the hotel lobby. You wanted to walk around the city. Again, Ms. Fisher felt she could not say no. You stopped at an ATM and showed her that your checking account balance was over a million dollars to impress her.
Mark Hurd, CEO
HEWLETT PACKARD COMPANY
June 24, 2010
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As you were leaving Madrid, you called her hotel room and talked about a deal you were working on to purchase EDS in Dallas, Texas. You told Ms. Fisher that you were meeting with the head of EDS in Dallas. You described the head of EDS as a "big guy", and as someone who was very impressed with himself, very cocky. You told Ms. Fisher the deal was likely going to go through and would be one of the biggest purchases in U.S. history.

Ms. Fisher told you that she knew of EDS from living in Dallas in that her mother had met Ross Perot, the founder of EDS. Ms. Fisher told her mother and her mother was appalled that you were discussing potential acquisitions. You told Ms. Fisher that she shouldn't disclose anything about the deal to anyone as it would be considered insider trading if stock was purchased by Ms. Fisher or anyone associated with her. Later you called her and asked if you could come to her room and give her a hug before you left. Ms. Fisher told you no, that she was not dressed, making an excuse as she was constantly making excuses so as to not be alone with you in private.

This continued for the next year and a half. Many events were added to her original contract - many extra cities including Philadelphia, Boston for a second time, Atlanta for a second time, Boise, Tokyo, Minneapolis and others. She continually had to put you off, make excuses, scurry away or simply leave. Oftentimes you would be irritated and angry and on a few occasions, you were so angry when she put you off, she expected to get fired. However you would then engage her again, try again and the situation and your annoyance would dissipate. However by 2009 it was clear you were tolerating her excuses less and less.

By July 2009 the practice was that anytime you were in Los Angeles, you would ask to meet with Ms. Fisher by way of a phone call from Ms. Fimbres. You met at Houston’s in Santa Monica, The Four Season’s in Beverly Hills, The Peninsula Hotel in Beverly Hills, The Beverly Wilshire. Once, at the Four Seasons, you suddenly and abruptly asked her to go away with you as if you were testing her. You said you wanted to “get her away from here”. She made the excuse that because she was a single mom and needed to care for her son when she was not travelling for business.

You later said in an irritated and dejected manner that you were feeling rejected because she would not go away with you. You offered to take care of her and constantly asked her if there was anything she needed. You once explained to her that you give endowments personally of about $30,000 a year to athletes that you feel are worthy, one of whom is a tennis player at Baylor. Ms. Fisher declined any offer of such a gift of money from you as she felt this would be inappropriate and would make her feel indebted to you in a personal way.

One of your last dinners was at Craft in Century City where you confessed that you felt like you could spend the rest of your life with her. You said you would have to see how the
chemistry in bed was but that that would not be a problem because “you try hard”.

Ms. Fisher had been telling you all this time and told you again affirmatively that she was not interested in dating a married man.

You then offered Ms. Fisher more events in New Mexico, Houston and Miami but again, Ms. Fisher did not sleep with you and, with your obvious growing irritation with her put-offs these opportunities never came to pass. At one point you offered her a $100,000 job but then reneged realizing you would not be able to see her in the manner you wished.

In October 2009, you met Ms. Fisher one final time in Boise, Idaho. Ms. Fimbres directed Ms. Fisher to join you for dinner. You invited Ms. Fisher to your room to watch a sporting event. Your demeanor was different this time. You appeared more decisive and impulsive. Suddenly you stood up, grabbed and kissed Ms. Fisher. Ms. Fisher was scared. She told you she was not feeling well and wriggled free hurriedly escaping to her room. You were angry. It was becoming clear. She knew that if she did not have sex with you soon, her job was over which is exactly what occurred. All your advances were unwelcome, awkward and were never reciprocated in any way. That was the last time she had contact with you. No new events or contracts were ever given to Ms. Fisher thereafter.

Ms. Fisher has been very damaged. You treated her as a sex object, hand-picking her from a TV show, expecting sexual favors in return for giving her work. This is the most egregious type of sexual harassment and this situation is exactly what our laws are borne out of. Women should not have to “put out” in order to keep their jobs. She refused your quid pro quo attempts at sex and has now been discarded by you and HP.

Ms. Fisher has had to relocate to New Jersey, where her parents live, which has obviously changed her life and independence completely. She is emotionally debilitated and is spiraling downwards. She misses Los Angeles terribly and feels that she has a dark cloud over her. It is hard for her to move on and emotionally deal with what has happened to her. She feels violated, used and disregarded all at the same time.
We are prepared to move forward and seek all available legal remedies on Ms. Fisher’s behalf. To use her as a subterfuge for your personal romantic desires is unconscionable. Nevertheless, we have asked Ms. Fisher to allow us to attempt an out-of-court settlement before the protracted nature and emotions of litigation set. If you are interested in resolving this matter and furthering discussions in this regard, please contact Margery N. Somers, Esq. of our offices who will handle this matter preliminarily. In that statute deadlines are looming we expect you or your representative will contact Ms. Somers in the next week. If we do not hear from anyone within that timeframe, we will assume you are not interested in resolving this matter confidentially prelitigation and we will move forward on Ms. Fisher’s behalf.

We hereby reserve Ms. Fisher’s rights at law and in equity.

Very truly yours,

ALLRED, MAROKO & GOLDBERG

[Signature]

GLORIA ALLRED

GA:js
HP today announced that Chairman, Chief Executive Officer and President Mark Hurd has decided with the Board of Directors to resign his positions effective immediately.

The Board has appointed CFO Cathie Lesjak, 51, as CEO on an interim basis. Lesjak is a 24-year veteran of the company who has served as HP's CFO and as a member of the company's Executive Council since January 2007. She oversees all company financial matters and will retain her CFO responsibilities during the interim period.

Hurd's decision was made following an investigation by outside legal counsel and the General Counsel's Office, overseen by the Board, of the facts and circumstances surrounding a claim of sexual harassment against Hurd and HP by a former contractor to HP. The investigation determined there was no violation of HP's sexual harassment policy, but did find violations of HP's Standards of Business Conduct.

A Search Committee of the Board of Directors has been created, consisting of Marc L. Andreessen, Lawrence T. Babbio, Jr., John H. Hammergren, and Joel Z. Hyatt, which will oversee the process for the identification and selection of a new CEO and Board Chair. HP's lead independent director, Robert Ryan, will continue in that position.

Hurd said: "As the investigation progressed, I realized there were instances in which I did not live up to the standards and principles of trust, respect and integrity that I have espoused at HP and which have guided me throughout my career. After a number of discussions with members of the board, I will move aside and the board will search for new leadership. This is a painful decision for me to make after five years at HP, but I believe it would be difficult for me to continue as an effective leader at HP and I believe this is the only decision the board and I could make at this time. I want to stress that this in no way reflects on the operating performance or financial integrity of HP."

"The corporation is exceptionally well positioned strategically," Hurd continued. "HP has an extremely talented executive team supported by a dedicated and customer focused work force. I expect that the company will continue to be successful in the future."

Robert Ryan, lead independent director of the Board, said: "The board deliberated extensively on this matter. It recognizes the considerable value that Mark has contributed to HP over the past five years in establishing us as a leader in the industry. He has worked tirelessly to improve the value of HP, and we greatly appreciate his efforts. He is leaving this company in the hands of a very talented team of executives. This departure was not related in any way to the company's operational performance or financial condition, both of which remain strong. The board recognizes that this change in leadership is unexpected news for everyone associated with HP, but we have strong leaders driving our businesses, and strong teams of employees driving performance."

"The scale, global reach, broad portfolio, financial strength and, very importantly, the depth and talent of the HP team are sustainable advantages that uniquely position the company for the future," said Lesjak. "I accept the position of interim CEO with the clear goal to move the company forward in executing HP's strategy for profitable growth. We have strong market momentum and our ability to execute is irrefutable as demonstrated by our Q3 preliminary results."

Lesjak has taken herself out of consideration as the permanent CEO but will serve as interim CEO until the selection process is complete. Candidates from both inside and outside the company will be considered. The selection of a new chairman will occur in conjunction with the CEO decision.

The company does not expect to make any additional structural changes or executive leadership changes in the near future.

HP announces preliminary third quarter results; raises full-year outlook for revenue and non-GAAP EPS

HP is announcing preliminary results for the third fiscal quarter 2010, with revenue of approximately $30.7 billion up 11% compared with the prior-year period.
In the third quarter, preliminary GAAP diluted earnings per share (EPS) were approximately $0.75 and non-GAAP diluted EPS were approximately $1.08. GAAP and non-GAAP EPS were negatively impacted by $0.02 pertaining to one-time charges relating to the previously announced U.S. Department of Justice settlement. Non-GAAP diluted EPS estimates exclude after-tax costs of approximately $0.33 per share, related primarily to restructuring, amortization of purchased intangible assets and acquisition-related charges.

For the fourth fiscal quarter of 2010, HP estimates revenue of approximately $32.5 billion to $32.7 billion, GAAP diluted EPS in the range of $1.03 to $1.05 and non-GAAP diluted EPS in the range of $1.25 to $1.27. Non-GAAP diluted EPS estimates exclude after-tax costs of approximately $0.22 per share, related primarily to restructuring, amortization of purchased intangible assets and acquisition-related charges.

For the full year, HP now expects revenue in the range of $125.3 billion to $125.5 billion. FY10 GAAP diluted EPS is expected to be in the range of $3.62 to $3.64 and non-GAAP diluted EPS in the range of $4.49 to $4.51. FY10 non-GAAP diluted EPS estimates exclude after-tax costs of approximately $0.87 per share, related primarily to restructuring, amortization of purchased intangibles and acquisition-related charges.

HP plans to release its final results for the third fiscal quarter on Thursday, Aug. 19, 2010, with a conference call at 6 p.m. ET/3 p.m. PT to provide additional details.

**HP to hold media and financial analyst calls today**

This afternoon HP will conduct audio webcasts for the media and financial analysts to discuss today's announcement.

Conference call for the media: 4:15 p.m. ET/1:15 p.m. PT. Members of the press can dial in at +1 866 713 8567 or +1 617 597 5326, participant code 29494237.

Audio webcast for financial analysts and stockholders: 4:45 p.m. ET/1:45 p.m. PT. Access the live audio webcast at www.hp.com/investor/IRbriefing. It is recommended that attendees dial in 15 minutes early to avoid registration delays.

**About HP**

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**Use of non-GAAP financial information**

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Oracle Hires Mark Hurd as President

Hurd Joins Oracle’s Board of Directors

REDWOOD SHORES, Calif. - September 6, 2010
Oracle (NASDAQ: ORCL) today announced that Mark V. Hurd has joined Oracle as President and has been named to Oracle’s Board of Directors. Mr. Hurd will report to Oracle CEO Larry Ellison.

"Mark did a brilliant job at HP and I expect he’ll do even better at Oracle," said Oracle CEO Larry Ellison. "There is no executive in the IT world with more relevant experience than Mark. Oracle's future is engineering complete and integrated hardware and software systems for the enterprise. Mark pioneered the integration of hardware with software when Teradata was a part of NCR."

"Mark is an outstanding executive and a proven winner," said Oracle President Safra Catz. "I look forward to working with him for years to come. As Oracle continues to grow we need people experienced in operating a $100 billion business."

"I believe Oracle's strategy of combining software with hardware will enable Oracle to beat IBM in both enterprise servers and storage," said Mark Hurd. "Exadata is just the beginning. We have some exciting new systems we are going to announce later this month at Oracle OpenWorld. I'm excited to be a part of the most innovative technology team in the IT industry."

Cautionary Statement Regarding Forward-Looking Statements

Statements in this press release relating to Oracle's future plans, expectations, beliefs, intentions and prospects are "forward-looking statements" and are subject to material risks and uncertainties. When used in this press release, the words "will", "future", "expect", "look forward to", similar expressions and any other statements that are not historical facts are intended to identify those assertions as forward-looking statements. Any such statement may be influenced by a variety of factors, many of which are beyond the control of Oracle, that could cause actual outcomes and results to be materially different from those projected, described, expressed or implied in this press release due to a number of risks and uncertainties. Accordingly, no assurances can be given that any of the events anticipated by the forward-looking statements will transpire or occur. A detailed discussion of these factors and other risks that affect our business is contained in our SEC filings, including our most recent reports on Form 10-K and Form 10-Q, particularly under the heading "Risk Factors." Copies of these filings are available online from the SEC or by contacting Oracle Corporation's Investor Relations Department at (800) 565-4073 or by clicking on SEC Filings on Oracle's Investor Relations website at http://www.oracle.com/investor. All information set forth in this press release is current as of September 6, 2010. Oracle undertakes no duty to update any statement in light of new information or future events.

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Session 6: Structuring Transactions and Bankruptcy

We will start with some background material on debt and priority and then turn to how those issues are dealt with in bankruptcy.

Bank of America National Trust and Savings Ass’n v. 203 N. LaSalle Street Partnership

526 U.S. 434 (1999)

Justice SOUTER delivered the opinion of the Court: The issue in this Chapter 11 reorganization case is whether a debtor’s prebankruptcy equity holders may, over the objection of a senior class of impaired creditors, contribute new capital and receive ownership interests in the reorganized entity, when that opportunity is given exclusively to the old equity holders under a plan adopted without consideration of alternatives. We hold that old equity holders are disqualified from participating in such a “new value” transaction by the terms of 11 U.S.C. § 1129(b)(2)(B)(ii), which in such circumstances bars a junior interest holder’s receipt of any property on account of his prior interest.

I

Petitioner, Bank of America National Trust and Savings Association (Bank), is the major creditor of respondent, 203 North LaSalle Street Partnership (Debtor or Partnership), an Illinois real estate limited partnership. The Bank lent the Debtor some $93 million, secured by a nonrecourse first mortgage on the Debtor’s principal asset, 15 floors of an office building in downtown Chicago. In January 1995, the Debtor defaulted, and the Bank began foreclosure.

In March, the Debtor responded with a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 1101 et seq., which automatically stayed the foreclosure proceedings, see § 362(a). The Debtor’s principal objective was to ensure that its partners retained title to the property so as to avoid roughly $20 million in personal tax liabilities, which would fall due if the Bank foreclosed. The Debtor proceeded to propose a reorganization plan during the 120-day period when it alone had the right to do so, see 11 U.S.C. § 1121(b); see also § 1121(c) (exclusivity period extends to 180 days if the debtor files plan within the initial 120 days). The Bankruptcy Court rejected the Bank’s motion to terminate the period of exclusivity to make way for a plan of its own to liquidate the property, and instead extended the exclusivity period for cause shown, under § 1121(d).

The value of the mortgaged property was less than the balance due the Bank, which elected to divide its undersecured claim into secured and unsecured deficiency claims under § 506(a) and § 1111(b). Under the plan, the Debtor separately classified the Bank’s secured claim, its unsecured deficiency claim, and unsecured trade debt owed to other creditors. See § 1122(a). The Bankruptcy Court found that the Debtor’s available assets were prepetition

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7 Indeed, the Seventh Circuit apparently requires separate classification of the deficiency claim of an under-
rents in a cash account of $3.1 million and the 15 floors of rental property worth $54.5 million. The secured claim was valued at the latter figure, leaving the Bank with an unsecured deficiency of $38.5 million.

So far as we need be concerned here, the Debtor’s plan had these further features:

1) The Bank’s $54.5 million secured claim would be paid in full between 7 and 10 years after the original 1995 repayment date.8

2) The Bank’s $38.5 million unsecured deficiency claim would be discharged for an estimated 16% of its present value.9

3) The remaining unsecured claims of $90,000, held by the outside trade creditors, would be paid in full, without interest, on the effective date of the plan.10

4) Certain former partners of the Debtor would contribute $6.125 million in new capital over the course of five years (the contribution being worth some $4.1 million in present value), in exchange for the Partnership’s entire ownership of the reorganized debtor.

The last condition was an exclusive eligibility provision: the old equity holders were the only ones who could contribute new capital.11

The Bank objected and, being the sole member of an impaired class of creditors, thereby blocked confirmation of the plan on a consensual basis. See § 1129(a)(8).12 The Debtor, however, took the alternate route to confirmation of a reorganization plan, forthrightly known as the judicial “cramdown” process for imposing a plan on a dissenting class. § 1129(b).

There are two conditions for a cramdown. First, all requirements of § 1129(a) must be met (save for the plan’s acceptance by each impaired class of claims or interests, see § 1129(a)(8)). Critical among them are the conditions that the plan be accepted by at least one class of unsecured creditor from other general unsecured claims. See In re Woodbrook Associates, 19 F.3d 312, 319 (1994). Nonetheless, the Bank argued that if its deficiency claim had been included in the class of general unsecured creditors, its vote against confirmation would have resulted in the plan’s rejection by that class. The Bankruptcy Court and the District Court rejected the contention that the classifications were gerrymandered to obtain requisite approval by a single class, and the Court of Appeals agreed. The Bank sought no review of that issue, which is thus not before us.

8 Payment consisted of a prompt cash payment of $1,149,500 and a secured, 7-year note, extendable at the Debtor’s option.

9 This expected yield was based upon the Bankruptcy Court’s projection that a sale or refinancing of the property on the 10th anniversary of the plan confirmation would produce a $19-million distribution to the Bank.

10 The Debtor originally owed $160,000 in unsecured trade debt. After filing for bankruptcy, the general partners purchased some of the trade claims. Upon confirmation, the insiders would waive all general unsecured claims they held.

11 The plan eliminated the interests of noncontributing partners. More than 60% of the Partnership interests would change hands on confirmation of the plan. The new Partnership, however, would consist solely of former partners, a feature critical to the preservation of the Partnership’s tax shelter.

12 A class of creditors accepts if a majority of the creditors and those holding two-thirds of the total dollar amount of the claims within that class vote to approve the plan. § 1126(c).
paired creditors, see § 1129(a)(10), and satisfy the “best-interest-of-creditors” test, see § 1129(a)(7). Here, the class of trade creditors with impaired unsecured claims voted for the plan, and there was no issue of best interest. Second, the objection of an impaired creditor class may be overridden only if “the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.” § 1129(b)(1). As to a dissenting class of impaired unsecured creditors, such a plan may be found to be “fair and equitable” only if the allowed value of the claim is to be paid in full, § 1129(b)(2)(B)(i), or, in the alternative, if “the holder of any claim or interest that is junior to the claims of such [impaired unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property,” § 1129(b)(2)(B)(ii). That latter condition is the core of what is known as the “absolute priority rule.”

The absolute priority rule was the basis for the Bank’s position that the plan could not be confirmed as a cramdown. As the Bank read the rule, the plan was open to objection simply because certain old equity holders in the Debtor Partnership would receive property even though the Bank’s unsecured deficiency claim would not be paid in full. The Bankruptcy Court approved the plan nonetheless, and accordingly denied the Bank’s pending motion to convert the case to Chapter 7 liquidation, or to dismiss the case. The District Court affirmed, as did the Court of Appeals. ***

II

The terms “absolute priority rule” and “new value corollary” (or “exception”) are creatures of law antedating the current Bankruptcy Code, and to understand both those terms and the related but inexact language of the Code some history is helpful. The Bankruptcy Act preceding the Code contained no such provision as subsection (b)(2)(B)(ii), its subject having been addressed by two interpretive rules. The first was a specific gloss on the requirement of § 77B (and its successor, Chapter X) of the old Act, that any reorganization plan be “fair and equitable.” 11 U.S.C. § 205(e) (repealed 1938) (§ 77B); 11 U.S.C. § 621(2) (repealed 1979) (Chapter X). The reason for such a limitation was the danger inherent in any reorganization plan proposed by a debtor, then and now, that the plan will simply turn out to be too good a deal for the debtor’s owners. Hence the pre-Code judicial response known as the absolute priority rule, that fairness and equity required that “the creditors ... be paid before the stockholders could retain [equity interests] for any purpose whatever.” *Northern Pacific R. Co. v. Boyd*, 228 U.S. 482, 508 (1913).

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13 Section 1129(a)(7) provides that if the holder of a claim impaired under a plan of reorganization has not accepted the plan, then such holder must “receive ... on account of such claim ... property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive ... if the debtor were liquidated under chapter 7 ... on such date.” The “best interests” test applies to individual creditors holding impaired claims, even if the class as a whole votes to accept the plan.

14 Claims are unimpaired if they retain all of their prepetition legal, equitable, and contractual rights against the debtor. § 1124.
The second interpretive rule addressed the first. Its classic formulation occurred in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), in which the Court spoke through Justice Douglas in this dictum:

“It is, of course, clear that there are circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor.... Where th[e] necessity [for new capital] exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made....

“[W]e believe that to accord ‘the creditor his full right of priority against the corporate assets’ where the debtor is insolvent, the stockholder’s participation must be based on a contribution in money or in money’s worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.”

308 U.S., at 121-122.

*** Enactment of the Bankruptcy Code in place of the prior Act might have resolved the status of new value by a provision bearing its name or at least unmistakably couched in its terms, but the Congress chose not to avail itself of that opportunity. *** The upshot is that this history does nothing to disparage the possibility apparent in the statutory text, that the absolute priority rule now on the books as subsection (b)(2)(B)(ii) may carry a new value corollary. Although there is no literal reference to “new value” in the phrase “on account of such junior claim,” the phrase could arguably carry such an implication in modifying the prohibition against receipt by junior claimants of any interest under a plan while a senior class of unconsenting creditors goes less than fully paid.

III

Three basic interpretations have been suggested for the “on account of” modifier. The first reading is proposed by the Partnership, that “on account of” harks back to accounting practice and means something like “in exchange for,” or “in satisfaction of.” On this view, a plan would not violate the absolute priority rule unless the old equity holders received or retained property in exchange for the prior interest, without any significant new contribution; if substantial money passed from them as part of the deal, the prohibition of subsection (b)(2)(B)(ii) would not stand in the way, and whatever issues of fairness and equity there might otherwise be would not implicate the “on account of” modifier.

This position is beset with troubles, the first one being textual. Subsection (b)(2)(B)(ii) forbids not only receipt of property on account of the prior interest but its retention as well. See also §§ 1129(a)(7)(A)(ii), (a)(7)(B), (b)(2)(B)(i), (b)(2)(C)(i), (b)(2)(C)(ii). A common instance of the latter would be a debtor’s retention of an interest in the insolvent business reorganized under the plan. Yet it would be exceedingly odd to speak of “retain[ing]” property in exchange for the same property interest, and the eccentricity of such a reading is underscored by the fact that elsewhere in the Code the drafters chose to use the very phrase “in exchange for,” § 1123(a)(5)(J) (a plan shall provide adequate means for implementation, including “issuance of securities of the debtor ... for cash, for property, for existing securities,
or in exchange for claims or interests”). It is unlikely that the drafters of legislation so long and minutely contemplated as the 1978 Bankruptcy Code would have used two distinctly different forms of words for the same purpose.

The second difficulty is practical: the unlikelihood that Congress meant to impose a condition as manipulable as subsection (b)(2)(B)(ii) would be if “on account of” meant to prohibit merely an exchange unaccompanied by a substantial infusion of new funds but permit one whenever substantial funds changed hands. “Substantial” or “significant” or “considerable” or like characterizations of a monetary contribution would measure it by the Lord Chancellor’s foot, and an absolute priority rule so variable would not be much of an absolute. Of course it is true (as already noted) that, even if old equity holders could displace the rule by adding some significant amount of cash to the deal, it would not follow that their plan would be entitled to adoption; a contested plan would still need to satisfy the overriding condition of fairness and equity. But that general fairness and equity criterion would apply in any event, and one comes back to the question why Congress would have bothered to add a separate priority rule without a sharper edge.

Since the “in exchange for” reading merits rejection, the way is open to recognize the more common understanding of “on account of” to mean “because of.” This is certainly the usage meant for the phrase at other places in the statute, see § 1111(b)(1)(A) (treating certain claims as if the holder of the claim “had recourse against the debtor on account of such claim”); § 522(d)(10)(E) (permitting debtors to exempt payments under certain benefit plans and contracts “on account of illness, disability, death, age, or length of service”); § 547(b)(2) (authorizing trustee to avoid a transfer of an interest of the debtor in property “for or on account of an antecedent debt owed by the debtor”); § 547(c)(4)(B) (barring trustee from avoiding a transfer when a creditor gives new value to the debtor “on account of which new value the debtor did not make an otherwise unavoidable transfer to ... such creditor”). So, under the commonsense rule that a given phrase is meant to carry a given concept in a single statute, the better reading of subsection (b)(2)(B)(ii) recognizes that a causal relationship between holding the prior claim or interest and receiving or retaining property is what activates the absolute priority rule.

The degree of causation is the final bone of contention. We understand the Government, as amicus curiae, to take the starchy position not only that any degree of causation between earlier interests and retained property will activate the bar to a plan providing for later property, but also that whenever the holders of equity in the Debtor end up with some property there will be some causation; when old equity, and not someone on the street, gets property the reason is res ipsa loquitur. An old equity holder simply cannot take property under a plan if creditors are not paid in full.

The Government conceded that, in the case before us, it had no need to press this more stringent view, since “whatever [the] definition of ‘on account of,’ a 100 percent certainty that junior equity[y] obtains property because they’re junior equity will satisfy that.” See Tr. of Oral Arg. 29 (internal quotation marks added).
There are, however, reasons counting against such a reading. If, as is likely, the drafters were treating junior claimants or interest holders as a class at this point then the simple way to have prohibited the old interest holders from receiving anything over objection would have been to omit the “on account of” phrase entirely from subsection (b)(2)(B)(ii). On this assumption, reading the provision as a blanket prohibition would leave “on account of” as a redundancy, contrary to the interpretive obligation to try to give meaning to all the statutory language. One would also have to ask why Congress would have desired to exclude prior equity categorically from the class of potential owners following a cramdown. Although we have some doubt about the Court of Appeals’s assumption that prior equity is often the only source of significant capital for reorganizations, old equity may well be in the best position to make a go of the reorganized enterprise and so may be the party most likely to work out an equity-for-value reorganization.

A less absolute statutory prohibition would follow from reading the “on account of” language as intended to reconcile the two recognized policies underlying Chapter 11, of preserving going concerns and maximizing property available to satisfy creditors. Causation between the old equity’s holdings and subsequent property substantial enough to disqualify a plan would presumably occur on this view of things whenever old equity’s later property would come at a price that failed to provide the greatest possible addition to the bankruptcy estate, and it would always come at a price too low when the equity holders obtained or preserved an ownership interest for less than someone else would have paid. A truly full value transaction, on the other hand, would pose no threat to the bankruptcy estate not posed by any reorganization, provided of course that the contribution be in cash or be realizable money’s worth, just as Ahlers required for application of Case’s new value rule.

IV

Which of these positions is ultimately entitled to prevail is not to be decided here, however, for even on the latter view the Bank’s objection would require rejection of the plan at issue in this case. It is doomed, we can say without necessarily exhausting its flaws, by its provision for vesting equity in the reorganized business in the Debtor’s partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan. Although the Debtor’s exclusive opportunity to propose a plan under § 1121(b) is not itself “property” within the meaning of subsection (b)(2)(B)(ii), the respondent partnership in this case has taken advantage of this opportunity by proposing a plan under which the benefit of equity ownership may be obtained by no one but old equity partners. Upon the court’s approval of that plan, the partners were in the same position that they would have enjoyed had they exercised an exclusive option under the plan to buy the equity in the reorganized entity, or contracted to purchase it from a seller who had first agreed to deal with no one else. It is quite true that the escrow of the partners’ proposed investment eliminated any formal need to set out an express option or exclusive dealing provision in the plan itself, since the court’s approval that created the opportunity and the partners’ action to obtain its advantage were simultaneous. But before the Debtor’s plan was accepted no one else could propose an alternative one, and after its acceptance no one else
could obtain equity in the reorganized entity. At the moment of the plan’s approval the Debtor’s partners necessarily enjoyed an exclusive opportunity that was in no economic sense distinguishable from the advantage of the exclusively entitled offeror or option holder. This opportunity should, first of all, be treated as an item of property in its own right. While it may be argued that the opportunity has no market value, being significant only to old equity holders owing to their potential tax liability, such an argument avails the Debtor nothing, for several reasons. It is to avoid just such arguments that the law is settled that any otherwise cognizable property interest must be treated as sufficiently valuable to be recognized under the Bankruptcy Code. Even aside from that rule, the assumption that no one but the Debtor’s partners might pay for such an opportunity would obviously support no inference that it is valueless, let alone that it should not be treated as property. And, finally, the source in the tax law of the opportunity’s value to the partners implies in no way that it lacks value to others. It might, indeed, be valuable to another precisely as a way to keep the Debtor from implementing a plan that would avoid a Chapter 7 liquidation.

Given that the opportunity is property of some value, the question arises why old equity alone should obtain it, not to mention at no cost whatever. The closest thing to an answer favorable to the Debtor is that the old equity partners would be given the opportunity in the expectation that in taking advantage of it they would add the stated purchase price to the estate. But this just begs the question why the opportunity should be exclusive to the old equity holders. If the price to be paid for the equity interest is the best obtainable, old equity does not need the protection of exclusiveness (unless to trump an equal offer from someone else); if it is not the best, there is no apparent reason for giving old equity a bargain. There is no reason, that is, unless the very purpose of the whole transaction is, at least in part, to do old equity a favor. And that, of course, is to say that old equity would obtain its opportunity, and the resulting benefit, because of old equity’s prior interest within the meaning of subsection (b)(2)(B)(ii). Hence it is that the exclusiveness of the opportunity, with its protection against the market’s scrutiny of the purchase price by means of competing bids or even competing plan proposals, renders the partners’ right a property interest extended “on account of” the old equity position and therefore subject to an unpaid senior creditor class’s objection.

It is no answer to this to say that the exclusive opportunity should be treated merely as a detail of the broader transaction that would follow its exercise, and that in this wider perspective no favoritism may be inferred, since the old equity partners would pay something, whereas no one else would pay anything. If this argument were to carry the day, of course, old equity could obtain a new property interest for a dime without being seen to receive anything on account of its old position. But even if we assume that old equity’s plan would not be confirmed without satisfying the judge that the purchase price was top dollar, there is a further reason here not to treat property consisting of an exclusive opportunity as subsumed within the total transaction proposed. On the interpretation assumed here, it would, of course, be a fatal flaw if old equity acquired or retained the property interest without paying full value. It would thus be necessary for old equity to demonstrate its payment of top dollar, but this it could not satisfactorily do when it would receive or retain its property under a
plan giving it exclusive rights and in the absence of a competing plan of any sort. Under a plan granting an exclusive right, making no provision for competing bids or competing plans, any determination that the price was top dollar would necessarily be made by a judge in bankruptcy court, whereas the best way to determine value is exposure to a market. This is a point of some significance, since it was, after all, one of the Code’s innovations to narrow the occasions for courts to make valuation judgments, as shown by its preference for the supramajoritarian class creditor voting scheme in § 1126(c). In the interest of statutory coherence, a like disfavor for decisions untested by competitive choice ought to extend to valuations in administering subsection (b)(2)(B)(ii) when some form of market valuation may be available to test the adequacy of an old equity holder’s proposed contribution.

Whether a market test would require an opportunity to offer competing plans or would be satisfied by a right to bid for the same interest sought by old equity is a question we do not decide here. It is enough to say, assuming a new value corollary, that plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation fall within the prohibition of § 1129(b)(2)(B)(ii).

The judgment of the Court of Appeals, accordingly, is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

In re Chrysler LLC
576 F.3d 108 (2nd Cir. 2009)

DENNIS JACOBS, Chief Judge: The Indiana State Police Pension Trust, the Indiana State Teachers Retirement Fund, and the Indiana Major Moves Construction Fund (collectively, the “Indiana Pensioners” or “Pensioners”), along with various tort claimants and others, appeal from an order entered in the United States Bankruptcy Court for the Southern District of New York, Arthur J. Gonzalez, Bankruptcy Judge, dated June 1, 2009 (the “Sale Order”), authorizing the sale of substantially all of the debtor’s assets to New CarCo Acquisition LLC (“New Chrysler”). On June 2, 2009 we granted the Indiana Pensioners’ motion for a stay and for expedited appeal directly to this Court, pursuant to 28 U.S.C. § 158(d)(2). On June 5, 2009 we heard oral argument, and ruled from the bench and by written order, affirming the Sale Order “for the reasons stated in the opinions of Bankruptcy Judge Gonzalez,” stating that an opinion or opinions would follow. This is the opinion.

In a nutshell, Chrysler LLC and its related companies (hereinafter “Chrysler” or “debtor” or “Old Chrysler”) filed a pre-packaged bankruptcy petition under Chapter 11 on April 30, 2009. The filing followed months in which Chrysler experienced deepening losses, received billions in bailout funds from the Federal Government, searched for a merger partner, unsuccessfully sought additional government bailout funds for a stand-alone restructuring, and ultimately settled on an asset-sale transaction pursuant to 11 U.S.C. § 363 (the “Sale”), which was approved by the Sale Order. The key elements of the Sale were set forth in a Master Transaction Agreement dated as of April 30, 2009: substantially all of Chrysler’s operat-
ing assets (including manufacturing plants, brand names, certain dealer and supplier relationships, and much else) would be transferred to New Chrysler in exchange for New Chrysler’s assumption of certain liabilities and $2 billion in cash. Fiat S.p.A agreed to provide New Chrysler with certain fuel-efficient vehicle platforms, access to its worldwide distribution system, and new management that is experienced in turning around a failing auto company. Financing for the sale transaction—$6 billion in senior secured financing, and debtor-in-possession financing for 60 days in the amount of $4.96 billion—would come from the United States Treasury and from Export Development Canada. The agreement describing the United States Treasury’s commitment does not specify the source of the funds, but it is undisputed that prior funding came from the Troubled Asset Relief Program (“TARP”), 12 U.S.C. § 5211(a)(1), and that the parties expected the Sale to be financed through the use of TARP funds. Ownership of New Chrysler was to be distributed by membership interests, 55% of which go to an employee benefit entity created by the United Auto Workers union, 8% to the United States Treasury and 2% to Export Development Canada. Fiat, for its contributions, would immediately own 20% of the equity with rights to acquire more (up to 51%), contingent on payment in full of the debts owed to the United States Treasury and Export Development Canada.

At a hearing on May 5, 2009, the bankruptcy court approved the debtor’s proposed bidding procedures. No other bids were forthcoming. From May 27 to May 29, the bankruptcy court held hearings on whether to approve the Sale. Upon extensive findings of fact and conclusions of law, the bankruptcy court approved the Sale by order dated June 1, 2009.

After briefing and oral argument, we affirmed the bankruptcy court’s order on June 5, but we entered a short stay pending Supreme Court review. The Supreme Court, after an extension of the stay, declined a further extension. The Sale closed on June 10, 2009.

The factual and procedural background is set out in useful detail in the opinions of Bankruptcy Judge Gonzalez. This opinion is confined to a discussion of the arguments made for vacatur or reversal. The Sale Order is challenged essentially on four grounds. First, it is contended that the sale of Chrysler’s auto-manufacturing assets, considered together with the associated intellectual property and (selected) dealership contractual rights, so closely approximates a final plan of reorganization that it constitutes an impermissible “sub rosa plan,” and therefore cannot be accomplished under § 363(b). We consider this question first, because a determination adverse to Chrysler would have required reversal. Second, we consider the argument by the Indiana Pensioners that the Sale impermissibly subordinates their interests as secured lenders and allows assets on which they have a lien to pass free of liens to other creditors and parties, in violation of § 363(f). We reject this argument on the ground that the secured lenders have consented to the Sale, as per § 363(f)(2). Third, the Indiana Pensioners challenge the constitutionality of the use of TARP funds to finance the Sale on a number of grounds, chiefly that the Secretary of the Treasury is using funds appropriated for relief of “financial institutions” to effect a bailout of an auto-manufacturer, and that this causes a constitutional injury to the Indiana Pensioners because the loss of their priorities in bankruptcy amounts to an economic injury that was caused or underwritten by TARP money.
We conclude that the Indiana Pensioners lack standing to raise this challenge. Finally, we consider and reject the arguments advanced by present and future tort claimants. ***

The Indiana Pensioners characterize the Sale as an impermissible, sub rosa plan of reorganization. See Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (In re Braniff Airways, Inc.), 700 F.2d 935, 940 (5th Cir. 1983). As the Indiana Pensioners characterize it, the Sale transaction “is a ‘Sale’ in name only; upon consummation, new Chrysler will be old Chrysler in essentially every respect. It will be called ‘Chrysler.’ ... Its employees, including most management, will be retained.... It will manufacture and sell Chrysler and Dodge cars and minivans, Jeeps and Dodge Trucks.... The real substance of the transaction is the underlying reorganization it implements.” Indiana Pensioners’ Br. at 46 (citation omitted).

Section 363(b) of the Bankruptcy Code authorizes a Chapter 11 debtor-in-possession to use, sell, or lease estate property outside the ordinary course of business, requiring in most circumstances only that a movant provide notice and a hearing. 11 U.S.C. § 363(b).2 We have identified an “apparent conflict” between the expedient of a § 363(b) sale and the otherwise applicable features and safeguards of Chapter 11. Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).

In Lionel, we consulted the history and purpose of § 363(b) to situate § 363(b) transactions within the overall structure of Chapter 11. The origin of § 363(b) is the Bankruptcy Act of 1867, which permitted a sale of a debtor’s assets when the estate or any part thereof was “of a perishable nature or liable to deteriorate in value.” Lionel, 722 F.2d at 1066 (citing Section 25 of the Bankruptcy Act of 1867, Act of March 2, 1867, 14 Stat. 517) (emphasis omitted). Typically, courts have approved § 363(b) sales to preserve “ ‘wasting asset[s].’ ” Id. at 1068 (quoting Mintzer v. Joseph (In re Sire Plan, Inc.), 332 F.2d 497, 499 (2d Cir. 1964)). Most early transactions concerned perishable commodities; but the same practical necessity has been recognized in contexts other than fruits and vegetables. ***

In the twenty-five years since Lionel, § 363(b) asset sales have become common practice in large-scale corporate bankruptcies. In the current economic crisis of 2008-09, § 363(b) sales have become even more useful and customary.6 ***

Resort to § 363(b) has been driven by efficiency, from the perspectives of sellers and buyers alike. The speed of the process can maximize asset value by sale of the debtor’s business as a going concern. Moreover, the assets are typically burnished (or “cleansed”) because (with certain limited exceptions) they are sold free and clear of liens, claims and liabilities. See infra

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2 The section provides: “The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate ....” 11 U.S.C. § 363(b)(1).

6 For instance, Lehman Brothers sold substantially all its assets to Barclays Capital within five days of filing for bankruptcy. Lehman Brothers filed for bankruptcy in the early morning hours of September 15, 2008. On September 20, 2008, the bankruptcy court approved the sale to Barclays of Lehman’s investment banking and capital markets operations, as well as supporting infrastructure including the Lehman headquarters in midtown Manhattan for $1.7 billion. See Bay Harbour Mgmt., L.C. v. Lehman Bros. Holdings Inc. (In re Lehman Bros. Holdings Inc.), No. 08-cv-8869(DLC), 2009 WL 667301, at *8 (2009) (affirming the § 363(b) sale order).
(discussing § 363(f) and tort issues). A § 363 sale can often yield the highest price for the assets because the buyer can select the liabilities it will assume and purchase a business with cash flow (or the near prospect of it). Often, a secured creditor can “credit bid,” or take an ownership interest in the company by bidding a reduction in the debt the company owes. See 11 U.S.C. § 363(k) (allowing a secured creditor to credit bid at a § 363(b) sale).

This tendency has its critics. The objections are not to the quantity or percentage of assets being sold: it has long been understood that § 363(b) sales may encompass all or substantially all of a debtor’s assets. Rather, the thrust of criticism remains what it was in Lionel: fear that one class of creditors may strong-arm the debtor-in-possession, and bypass the requirements of Chapter 11 to cash out quickly at the expense of other stakeholders, in a proceeding that amounts to a reorganization in all but name, achieved by stealth and momentum.

As § 363(b) sales proliferate, the competing concerns identified in Lionel have become harder to manage. Debtors need flexibility and speed to preserve going concern value; yet one or more classes of creditors should not be able to nullify Chapter 11’s requirements. A balance is not easy to achieve, and is not aided by rigid rules and prescriptions. Lionel’s multi-factor analysis remains the proper, most comprehensive framework for judging the validity of § 363(b) transactions.

Adopting the Fifth Circuit’s wording in Braniff, 700 F.2d at 940, commentators and courts—including ours—have sometimes referred to improper § 363(b) transactions as “sub rosa plans of reorganization.” The term “sub rosa” is something of a misnomer. It bespeaks a covert or secret activity, whereas secrecy has nothing to do with a § 363 transaction. Transactions blessed by the bankruptcy courts are openly presented, considered, approved, and implemented. Braniff seems to have used “sub rosa” to describe transactions that treat the requirements of the Bankruptcy Code as something to be evaded or subverted. But even in that sense, the term is unhelpful. The sale of assets is permissible under § 363(b); and it is elementary that the more assets sold that way, the less will be left for a plan of reorganization, or for liquidation. But the size of the transaction, and the residuum of corporate assets, is, under our precedent, just one consideration for the exercise of discretion by the bankruptcy judge(s), along with an open-ended list of other salient factors.

Braniff’s holding did not support the argument that a § 363(b) asset sale must be rejected simply because it is a sale of all or substantially all of a debtor’s assets. Thus a § 363(b) sale may well be a reorganization in effect without being the kind of plan rejected in Braniff. Although Lionel did not involve a contention that the proposed sale was a sub rosa or de facto reorganization, a bankruptcy court confronted with that allegation may approve or disapprove a § 363(b) transfer that is a sale of all or substantially all of a debtor’s assets, using the

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9 The transaction at hand is as good an illustration as any. “Old Chrysler” will simply transfer the $2 billion in proceeds to the first lien lenders, and then liquidate. The first lien lenders themselves will suffer a deficiency of some $4.9 billion, and everyone else will likely receive nothing from the liquidation. Thus the Sale has inevitable and enormous influence on any eventual plan of reorganization or liquidation. But it is not a “sub rosa plan” in the Braniff sense because it does not specifically “dictate,” or “arrange” ex ante, by contract, the terms of any subsequent plan.
analysis set forth in Lionel in order to determine whether there was a good business reason for the sale.

The Indiana Pensioners argue that the Sale is a sub rosa plan chiefly because it gives value to unsecured creditors (i.e., in the form of the ownership interest in New Chrysler provided to the union benefit funds) without paying off secured debt in full, and without complying with the procedural requirements of Chapter 11. However, Bankruptcy Judge Gonzalez demonstrated proper solicitude for the priority between creditors and deemed it essential that the Sale in no way upset that priority. The lien holders’ security interests would attach to all proceeds of the Sale: “Not one penny of value of the Debtors’ assets is going to anyone other than the First-Lien Lenders.” Opinion Granting Debtor’s Motion Seeking Authority to Sell, May 31, 2009, (“Sale Opinion”) at 18. As Bankruptcy Judge Gonzalez found, all the equity stakes in New Chrysler were entirely attributable to new value—including governmental loans, new technology, and new management—which were not assets of the debtor’s estate.

The Indiana Pensioners’ arguments boil down to the complaint that the Sale does not pass the discretionary, multifarious Lionel test. The bankruptcy court’s findings constitute an adequate rebuttal. Applying the Lionel factors, Bankruptcy Judge Gonzalez found good business reasons for the Sale. The linchpin of his analysis was that the only possible alternative to the Sale was an immediate liquidation that would yield far less for the estate—and for the objectors. The court found that, notwithstanding Chrysler’s prolonged and well-publicized efforts to find a strategic partner or buyer, no other proposals were forthcomings. In the months leading up to Chrysler’s bankruptcy filing, and during the bankruptcy process itself, Chrysler executives circled the globe in search of a deal. But the Fiat transaction was the only offer available.

The Sale would yield $2 billion. According to expert testimony—not refuted by the objectors—an immediate liquidation of Chrysler as of May 20, 2009 would yield in the range of nothing to $800 million.12 Crucially, Fiat had conditioned its commitment on the Sale being completed by June 15, 2009. While this deadline was tight and seemingly arbitrary, there was little leverage to force an extension. To preserve resources, Chrysler factories had been shuttered, and the business was hemorrhaging cash. According to the bankruptcy court, Chrysler was losing going concern value of nearly $100 million each day.

On this record, and in light of the arguments made by the parties, the bankruptcy court’s approval of the Sale was no abuse of discretion. With its revenues sinking, its factories dark, and its massive debts growing, Chrysler fit the paradigm of the melting ice cube. Going concern value was being reduced each passing day that it produced no cars, yet was obliged to pay rents, overhead, and salaries. Consistent with an underlying purpose of the Bankruptcy Code—maximizing the value of the bankrupt estate—it was no abuse of discretion to determine that the Sale prevented further, unnecessary losses.

12 The expert’s earlier estimates of liquidation value had been higher. For example, in early May 2009, the same expert opined that a liquidation might yield between nothing and $1.2 billion. But, from the beginning of May until the end, Chrysler expended $400 million in cash collateral.
The Indiana Pensioners exaggerate the extent to which New Chrysler will emerge from the Sale as the twin of Old Chrysler. New Chrysler may manufacture the same lines of cars but it will also make newer, smaller vehicles using Fiat technology that will become available as a result of the Sale—moreover, at the time of the proceedings, Old Chrysler was manufacturing no cars at all. New Chrysler will be run by a new Chief Executive Officer, who has experience in turning around failing auto companies. It may retain many of the same employees, but they will be working under new union contracts that contain a six-year no-strike provision. New Chrysler will still sell cars in some of its old dealerships in the United States, but it will also have new access to Fiat dealerships in the European market. Such transformative use of old and new assets is precisely what one would expect from the § 363(b) sale of a going concern.

II

The Indiana Pensioners next challenge the Sale Order’s release of all liens on Chrysler’s assets. In general, under § 363(f), assets sold pursuant to § 363(b) may be sold “free and clear of any interest” in the assets when, inter alia, the entity holding the interest consents to the sale. 11 U.S.C. § 363(f)(2). The bankruptcy court ruled that, although the Indiana Pensioners did not themselves consent to the release, consent was validly provided by the collateral trustee, who had authority to act on behalf of all first-lien credit holders.

We agree. Through a series of agreements, the Pensioners effectively ceded to an agent the power to consent to such a sale; the agent gave consent; and the Pensioners are bound. Accordingly, questions as to the status or preference of Chrysler’s secured debt are simply not presented in this case.

III

The Indiana Pensioners argue that the Secretary of the Treasury (“Secretary”) exceeded his statutory authority and violated the Constitution by using TARP money to finance the sale of Chrysler’s assets. Pensioners raise interesting and unresolved constitutional issues concerning the scope of the Secretary’s authority under TARP and the use of TARP money to bail out an automobile manufacturer. However, federal courts are constrained by our own constitutional limitations, including the non-waivable Article III requirement that we have jurisdiction over the case or controversy before us. We do not decide whether the Secretary’s actions were constitutional or permitted by statute, because we conclude that the Indiana Pensioners lack standing to raise the TARP issue, and that we lack jurisdiction in this case to entertain that challenge.

IV

Finally, several objectors appeal from that portion of the Sale Order extinguishing all existing and future claims against New Chrysler, that “(a) arose prior to the Closing Date, (b) relate[] to the production of vehicles prior to the Closing Date or (c) otherwise [are] assertable against the Debtors or [are] related to the Purchased Assets prior to the closing date.” Sale Order at 40. The objectors can be divided into three groups: (1) plaintiffs with existing product liability claims against Chrysler; (2) plaintiffs with existing asbestos-related claims against Chrysler; and (3) lawyers undertaking to act on behalf of claimants who, although
presently unknown and unidentified, might have claims in the future arising from Old Chrysler’s production of vehicles. We consider each group’s arguments in turn.

A. Existing Product Liability Claims

The Ad Hoc Committee of Consumer-Victims of Chrysler LLC and William Lovitz et al. challenge the foreclosing of New Chrysler’s liability for product defects in vehicles produced by Old Chrysler. Section 363(f) provides, in relevant part, that a “trustee may sell property ... free and clear of any interest in such property,” under certain circumstances. 11 U.S.C. § 363(f) (emphasis added). The objectors argue that personal injury claims are not “interests in property,” and that the district court’s reliance on In re Trans World Airlines, Inc., 322 F.3d 283 (3d Cir. 2003) (“TWA”), which advances a broad reading of “interests in property,” was misplaced.

We have never addressed the scope of the language “any interest in such property,” and the statute does not define the term. In TWA, the Third Circuit considered whether (1) employment discrimination claims and (2) a voucher program awarded to flight attendants in settlement of a class action constituted “interests” in property for purposes of § 363(f). *** After surveying its own precedents and the Fourth Circuit’s decision in United Mine Workers of Am.1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.), 99 F.3d 573 (4th Cir. 1996), the TWA court held that “[w]hile the interests of the [plaintiffs] in the assets of TWA’s bankruptcy estate are not interests in property in the sense that they are not in rem interests, ... they are interests in property within the meaning of section 363(f) in the sense that they arise from the property being sold.” 322 F.3d at 290 (emphasis added). ***

Appellants argue that these decisions broadly construing the phrase “any interest in such property” fail to account for the language of 11 U.S.C. § 1141(c), a provision involving confirmed plans of reorganization. Section 1141(c) provides that “except as otherwise provided in the [reorganization] plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor.” 11 U.S.C. § 1141(c) (emphasis added). Appellants argue that Congress must have intentionally included the word “claims” in § 1141(c), and omitted the word from § 363(f), because it was willing to extinguish tort claims in the reorganization context, but unwilling to do so in the § 363 sale context. Appellants account for this discrepancy on the basis that reorganization provides unsecured creditors procedural rights that are not assured in a § 363(b) sale.

We do not place such weight on the absence of the word “claims” in § 363(f). The language and structure of § 1141(c) and § 363(f) differ in many respects. Section 1141(c), for example, applies to all reorganization plans; § 363(f), in contrast, applies only to classes of

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18 The Bankruptcy Code defines “claim” as: (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured. 11 U.S.C. § 101(5).
property that satisfy one of five criteria. Thus, while § 363 sales do not afford many of the procedural safeguards of a reorganization, § 363(f) is limited to specific classes of property.

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We agree with TWA and Leckie that the term “any interest in property” encompasses those claims that “arise from the property being sold.” See TWA, 322 F.3d at 290. By analogy to Leckie (in which the relevant business was coal mining), “[appellants’] rights are grounded, at least in part, in the fact that [Old Chrysler’s] very assets have been employed for [automobile production] purposes: if Appellees had never elected to put their assets to use in the [automobile] industry, and had taken up business in an altogether different area, [appellants] would have no right to seek [damages].” Leckie, 99 F.3d at 582.

“To allow the claimants to assert successor liability claims against [the purchaser] while limiting other creditors’ recourse to the proceeds of the asset sale would be inconsistent with the Bankruptcy Code’s priority scheme.” TWA, 322 F.3d at 292. Appellants ignore this overarching principle and assume that tort claimants faced a choice between the Sale and an alternative arrangement that would have assured funding for their claims. But had appellants successfully blocked the Sale, they would have been unsecured creditors fighting for a share of extremely limited liquidation proceeds. Given the billions of dollars of outstanding secured claims against Old Chrysler, appellants would have fared no better had they prevailed.

The possibility of transferring assets free and clear of existing tort liability was a critical inducement to the Sale. As in TWA, “a sale of the assets of [Old Chrysler] at the expense of preserving successor liability claims was necessary in order to preserve some [55,000] jobs, ... and to provide funding for employee-related liabilities, including retirement benefits [for more than 106,000 retirees].” TWA, 322 F.3d at 293; see also Sale Opinion at 3.

It is the transfer of Old Chrysler’s tangible and intellectual property to New Chrysler that could lead to successor liability (where applicable under state law) in the absence of the Sale Order’s liability provisions. Because appellants’ claims arose from Old Chrysler’s property, § 363(f) permitted the bankruptcy court to authorize the Sale free and clear of appellants’ interest in the property.

B. Asbestos Claims

On behalf of herself and others with outstanding or potential claims against Old Chrysler resulting from exposure to asbestos, Patricia Pascale argues that the Sale Order improperly grants New Chrysler immunity without assuring compliance with 11 U.S.C. § 524(g).

Section 524(g) *** authorizes the court “to enjoin entities from taking legal action for the purpose of directly or indirectly collecting, recovering, or receiving payment or recovery with respect to any [asbestos-related] claim or demand.” 11 U.S.C. § 524(g)(1)(B). To obtain relief under § 524(g), a debtor must “[c]hannel [ ] asbestos-related claims to a personal injury trust [to] relieve[ ] the debtor of the uncertainty of future asbestos liabilities.” In re Combustion Eng’g, Inc., 391 F.3d 190, 234 (3d Cir. 2004). Injunctions granting relief under this provision are subject to numerous requirements and conditions. See 11 U.S.C. § 524(g)(2)(B); Combustion Eng’g, 391 F.3d at 234 & n. 45.
By its terms, however, § 524(g) applies only to “a court that enters an order confirming a plan of reorganization under chapter 11.” 11 U.S.C. § 524(g)(1)(A). Sections I and II of this opinion conclude that the Sale was proper under § 363. That determination forecloses the application of § 524(g) because there is no plan of reorganization as yet. Moreover, the bankruptcy court in this case did not issue an injunction, as is permitted by § 524(g)(1)(B), and the debtor did not establish a trust subsuming its asbestos liability. Accordingly, there is no merit to Pascale’s argument that the Sale Order violates § 524(g).

C. Future Claims

The Sale Order extinguished the right to pursue claims “on any theory of successor or transferee liability. whether known or unknown as of the Closing, now existing or hereafter arising, asserted or unasserted, fixed or contingent, liquidated or unliquidated.” Sale Order at 40-41. This provision is challenged on the grounds that: (1) the Sale Order violates the due process rights of future claimants by extinguishing claims without providing notice; (2) a bankruptcy court is not empowered to trump state successor liability law; (3) future, unidentified claimants with unquantifiable interests could not be compelled “to accept a money satisfaction,” 11 U.S.C. § 363(f)(5); and (4) future causes of action by unidentified plaintiffs based on unknown events cannot be classified as “claims” under the Bankruptcy Code.

We affirm this aspect of the bankruptcy court’s decision insofar as it constituted a valid exercise of authority under the Bankruptcy Code. However, we decline to delineate the scope of the bankruptcy court’s authority to extinguish future claims, until such time as we are presented with an actual claim for an injury that is caused by Old Chrysler, that occurs after the Sale, and that is cognizable under state successor liability law.

CONCLUSION

We have considered all of the objectors-appellants’ contentions on these appeals and have found them to be without merit. For the foregoing reasons, we affirm the June 1, 2009 order of the bankruptcy court authorizing the Sale.