as a group.[45] The Partnership Agreement does not require; therefore, the Limited Partners cannot be said to have agreed, that one specific method of valuation would be appropriate.

Plaintiffs note that Daniels' first appraisal report, dated September 30, 1994, stated that an aggregate valuation may result in a higher appraisal value.

> It should be noted that the market sometimes places a premium on the ability to acquire a large block of subscribers in a single transaction, due to economies of scale and the lack of opportunity to purchase large numbers of subscribers from a single seller. Therefore, while we have appraised the various Systems at the operating group level, as per the Procedures Letter, selling the entire Partnership to one or a limited number of buyers could generate a premium cash flow multiple, and thus a higher price. In addition, to certain strategic buyers, some of these individual Systems might command a premium price due to its fit with the acquiror's other systems and future plans.[46]

A similar statement appears in Daniels' final, revised appraisal.[47] Plaintiffs' expert Timothy S. Pecaro ("Pecaro") testified that valuing the systems as a whole "could have yielded a greater appraised value"[48] and that individual valuation may generate a lower value as a result of the failure to reflect factors such as premiums historically paid for larger system groups, synergies, economies of scale and decreased risk due to diversification.[49] Defendants counter the argument that the experts should have valued the Partnership as a group with the assertion that they believed that selling the assets individually would have generated higher transaction costs and brokerage fees.

The evidence regarding how and why Daniels decided to value the assets individually is confusing at best. I am unsure whether "standard appraisal techniques" would require considering the General Partner's right of first refusal to be the dominant factor in determining the fair market value of the Partnership systems. The evidence with respect to Fitzgerald's

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[45]Pl. App. 13 at 1 (Letter dated May 12, 1995, from Flynn to Fitzgerald).

[46]Pl. App. Ex. 7 (Cencom Cable Income Partners, L.P., Appraisal Analysis Summary as of September 30, 1994) at 14.

[47]*See* Pl. Ex. 9 at 15.

[48]Pecaro Aff. ¶ 10(a).

[49]*Id.* ¶ 34.

decision is just as unclear. Because the record lacks undisputed evidence that either the decision to value the assets individually or as a group truly valued the partnership systems "on a going concern basis . . . in conformity with standard appraisal techniques" as the Partnership Agreement requires,[50] I cannot grant summary judgment on this issue. It is not proper or possible at this point to determine whether the General Partner failed to follow the express terms of the Partnership Agreement until the factual dispute over the actual meaning of the terms "going concern" and "standard appraisal techniques" can be resolved.

F. Disclosure of Valuation Summaries

Plaintiffs allege that the defendants breached their duty of candor by failing to disclose the cash flows underlying the valuations of the Partnership.[51] This failure, according to plaintiffs, "impaired the reliability and completeness of the appraisals."[52] Defendants assert that the Partnership Agreement does not require disclosure of the underlying cash flows. Relying on ***Bershad v. Curtiss-Wright Corp.***,[53] defendants also assert that they did not breach their duty of candor because the cash flows were not material to the Limited Partners' decision to approve or disapprove of the sale and because disclosure of the flows would not have changed the Limited Partners' votes.

Both sides have presented affidavits which may be read to assert conflicting opinions on whether the valuations were presented in accordance with standard appraisal techniques, as required by the Partnership Agreement. Fineberg testified that his "appraisal was prepared in accordance with standard appraisal techniques and practices and in [his] judgment, [his] initial appraisal and the update represent [his] honest and informed judgment as to the fair market value of the appraised assets as of those respective dates."[54] Plaintiffs' expert Pecaro testified, however, that "[t]he Fineberg and Daniels appraisals, which are 'summary appraisals', omit material information and do not conform to certain standards regarding business valuations: the Uniform Standards of Professional Appraisal Practice, Standards 10-1(b), 10-2(f), and Statement on Appraisal Standards No. 2."[55] These "standards require that an appraisal contain

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[50]*See* PA at A-2.
[51]Compl. ¶ 28(h).
[52]*Id.*
[53]Del. Supr., 535 A.2d 840, 846 (1987).
[54]Fineberg Aff. ¶ 3.
[55]Pecaro Aff. ¶ 35.

sufficient information (including any limiting conditions) so that the appraisal can be understood, set forth all assumptions and limiting conditions that affect the analysis, opinions and conclusions, and that in a discounted cash flow analysis, all underlying assumptions be accurate and fully disclosed."[56]

The testimony of these two experts creates an impenetrable haze. Pecaro does not state that the Fineberg's and Daniels' appraisals were performed incorrectly or that Fineberg or Daniels failed to follow standard practices in *performing* their valuations. Pecaro does state that the valuation, *as presented*, failed to reveal material information. Fineberg's testimony does not directly address the presentation of his appraisal. It is not possible for me, and inappropriate for me to attempt, to resolve the issue of whether the presentation of the appraisals conformed with standard techniques and whether the presentation, as it stands, must and does adequately disclose all material facts. Again, the facts in this situation must be more thoroughly developed before it is possible to apply the law. Summary judgment on this claim must be denied.

G. Termination of Distributions

Pursuant to section 7.3 of the Partnership Agreement, the Limited Partners are entitled to receive one hundred percent of all cash available for distribution until their 11% preferred return is paid. Plaintiffs allege that defendants failed to provide the Limited Partners with their share of the cash available for distribution after the effective date of June 30, 1995. Defendants assert an effective date had to be established in order to value the Partnership, to set a price and to identify the proposed distributions to the Limited Partners so these figures could be provided in the required public filings. Continued operation after the effective date, according to the defendants, would have required further operational and capital expenditures, which would have prevented the establishment of the required figures.[57] With respect to plaintiffs' claim that the termination of distributions violated section 7.3, defendants assert that the plaintiffs knew the Partnership was scheduled for liquidation in September 1994, and, therefore, that the Limited Partners had "no expectation" of distributions after that date. Moreover, defendants assert that, although they had no obligation to do so, they provided plaintiffs with interest on their final distribution.[58]

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[56] *Id.* ¶ 36.
[57] Browne Aff. ¶¶ 8, 9.
[58] *See* DS at I-3.

Section 8.1A of the Partnership Agreement states that "[t]he Partnership shall dissolve and its affairs shall be wound up upon the happening of any" one of several events including the expiration of the Partnership term, which is separately defined in the Agreement as September 30, 1994.[59] Section 8.2 states that the General Partner *shall* proceed with winding up, liquidating and distributing the Partnership Assets upon the dissolution of the Partnership. Section 8.1B states that the dissolution "shall be effective on the day on which the event occurs giving rise to the dissolution, *but the Partnership shall not terminate until this Agreement has been cancelled and the Partnership Assets have been distributed* as provided in Section 8.2."[60] The General Partner has failed to provide any evidence that the Partnership Agreement allows for the termination of the priority distributions before the termination of the Partnership, the cancellation of the Agreement or the winding up, liquidation or distribution of its assets. Thus, it is not possible to grant summary judgment to defendants on the theory that, as a matter of law, the General Partner improperly terminated their priority distributions on terms arguably inconsistent with the Partnership Agreement. Accordingly, summary judgment on this claim is denied.

H. Establishment of Cash Reserve

Plaintiffs next claim that the General Partner had "no reasonable basis" for withholding almost $15 million of the purchase price to pay obligations and contingencies of the Partnership and that the withholding provided the General Partner a "higher yield" on the purchase and shielded the General Partner "from the normal risks of such ownership."[61] Defendants admit they withheld the funds. They also assert, however, that section 8.2(c) of the Partnership Agreement provided them with both the right to withhold such funds and the responsibility to withhold in order to cover any contingent obligations. Furthermore, defendants argue that the Disclosure Statement adequately disclosed and thoroughly discussed the withholding.[62] In their brief, plaintiffs clarify that they are not claiming that the General Partner did not have the right to withhold funds but that the "purpose" of the withholding was misrepresented in the Disclosure Statement. The true purpose, according to plaintiffs, "was to provide funds readily available to defendants by which they could enforce the General

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[59]*See* PA § 2.4.
[60]Emphasis added.
[61]Compl. ¶ 32.
[62]*See, e.g.*, DS at I-2, 5, 20.

Partner's alleged right of indemnity against the Limited Partners."[63] Plaintiffs are apparently referring to section 4.6 of the Partnership Agreement, which provides that the Partnership shall, under certain conditions, indemnify the General Partner. In support, plaintiffs cite to pages missing in the record from the deposition of defendant Kent[64] and the deposition of defendant Browne who stated that, to his knowledge, at the time of his deposition, the costs of this litigation constituted the only claim against the withheld funds as an "indemnity obligation on the partnership."[65]

The Disclosure Statement states that "[t]he Partnership intends to hold back $100 of the $886 distribution as a reserve from which to pay obligations and contingencies of the Partnership. The General Partner cannot predict the amount or the timing of any such obligations or contingencies."[66] The Disclosure Statement also reveals that any unused reserves will be returned to the limited partners with interest.[67] Plaintiffs fail to explain how the description of the reserves is in any way misleading or how use of the reserves to cover contingencies of the Partnership is not clearly authorized by the Partnership Agreement. Plaintiffs simply boldly assert that the reserves have been or are being used in a manner favoring the interests of the General Partner without any support for the proposition that the General Partner's actions are inconsistent with the authority granted by the Limited Partners in the Partnership Agreement. I grant defendants' motion for summary judgment on this count.

I. Representation of the Market for Cable Systems

The Disclosure Statement includes a statement from the General Partner that describes the outlook for the cable industry. The General Partner stated that it "believes that the cable television industry is beginning to recover from the adverse consequences of the regulatory and financial factors described" elsewhere in the Disclosure Statement but that because of "the current uncertainty of the regulatory environment, the General Partner believes that it is premature to assess definitely the financial and other effects relating to the adoption" of proposed new legislation.[68] The Disclosure Statement also states that the industry is, and

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[63]Ans. Br. at 42.
[64]Kent Dep. at 151-2.
[65]Browne Dep. at 81.
[66]DS at I-2.
[67]*Id.* at I-2, 5.
[68]DS at 3.

presumably with or without further governmental deregulation will continue to be, "affected by increasingly intense competition due to the recent development of technological innovations and the legal developments" described elsewhere.[69] Finally, it states that this competition may increase if deregulation removes obstacles currently preventing market participation by additional competitors.

Plaintiffs allege that defendant Kent did not share the belief represented by the Disclosure Statement. In support of this allegation, plaintiffs cite to an magazine article that reported on an interview with Kent. According to the article, "Kent is so bullish on cable" that Charter had teamed up with third parties to bid against large broadcast companies in an auction for Multimedia Inc." The article also states: "'We didn't buy into the conventional wisdom' that cable had become something to run from, says Kent."

[9] Nothing obligated Kent to share in the opinion expressed by the General Partner in the Disclosure Statement. Moreover, a magazine article cannot be an official comment on behalf of the Partnership. No reasonable person would conclude that such alleged "puffing" about future performance is a material fact that a prudent investor would rely upon in determining how to vote. Accordingly, on these obvious and uncontroverted facts, I grant summary judgment on this claim.[70]

J. Additional Fees

On December 18, 1995, the Limited Partners received a letter supplementing the Disclosure Statement, which stated that, due to a calculation error, the distribution to each Limited Partner would upbe reduced by $17.[71] According to the letter, the $17 represented funds owed to the General Partner which included "partial return of the General Partner's initial capital investment."[72] The letter further stated that, due to this change, the General Partner believed it best to provide the Limited Partners with an opportunity to change their vote and set a January 8, 1996, deadline. Plaintiffs argue that this additional deduction, which was not identified in the initial Disclosure Statement, requires a new vote and that "[t]here is no basis for defendants' contention that they can reduce the

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[69] *Id.*

[70] *See Emerald Partners v. Berlin*, Del. Ch., C.A. No. 9700, Steele, V.C. (Sept. 22, 1995) ("If uncontroverted facts are so obvious that reasonable minds could not differ on the question of materiality, a decision on summary judgment becomes appropriate.").

[71] Pls.' App. Ex. 33 (DS Supplement dated Dec. 18, 1995).

[72] *Id.*

consideration paid to the Limited Partners by putting the onus on the Limited Partners to rescind their votes."[73]

Plaintiffs do not challenge the validity of the additional deductions, nor do they allege that the supplemental disclosure misled them or that the General Partner failed to provide enough time for the Limited Partners to consider the supplemental disclosure and to decide whether to change their votes. I find no basis for a conclusion that an unchallenged deduction of $17 requires the General Partner to solicit new votes. The Limited Partners were adequately informed and had sufficient time to consider the information presented. I grant summary judgment on this claim.

K. Damages

In my previous ruling, I noted that plaintiffs' damages, if any, would be measured by the difference between the purchase price and the valuation that plaintiffs prove to be proper.[74] Defendants seek summary judgment on the issue of damages based on their belief that plaintiffs have failed to present evidence that the proper value exceeds the purchase price. Plaintiffs have submitted some evidence that if certain adjustments were made to the valuation process, the proper value, and correspondingly purchase price, would increase.

[10] Pecaro testified that the Kagan appraisal included extraordinary capital expenditures that lowered the valuation by $16.8 million.[75] Defendants assert that these capital expenditures were provided to Kagan because, unlike the other appraisers, Flynn did not perform an independent analysis of the Partnership's estimated capital expenditures. There is some evidence that defendants may not have provided this information to each of the appraisers, supporting the contention that defendants may have breached their duty of loyalty by selectively providing information to some, but not all, of the appraisers in an attempt to minimize the valuations. Plaintiffs are not required to establish a specific dollar amount of damages at this stage of the proceedings. They need only present some credible evidence, though disputed, that supports a claim for damages. Summary judgment must be denied on this specific allegation of monetary damage.

I find that plaintiffs produce support for consequential damages on only one other claim. Pecaro testified that the Limited Partners lost approximately $3.7 million as a result of the General Partner's decision to

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[73]Ans. Br. at 38.
[74]*Cencom I* at 14.
[75]*Id.* ¶ 41.

terminate the Limited Partners' priority distribution on the effective date.[76] This claim, unrelated to the purchase price, if proved at trial, could result in consequential damages, and therefore the General Partner is not entitled to summary judgment on this issue.

III. CONCLUSION

Defendants' motion for summary judgment is granted in part and denied in part.

IT IS SO ORDERED.

GALE v. BERSHAD

No. 15,714

Chancery Court of the State of Delaware, New Castle

March 3, 1998
Revised March 4, 1998

Defendants, a corporation and members of its board of directors, sought to dismiss plaintiff's claim for failure to state a claim under Rule 12(b)(6). Plaintiff, a preferred shareholder of the corporation, brought a claim for violation of contractual and fiduciary duties alleging that the directors had approved a redemption of preferred stock at an unreasonably low and unfair price. The plaintiff contended, *inter alia*, that the directors created a conflict of interest because they held significant shares of common stock which would increase in value as a result of their preferred share redemption approval.

The court of chancery, per Vice-Chancellor Jacobs, granted defendant's motion to dismiss the breach of fiduciary duty claim, but denied the motion to dismiss the breach of contract claims. Under Delaware law, a plaintiff cannot claim both a breach of a contractual duty

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[76]Pecaro Aff. ¶ 39.

of fair dealing and a breach of fiduciary duty of fair dealing. Thus, where the obligation of giving fair value for preferred stock arises from contract, a breach of fiduciary duty claim arising out of the same conduct cannot also withstand a motion to dismiss. Allowing a fiduciary duty claim to coexist would undermine the primacy of contract law over fiduciary law in matters involving contractual rights of preferred stockholders.

1. Pretrial Procedure ⟹ 622

Under Rule 12(b)(6) a complaint will be dismissed where it is reasonably certain that it fails to state a claim upon which relief may be granted; conversely, a motion to dismiss will be denied if the complaint alleges facts that, if true, would state a legally valid claim. DEL. CH. CT. R. 12(b)(6).

2. Pleading ⟹ 16, 34(1)

Under Rule 12(b)(6), in construing a complaint, all inferences are drawn in favor of the non-moving party, but the court need not credit conclusory allegations of fact or law that are not supported by allegations of specific fact. DEL. CH. CT. R. 12(b)(6).

3. Pleading ⟹ 16

At the pleading stage under a Rule 12(b)(6), all a court can decide is whether the complaint on its face states a claim upon which relief may be granted. DEL. CH. CT. R. 12(b)(6).

4. Motions ⟹ 21

With limited exceptions, a complaint need only give general notice of the claim asserted and will not be dismissed unless it is clearly without merit, either as a matter of law or fact.

5. Motions ⟹ 18.1, 21

Where plaintiff's complaint (1) identifies a stock redemption provision in the certificate of incorporation upon which the claims rest, (2) alleges defendants breached their obligation to treat the OTC Bulletin Board as a qualifying organization under the certificate on which to calculate the stock's fair market value, (3) avers that as a result of the valuation methodology actually chosen by the corporation's board yielded

an inadequate fair value for the shares, and (4) that shareholders were injured, such allegations suffice to give defendants notice of the matter of the cause of action and to state a cognizable claim for relief.

6. Contracts ⚷ 326

The implied covenant of good faith and fair dealing requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the contract.

7. Contracts ⚷ 278, 324(2)

Where a complaint alleges that the board of directors was obligated to pay fair value in redeeming preferred shares of stock and this allegation is rooted in the express terms of the certificate of incorporation, the complaint alleges a legally sufficient claim that the board violated its contractual duty.

8. Pleading ⚷ 16

In a bad faith claim, plaintiff's allegations that directors of the defendant corporation, who had a significant common stock holding, created a material conflict of interest when the board approved the redemption offer are sufficient to survive a Rule 12(b)(6) motion, because implicit in these allegations is that the directors had a conflicting self-interest motivation to redeem the preferred for an inadequately low price which would increase the common stock's value. DEL. CH. CT. R. 12(b)(6).

9. Contracts ⚷ 325, 331.1, 332

If a complaint alleges breach of duty which is contractual, that would preclude any fiduciary claim based on the same conduct.

10. Contracts ⚷ 332

Where a claimed right to good faith calculation of fair value for stocks arises from a certificate of incorporation's contractual promise that holders of preferred stock shall receive fair value for their redeemed shares, that claim is one for breach of the implied covenant for which the remedy would be the difference in value between the board's improper calculation of fair value, and the value as adjudicated by the court.

11. Corporations ⟹ 307

The function of the implied covenant of good faith and fair dealing in defining the duties of parties to a contract, is analogous to the role of fiduciary law in defining the duties owed by fiduciaries.

12. Corporations ⟹ 307, 320

To allow a fiduciary duty claim to coexist in parallel with an implied contractual claim, would undermine the primacy of contract law over fiduciary law in matters involving the essentially contractual rights and obligations of preferred stockholders.

13. Corporations ⟹ 307, 320

Where a contract claim addresses alleged wrongdoing by a board of directors, any fiduciary duty claim arising out of the same conduct is superfluous.

Norman M. Monhait, Esquire, and Carmella P. Keener, Esquire, of Rosenthal, Monhait, Gross & Goddess, Wilmington, Delaware, for plaintiff.

Anne C. Foster, Esquire, and Megan Semple Greenberg, Esquire, of Richards, Layton & Finger, Wilmington, Delaware; and James H. Schropp, Esquire, and Erik J. Heipt, Esquire, of Fried, Frank, Harris, Shriver & Jacobson, New York, New York, of counsel, for defendants.

JACOBS, *Vice-Chancellor*

Pending is the defendants' motion under Court of Chancery Rule 12(b)(6) to dismiss this action for failure to state a legally sufficient claim. The plaintiff, David Gale ("Gale"), owned 352 shares of $1.20 Cumulative Exchangeable Redeemable Preferred Stock (the "Preferred") of Axsys Technologies, Inc., a Delaware corporation ("Axsys"). Gale brought this suit against Axsys and its three directors (the "Board"),[1] alleging that they had caused Axsys to redeem the Preferred at an unreasonably low and unfair price, in violation of contractual and fiduciary duties owed to the

[1]The Board members are Axsys Chief Executive Officer and Chairman of the Board Stephen W. Bershad ("Bershad"), Anthony J. Firoelli, Jr. ("Firoelli"), and Eliot M. Fried ("Fried").

Preferred stockholders. For the reasons set forth below, I grant defendants' motion to dismiss the breach of fiduciary duty claim, but deny the motion to dismiss the breach of contract claims.

I. FACTS

The facts recited below are based upon the allegations of the Complaint. Axsys had two classes of stock issued and outstanding-Common and the Preferred. In 1997, Axsys announced a voluntary exchange offer to the holders of its Preferred (the "Exchange Offer"), wherein Axsys offered to exchange 0.75 shares of Common stock for each share of Preferred. The Exchange Offer closed on March 17, 1997, and 530,000 shares of Preferred (including 149,041 Preferred shares owned by CEO Bershad) were exchanged for 397,000 shares of Common. That left 200,873 Preferred shares which were not tendered into the Exchange Offer, including Gale's 352 shares. After the Exchange Offer closed, no Axsys Board member held any shares of Preferred.[2]

On April 30, 1997, the closing price of the Common on NASDAQ was $12.50 per share. As of April 30, Mr. Bershad owned 1,248,812 shares, or 41.8%, of the Common stock, including the Common stock he acquired in the Exchange offer: Mr. Fiorelli owned 13,849 shares, or 6.9%, of the Common; and although Mr. Fried owned no Common stock personally, a subsidiary of his employer held 463,741 shares, or 15.5%, of the Common.[3]

On April 30, 1997, six weeks after the Exchange Offer closed, Axsys announced that it would redeem all of the outstanding (i.e., non-tendered) shares of Preferred for $7.70 per share cash (the "Redemption"). Under the provision of the Certificate of Incorporation (the "Certificate")[4] that governs redemption of the Preferred, Axsys could redeem the Preferred either for $8.00 per share or for 110% of "Fair Value Per Share," plus the amount of any accrued and unpaid dividends (without interest).[5] The Board

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[2]Axsys's Exchange Offering Circular disclosed that Mr. Bershad would be exchanging all of his holdings of Preferred.

[3]Defendant Fried was managing director and co-chairman of the investment committee of Lehman Bros., whose subsidiary, Lehman Electric, Inc., held the Axsys Common.

[4]Greenberg Aff., Ex. A., Certificate of Amendment of Certificate of Incorporation of Vernitron Corporation Effecting The Amendment and Restatement of the Certificate of the Designation, Powers, Preferences and Rights of the $3.75 Cumulative Exchangeable Redeemable Preferred Stock Par Value $0.01 Per Share ¶ 3(f)(ii) (Aug. 14, 1991) [hereinafter, "Certificate ¶ 3(f)(ii)"]. In 1996, Vernitron Corp. changed its name to Axsys Technologies, Inc. Greenberg Aff. ¶ 3.

[5]The relevant language of the Certificate, which is incorporated into the complaint by reference, provides:

chose not to redeem at $8.00 per share. Instead, it calculated the redemption price under the "Fair Value Per Share" formula in the Certificate, which was:

> **price per share = (1.1 x Fair Value Per Share) + unpaid, accrued dividends**

The redemption provision prescribes the methodology by which "Fair Value Per Share" (referred to as "Fair Value") is to be calculated.[6] That provision directs the Board to average the closing prices for Axsys Preferred quoted on the New York Stock Exchange Composite Tape for ten consecutive trading days, beginning fifteen trading days before the date of the redemption. If the Preferred is not traded on a national stock exchange, then the Board must use the average of the highest reported bid and lowest reported asked prices obtained from NASDAQ. If NASDAQ is not reporting such information, then Fair Value must be determined from prices quoted by a similar National Association of Securities Dealers, Inc. ("NASD") organization. Lastly, as a "default," the Certificate mandates that if the Preferred is not being traded on any market, the Board should determine Fair Value by its own chosen method.

> [T]he Corporation [Axsys] at its option may redeem, to the extent funds are legally available therefor, the Exchangeable Preferred Stock [i.e., the Preferred], at any time in whole or from time to time in part, at a price of $8.00 per share or an amount per share equal to the product of 1.1 and Fair Value Per Share, in either case together with an amount equal to accrued and unpaid dividends thereon to the date fixed for redemption, without interest.

Certificate ¶ 3(f)(ii), at 4.

[6]Under ¶ 3(f)(ii) of the Certificate:

> "Fair Value Per Share" means on any date of determination, the average of the daily closing prices per share of Exchangeable Preferred Stock for the 10 consecutive New York Stock Exchange trading days commencing 15 New York Stock Exchange trading days before such date. The closing price for each day shall be the last sale price regular way or, in case no such sales take place on such day, the average of the closing bid and asked prices regular way, in either case on the New York Stock Exchange Composite Tape, or, if the Exchangeable Preferred Stock is not listed or admitted to trading on any national securities exchange, the average of the highest reported bid and lowest reported asked prices as furnished by the National Association of Securities Dealers, Inc. through NASDAQ or a similar organization if NASDAQ is no longer reporting such information. If the Exchangeable Preferred Stock is not reported on NASDAQ or any such similar organization, Fair Value Per Share shall mean the fair value per share of the Exchangeable Preferred Stock as determined by the Board of Directors of the Company.

Certificate ¶ 3(f)(ii), at 4-5.

In short, the Certificate directs the Board to calculate Fair Price based on closing price data obtained from one of the public trading markets specified in the Certificate, unless the Axsys Preferred is not traded in any of those markets, in which case the Board may devise its own methodology to calculate Fair Value.

In its April 30 Redemption announcement, Axsys announced that it would pay $7.70 per Preferred share. That amount included $1.54 in unpaid, accrued dividends, plus $6.16 per share, representing 110% of the Board-determined Fair Value.[7] It is the $5.60 Fair Value figure that forms the crux of this dispute.[8]

The Board calculated Fair Value by using the above-described "default" methodology specified in the Certificate, i.e., "the fair value per share of the Exchangeable Preferred Stock as determined by the Board of Directors of the Company."[9] It is undisputed that the Preferred was not traded on any national securities exchange or on NASDAQ. Prices for the Preferred were, however, quoted on the OTC Bulletin Board, which is a trading service maintained under the auspices of NASD. The Axsys Board apparently concluded that the OTC Bulletin Board did not quality as a market quotation system that triggered the Board's contract obligation to calculate Fair Value based on closing prices "furnished by the National Association of Securities Dealers, Inc. through NASDAQ or a similar organization."

* * *

In this action, Gale challenges the Redemption of the Preferred on two grounds. He first contends that the Axsys Board was obligated to--but did not--use the average of closing prices on the OTC Bulletin Board as the basis for calculating the Preferred's Fair Value. Second, and alternatively, Gale claims that even if the Board properly used its own methodology to calculate Fair Value, the resulting $7.70 Redemption price was unreasonably and unfairly low. As a consequence, he argues, the Board violated its implied contractual obligation of good faith and fair dealing, as well as its fiduciary duty of loyalty to its Preferred shareholders. On this

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[7]Regardless of the methodology under which the Fair Value figure is derived, the Certificate directs the Board to multiply that Fair Value figure by 1.1, which results in the Preferred stockholders receiving a 10% premium above Fair Value as part of the redemption price. Certificate ¶ 3(f)(ii).

[8]The Fair Value offered in the Redemption (exclusive of unpaid, accrued dividends) was ($6.16 ÷ 1.1) or $5.60 per share.

[9]Certificate ¶ 3(f)(ii), at 5.

motion the defendants contend that these claims are insufficient as a matter of law.

II. STANDARD OF REVIEW AND THE PARTIES' CONTENTIONS

[1-2] Under Rule 12(b)(6) a complaint will be dismissed where it is reasonably certain that it fails to state a claim upon which relief may be granted.[10] Conversely, the motion will be denied if the complaint alleges facts that, if true, would state a legally valid claim.[11] In constructing the complaint, all inferences are drawn in favor of the non-moving party, but the Court need not credit conclusory allegations of fact or law that are not supported by allegations of specific fact.[12] Gale's claims are addressed below in accordance with that standard.

A. The Express Contract Claim

Gale claims that the defendants breached the Certificate's provision that prescribed the methodology for calculating Fair Value in a redemption of the Preferred. Specifically, Gale argues that the OTC Bulletin Board is an organization "similar" to NASDAQ, and therefore, the Board was required by the Certificate to determine Fair Value based on the average closing price as reported on the OTC Bulletin Board. The defendants respond by arguing that the OTC Bulletin Board is not and could not be considered an organization "similar" to NASDAQ. Alternatively, even if the OTC Bulletin Board were a "similar" organization, the defendants argue, plaintiff has not alleged facts showing that closing price data quoted on the OTC Bulletin Board would have enabled the Board to calculate the Preferred's Fair Value.

The first argument misapprehends the standard for evaluating a complaint under Rule 12(b)(6). Defendants' contention that the OTC

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[10]Rabkin v. Philip A. Hunt Chem. Corp., Del. Supr., 498 A.2d 1099, 1104 (1985) ("[I]t must appear with a reasonable certainty that a plaintiff would not be entitled to the relief sought under any set of facts which could be proven to support the action.").

[11]See e.g., In re Santa Fe Pacific Corp., Del. Supr., 669 A.2d 59, 71-72 (1995) (reversing trial court's dismissal of well-pleaded Unocal claim that board's defensive measures were unreasonable in light of perceived threat to corporation).

[12]Grobow v. Perot, Del. Supr., 539 A.2d 180, 187 n.6 (1988) ("Even under the less stringent standard of a Chancery Court Rule 12(b)(6) motion to dismiss, all facts of the pleadings and reasonable inferences to be drawn therefrom are accepted as true, but neither inferences nor conclusions of fact unsupported by allegations of specific facts upon which the inferences or conclusions rest are accepted as true.").

Bulletin Board could never be considered an organization "similar" to NASDAQ rests upon facts intrinsic to the complaint. The plaintiffs counterargument--that the OTC Bulletin Board is similar--also rests upon extrinsic facts. That issue cannot be resolved as a matter of law on the face of the pleading.

[3] At this procedural stage, all the Court can decide is whether the complaint on its face states a claim upon which relief may be granted. Here, the complaint alleges that (i) the OTC Bulletin Board is a "similar" organization within the meaning of the Preferred's Certificate, and (ii) Axsys breached the Certificate by not utilizing the closing prices for Axsys Preferred derived from the OTC Bulletin Board. That is sufficient to state a legally cognizable claim for breach of contract.

[4-5] The defendants also argue that OTC Bulletin Board could not have provided ten days of consecutive closing price data from which to calculate Fair Value, but (alternatively) even if the OTC Bulletin Board did contain such information, that data is not pleaded in the complaint. This argument is also flawed. With limited exceptions, "[a] complaint need only give general notice of the claim asserted and will not be dismissed unless it is clearly without merit, either as a matter of law or fact."[13] Gale's complaint (i) identifies the redemption provision upon which his claim rests, (ii) alleges that the defendants breached their obligation to treat the OTC Bulletin Board as an organization similar to NASDAQ, and (iii) avers that as a result, the valuation methodology chosen by the Board yielded an inadequate Fair Value for their shares, and that the Preferred shareholders were injured.[14] These allegations suffice to give the defendants notice of the nature of Gale's cause of action and to state a cognizable claim for relief.[15]

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[13]Rabkin, 498 A.2d at 1104; Loudon v. Archer-Daniels-Midland Co., Del. Supr., 700 A.2d 135, 140 (1997) ("A requirement that the pleader state facts 'with particularity' is reserved for derivative stockholder claims under Chancery Rule 23.1 and for fraud or mistake claims under Rule 9(b).") (citations omitted).

[14]See Moore Bus. Forms, Inc. v. Cordant Holdings Corp., Del. Ch., C.A. No. 13911, Mem. Op. at 13, Jacobs, V.C. (Nov. 2, 1995) ("To survive a motion to dismiss, a complaint stating a claim for breach of contract must identify a contractual obligation, whether express or implied, a breach of that obligation by the defendant, and resulting damage to the plaintiff.").

[15]The defendant's argument showing that the OTC Bulletin Board could never have provided under any set of circumstances the data necessary to calculate Fair Value, is an impermissible effort to litigate the factual dispute underlying Gale's claim at the pleading stage. Those underlying factual contentions must await a motion for summary judgment or a trial.

B. The Implied Contract Claim

[6] Gale's second claim is that even if the Board was permitted to select its own valuation methodology, in these circumstances the methodology chosen by the Board resulted in an unreasonably and unfairly low valuation. That, Gale urges, constitutes a breach of the implied covenant of good faith and fair dealing that "requires a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the contract."[16]

The basis for this claim for breach of the implied covenant of good faith and fair dealing is the Certificate language mandating that "Fair Value Per Share shall mean the fair value per share of the Exchangeable Preferred Stock as determined by the Board of Directors of the Company."[17] The impact of that language is that, regardless of the method the Board uses, the resulting valuation must represent a "fair value" for the Preferred.

The obligation to calculate a Fair Value that represents "fair value" is (despite the appearance) not a redundancy. The Certificate provision mandating how the Board must determine Fair Value in the Redemption, first directs the Board to average closing prices for the Preferred reported on the NYSE Composite Tape. If the Preferred is not listed there, or on any other national securities exchange, the Board must then use trading prices for the Preferred reported on NASDAQ, but if that information is not reported on NASDAQ, then as reported by a similar NASD organization. These provisions have a common thread: the Board must base its valuation of the Preferred on current market prices. Implicit is the premise that prices derived from the market tend to assure that the Preferred shareholders' economic interest in receiving adequate compensation for their redeemed shares, will be protected.

Even under the contingency in which the Preferred is not traded in any market and no market price is available, the Board may choose its own method to value the Preferred, subject to the requirement that the amount offered represent the "fair value" of the redeemed Preferred shares. The implication is that in the absence of market-based price data to guide the Board's valuation, the Board must value the Preferred in a manner comparably calculated to yield fair value to the investors being forced to relinquish their Preferred.

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[16]Wilgus v. Salt Pond Inv. Co., Del. Ch., 498 A.2d 151, 159 (1985) (citing RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981)).

[17]Certificate ¶ 3(f)(ii), at 5 (emphasis added).

That obligation forms the basis of Gale's implied contract claim, which is that the Redemption offer significantly understates the Preferred's fair value, which (plaintiff alleges) fell somewhere in the range of $8.00 to $9.50 per share.[18] Therefore, Gale concludes, the Board's $5.60 per share valuation constituted a breach of its

[start - revised page - March 4, 1998]

implied obligation to determine the Preferred's Fair Value in good faith.

The defendants argue that this claim is legally insufficient on two grounds: (i) the implied covenant claim would contradict express terms of the Certificate and (ii) the complaint discloses no motivation for the defendants to have acted in bad faith. Neither ground has merit.

[7] Gale's claim that the Board was obligated to pay fair value in redeeming the Preferred, is founded upon the Certificate's express terms, and does not (as the defendants suggest) contradict those terms. Although the Certificate does authorize the Board to use its own methods to calculate Fair Value, it commands that the result represent "fair value" for the shares. The complaint states a legally sufficient claim that Axsys and its Board violated that implied obligation to select, in good faith, a valuation method that would yield a fair value.[19]

[8] Defendants' second argument is similarly devoid of merit. Assuming without deciding that Gale is required to plead a culpable "state of mind" as an element of a bad faith claim, he did that. Gale alleges that two of the defendant directors held approximately 49% of the Axsys Common, that the other director's employer held 10%, and that the directors' significant stock holdings created a material conflict of

[end - revised page - March 4, 1998]

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[18]Gale alleges several alternative ways that the Preferred's fair value could have been calculated:

(1) The Exchange Offer pegged the Preferred's value at 75% of Common (i.e., a conversion ratio of .75 Preferred to 1 Common) and the Common's median (not average) trading price was $12.625 during that time period. Three quarters of the median price is $9.47. Compl. ¶ 10.

(2) On the date of the Redemption announcement, the Common closed at $12.50. Three quarters of that price is $9.375. Compl. ¶ 12.

(3) The Preferred traded on the OTC Bulletin Board after the Exchange Offer at $8.00 per share (with one trade taking place at $8.25). Compl. ¶ 14.

[19]See Moore Bus. Forms, Inc., Mem. Op. at 16 ("To state a claim for breach of an implied covenant of good faith and fair dealing, a plaintiff must identify a specific implied contractual obligation.").

interest when the Board approved the Redemption offer. Implicit in these allegations is that the directors had a conflicting self-interested motivation to redeem the Preferred for an inadequately low price, because the lower the Redemption price, the more that the Common would increase in value. Those allegations are sufficient to state a claim for breach of the implied covenant of good faith and fair dealing.[20]

C. The Fiduciary Claim

The same facts that underlie Gale's implied contract claim also form the basis of his fiduciary claim. Gale contends that the Axsys Board breached its duty of loyalty to the holders of Axsys Preferred, because the Board members had a conflicting self-interest by virtue of their ownership (or, in Fried's case, by virtue of his position as the employee of an owner) of sizeable blocks of Common. Gale contends that given the directors' self-interest, the Redemption amounted to "plain vanilla self-dealing."[21]

This fiduciary claim is substantially identical to Gale's implied contract claim that the Board failed to determine Fair Value in good faith. Plaintiff charges that that conduct, besides breaching the defendants' implied covenant of good faith and fair dealing, also breached the Board's fiduciary duty of loyalty. The defendants argue, in response, that because the dispute involves a right or obligation created by a contractual term in the Preferred's governing instrument, fiduciary principles play no role because the dispute must be adjudicated under contract principles.[22]

[9-10] The issue is whether the duty sought to be enforced arises out of the parties' contractual, as opposed to their fiduciary, relationship. If the duty is contractual, that would preclude any fiduciary claim based upon the same alleged conduct.[23] To decide that issue, the Court must determine whether Gale's claimed right to a fair valuation of the Preferred arises from

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[20]See, e.g., Desert Equities, Inc. v. Morgan Stanley Lvgd. Equity Fund, L.P., Del. Supr., 624 A.2d 1199, 1208 (1993) (Finding allegations that "the General Partner has willfully, wrongfully and in bad faith excluded plaintiff from participating in three or more Fund II investments in retaliation for plaintiff's lawsuit against various Morgan defendants" stated a valid, bad faith claim).

[21]Pl.'s An. Br. at 13.

[22]See, e.g., Moore Bus. Forms, Inc., Mem. Op. at 11-12.

[23]Jedwab v. MGM Grand Hotels, Inc., Del. Ch., 509 A.2d 584, 594 (1986) ("[W]ith respect to matters relating to preferences or limitations that distinguish Preferred stock from common, the duty of the corporation and its directors is essentially contractual and the scope of the duty is appropriately defined by reference to the specific words evidencing that contract; where however the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards.").

the Certificate provision governing the terms of the Preferred, or whether it is a right or obligation created not by virtue of any preference, and is shared equally with the Common. In this case, the claimed right to a good faith calculation of Fair Value arises from the Certificate's contractual promise that holders of Preferred shall receive "fair value" for their redeemed shares. That claim is one for a breach of the implied covenant, for which the remedy would be the difference in value between the Board's improper calculation of Fair Value and the value as adjudicated by this Court.

[11-13] The function of the implied covenant of good faith and fair dealing in defining the duties of parties to a contract, is analogous to the role of fiduciary law in defining the duties owed by fiduciaries.[24] An important difference, however, is that the implied covenant specifically protects the Preferred shareholders' expectation that the Axsys Board will properly perform their contractual obligations under the Certificate.[25] To allow a fiduciary duty claim to coexist in parallel with an implied contractual claim, would undermine the primacy of contract law over fiduciary law in matters involving the essentially contractual rights and obligations of preferred stockholders.[26] Stated differently, because the contract claim addresses the alleged wrongdoing by the Board, any fiduciary duty claim arising out of the same conduct is superfluous. For that reason, the Court will dismiss Gale's fiduciary claim.

III. CONCLUSION

For the above reasons, the defendants' motion to dismiss the plaintiff's express and implied contract claims is denied, but their motion to dismiss his fiduciary claim is granted. **IT IS SO ORDERED.**

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[24]HB Korenvaes Inv., L.P. v. Marriot Corp., Del. Ch., C.A. No. 12922, Mem. Op. at 11, Allen, C., (June 9, 1993) ("Indeed the contract doctrine of an implied covenant of good faith and fair dealing may be thought in some ways to function analogously to the fiduciary concept.").

[25]The implied covenant is invoked where a party's arbitrary or unreasonable conduct does not violate the express terms of an agreement but would nonetheless frustrate the other side's enjoyment of the bargain.

[26]See Moore Bus. Forms, Inc., Mem. Op. at 11-12 ("What can be said ... is that disputes that relate to obligations 'expressly treated and rights [that are] created' by contract will be governed by contract principles.") (citing HB Korenvaes Inv., L.P. v. Marriot Corp., Mem. Op. at 13).

GRUBB v. BAGLEY

No. 13,882-NC

Court of Chancery of the State of Delaware, New Castle

February 25, 1998

Plaintiffs, minority stockholders of a closely-held corporation, brought an action and a pending appraisal proceeding as a result of a cash-out merger between the corporation and another corporation formed by its board. Plaintiffs claimed defendants breached their fiduciary duty and breached a stockholders' buy-sell agreement. With respect to breach of fiduciary duty, plaintiffs claimed that the cash-out merger price did not reflect the fair value of the company, and defendants breached their duty of disclosure by use of illegal discounts. Plaintiffs also claimed that defendants breached two provisions of the buy-sell agreement. Defendants argued that summary judgment was proper as to the fiduciary duty claim on the ground that plaintiffs were limited to their appraisal remedy, and that defendants were protected from liability because of reliance upon a fairness opinion rendered by an investment banking firm. Defendants argued for dismissal of the contract claim for waiver or laches.

The court of chancery, per Vice-Chancellor Balick, held that the merits of the fiduciary duty claim could not be decided on a motion for summary judgment because the fairness of the process and the cash-out price involved issues of material fact. Defendants' motion for summary judgment was granted on plaintiffs' contract claim because plaintiffs failed to present any evidence that defendants violated the non-compete clause of the buy-sell agreement.

1. Pretrial Procedure ⟹ 675, 679, 687

When a party has presented matters outside the complaint, a motion will be treated as one for summary judgment, in accordance with Court of Chancery Rule 12(b). DEL. CH. CT. R. 12(b).

2. Corporations ⟹ 584

Although an appraisal remedy is exclusive where cashed-out stockholders challenge the economic judgments involved in a corporation's determination of its stock's fair value, they may also seek other appropriate relief for breach of fiduciary duty.

3. Corporations ⟹ 310(1)

Where a company has a contractual right to buy stock for book value in specific circumstances not involving a cash-out merger, stockholders who are cashed out have a statutory right to their stock's intrinsic or fair value.

4. Corporations ⟹ 320(1)

Where a defendant argues protection from liability because of the defendant's reliance on a fairness opinion by an investment banking firm, that reliance affords a defense only if the board acted reasonably and in good faith.

5. Corporations ⟹ 310(1), 584

It is settled Delaware law that there is no reliance requirement in a claim for breach of a fiduciary duty of disclosure.

6. Corporations ⟹ 310(1), 320(1)

Where a defendant's primary position on the disclosure claims is lack of reliance, and those claims are merely part of the breach of fiduciary duty claim that survives summary judgment, plaintiffs would not be entitled to damages to the extent that any arguably material omitted fact was actually known to the stockholders of a family owned company.

7. Judgment ⟹ 186

Where there are genuine issues of material fact as to the fairness of the process used to determine the fair value of shares as well as the price, and the issue as to the price does not simply involve reasonable differences on matters of economic judgment, a defendants' motion to dismiss the fiduciary duty claim may be denied.

8. Contracts ⟹ 170, 175
Judgment ⟹ 185(1)
Pretrial Procedure ⟹ 680

Where plaintiffs do not seek to offer extrinsic evidence supporting their interpretation of a buy-sell agreement for stock, but rely solely on the contract language, a court can interpret the contract as a matter of law.

9. Contracts ⟹ 9(1), 170
Corporations ⟹ 310(1)

A contract will not be read to restrict a corporation's statutory right to cash-out minority stockholders in the absence of clear language to that effect.

10. Corporations ⟹ 310(11), 320(1), 320(6), 584

Where defendant shareholders of a closely-held corporation form another corporation to accomplish a merger approved by its board, and plaintiff shareholders present no evidence that the new corporation was a competitor of the closely-held company, or engaged in any business activity during the period between its formation and merger, defendants did not violate a non-compete clause of a buy-sell agreement.

Wayne J. Carey, Esquire, and Ronald A. Brown, Jr., Esquire, of Prickett, Jones, Elliott, Kristol & Schnee, Wilmington, Delaware; and Frederick V. Locbihler, Esquire, and David S. Barritt, Esquire, of Chapman and Cutler, Chicago, Illinois, of counsel, for plaintiffs.

Craig B. Smith, Esquire, and David A. Jenkins, Esquire, of Smith, Katzenstein & Furlow, Wilmington, Delaware; and Lawrence R. Moelmann, Esquire, and Gary E. Medler, Esquire, of Hinshaw & Culbertson, Chicago, Illinois, of counsel, for defendants.

BALICK, *Vice-Chancellor*

The defendants seek summary judgment on claims by minority stockholders who were cashed out in a merger under § 251 of the Delaware General Corporation Law. In addition to their pending appraisal proceeding, the plaintiffs have filed this action claiming breach of fiduciary duty and breach of a stockholders' agreement. I will deny summary

judgment on the fiduciary duty claim and grant summary judgment on the contract claim.

Background Facts

The Herget National Bank of Pekin, Illinois is controlled by the Herget Financial Corp., a Delaware corporation ("Herget Financial"). The stockholders of Herget Financial are descendants of the bank's founders. In 1989, the company and all of the stockholders entered into a Buy-Sell Agreement. The agreement restricts sales to anyone but related parties and in specified circumstances gives the company or other stockholders the right to purchase for book value the stock of a stockholder who desires to sell.

At the time of the merger, there were 16 stockholders belonging to four families. The plaintiffs are related to William E. Tunis. In the summer of 1993, Mr. Tunis resigned from the board of Herget Financial and joined the board of another bank operating in Pekin. Because the other stockholders believed that he was violating the non-compete clause of the Buy-Sell Agreement, Mr. Tunis transferred his shares to his children. The other stockholders, who owned 87.59% of the company's stock, nevertheless decided to cash out the Tunis family.

For the purpose of accomplishing the merger, the board incorporated The Second Fourth Street Financial Corp., a Delaware corporation ("Fourth Street"). Pursuant to an exchange offer preceding the merger, the "Affiliated Stockholders" received one share of Fourth Street for each of their shares of Herget Financial. Pursuant to the merger, the "Unaffiliated Stockholders," the Tunis family, received $200 cash for each of their shares of Herget Financial. The merger was consummated on July 25, 1994. After the merger, Fourth Street changed its name to Herget Financial Corp.

Fiduciary Duty Claim

[1-2] The defendants have moved to dismiss the plaintiffs' fiduciary duty claim on the ground that the plaintiffs are limited to their appraisal remedy. Since the parties have presented matters outside the complaint, the motion will be treated as one for summary judgment, in accordance with Del.Ch.R. 12(b). Although the appraisal remedy is exclusive where cashed-out stockholders challenge the economic judgments involved in the

corporation's determination of the stock's fair value, they may also seek other appropriate relief for breach of fiduciary duty.[1]

[3] Although the company had a contractual right to buy stock for book value in specific circumstances not involving a cash-out merger, stockholders who are cashed out have a statutory right to their stock's intrinsic or fair value.[2] The plaintiffs have presented evidence that the defendants decided to set the merger price at or near book value, even though they knew that book value was much less than the stock's intrinsic value. According to the plaintiffs' expert, the $200 merger price was based on marketability and minority discounts prohibited by Delaware law, and without those illegal discounts the stock's fair value was $354.60.[3]

[4] The defendants argue that they are protected from liability because they relied on a fairness opinion by an investment banking firm, Stifel, Nicolaus & Company, Inc.[4] The statute affords a defense only if the board acted reasonably and in good faith. There are genuine issues of material fact on those issues.

[5] The plaintiffs also claim that the defendants breached their duty of disclosure. The defendants argue that the plaintiffs could not have been harmed by any breach of the duty of disclosure because all of the plaintiffs have perfected their appraisal rights. Although the plaintiffs cannot claim that any disclosure violation caused them to vote for the merger, Delaware law is settled that there is no reliance requirement in a claim for breach of a fiduciary duty of disclosure.[5]

[6] Since the defendants' primary position on the disclosure claims is lack of reliance, and those claims are merely part of the breach of fiduciary duty claim that survives summary judgment for the reasons stated above, it is not necessary to discuss each disclosure claim at this stage. I will simply say that the plaintiffs would not be entitled to damages to the extent that any arguably material omitted fact was actually known to the stockholders of this family-owned company.[6]

The strongest disclosure claim is related to the alleged use of illegal discounts. The proxy statement simply disclosed the investment banker's

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[1]Cinerama, Inc. v. Technicolor, Inc., Del.Supr., 663 A.2d 1156 (1995); Rabkin v. Philip A. Hunt Chemical Corp., Del.Supr., 498 A.2d 1099 (1985); Weinberger v. UOP, Inc., Del.Supr., 457 A.2d 701 (1983); Seagraves v. Urstadt Property, Del.Ch., C.A. No. 10307, Jacobs, V.C. (April 1, 1996); Nebel V. Southwest Bancorp., Inc., Del.Ch., C.A. No. 13618, Jacobs, V.C. (July 5, 1995).

[2]8 Del. C. § 262(h).

[3]Cavalier Oil Corp. v. Harnett, Del.Supr., 564 A.2d 1137 (1989).

[4]8 Del. C. § 141(e).

[5]In re Tri-Star Pictures, Inc., Lit., Del.Supr., 634 A.2d 319, 327 n.10 (1993).

[6]Cf. Loudon v. Archer-Daniels-Midland Co., Del.Supr., 700 A.2d 135 (1997).

conclusion that the merger price was fair from a financial point of view. In the exercise of due care, the defendants should have at least understood and disclosed enough about the method used to determine fair value to give the plaintiffs an opportunity to seek to enjoin the merger on the ground that the price was based on illegal marketability or minority discounts.[7]

[7] Because there are genuine issues of material fact as to the fairness of the process as well as the price, and the issue as to the price does not simply involve reasonable differences on matters of economic judgment, the defendants' motion to dismiss the fiduciary duty claim must be denied.

Contract Claim

The plaintiffs also claim that the defendants breached two provisions of the Buy-Sell Agreement, and seek rescissory damages under Section 11 of the contract:

> Remedies. The remedy at law for any breach or threatened breach of this Agreement is inadequate, and any party is entitled to an injunction, specific performance, and other equitable relief without proof of actual damage, as well as any other remedy which the party may have under law or equity.

The defendants move to dismiss the contract claim for waiver or laches. They argue that they were prejudiced by the plaintiffs' failure to claim rescissory damages for breach of the agreement until the filing of their Second Amended Complaint two years after the merger. Since the agreement may be amended or terminated by stockholders owning at least 80% of the stock, and the affiliated stockholders own 87.59%, the defendants say that they could have amended the agreement if the plaintiffs had sought to enjoin the merger on the ground that it was prohibited by the Buy-Sell Agreement. Because the plaintiffs' interpretation of the contract is not persuasive, it is unnecessary to discuss the defenses of waiver or laches.

The plaintiffs contend that the merger violated Section 2(h)(1) of the agreement:

> (h) Sale of 51% or More of the Shares; Other Events. (1) notwithstanding the foregoing [restriction on

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[7]Cf. Wacht v. Continental Hosts, Ltd., Del.Ch., C.A. No. 7954, Chandler, V.C. (Sept. 16, 1994), Mem. Op. at 7.

> stock sales], no right shall arise to the Company or the other Shareholders under this Section 2 if the Shares are to be disposed of pursuant to any of the following events:
>
> (A) a sale of at least 51% of the Shares to any person or entity who was not a Shareholder prior to the sale, except as provided in Section 2(h)(2) hereof;
>
> (B) the Company is completely liquidated;
>
> (C) the Company is a party to a merger, consolidation or other reorganization in which the Company is not the surviving corporation; or
>
> (D) the Company sells substantially all of its operating assets,
>
> provided, that each Shareholder is given the opportunity to dispose of his Shares for an amount per share which is equal to the amount per share realized by any other Shareholder. The Shareholders shall fully cooperate in, and shall not impede the disposition of any Shares pursuant to this Section (2)(h). (emphasis added)

Section 2 of the The Buy-Sell Agreement requires any stockholders of Herget Financial who desire to sell their stock to first offer it to the company or the other stockholders at book value. Section 2(h)(1) says that no rights arise under Section 2 when the company is a party to a merger in which the company is not the surviving entity, provided that

> each Shareholder is given the opportunity to dispose of his Shares for an amount per share which is equal to the amount per share realized by any other Shareholder.

The plaintiffs argue that this language required that they receive the same consideration in the merger that the affiliated stockholders received in the exchange offer that preceded the merger, namely, stock in the surviving entity. In effect, they contend that the contract prohibits a merger to cash out minority stockholders.

[8] Since the plaintiffs do not seek to offer extrinsic evidence supporting their interpretation, but rely solely on the language quoted above, the court can interpret the contract as a matter of law. The contract provides that it

should be construed in accordance with the laws of Illinois. The following interpretation is based on standard principles of contract construction. The parties have not cited any Illinois authority inconsistent with this interpretation.

There is no evidence that the plaintiffs understood the contract to restrict the company's statutory right to cash out minority stockholders. The Buy-Sell Agreement was entered into shortly after an earlier cash-out of minority stockholders. If the plaintiffs understood the quoted language to prohibit such a merger, they would have surely sought to enjoin it.

[9] A contract will not be read to restrict a corporation's statutory right to cash out minority stockholders in the absence of clear language to that effect. The main thrust of Section 2 (h)(1) is to recognize the company's right to be a party to a merger. The language on which the plaintiffs rely is most reasonably read to simply assure that all stockholders who are cashed out will receive the same amount and that none will receive any additional payment, such as a control premium, consulting contract, or any other payment not equally available to others. That requirement was satisfied in this case.

The plaintiffs also allege that the terms of the merger violated the non-compete clause of the contract. The non-compete clause of the Buy-Sell Agreement prohibits stockholders from aiding or abetting a competitor of the company or the bank without the approval of Herget Financial's board. The plaintiffs assert that the defendants breached the contract by serving on the board of Fourth Street during the period immediately before the merger.

[10] The defendants formed Fourth Street to accomplish a merger approved by the board. The plaintiffs have presented no evidence that Fourth Street was a competitor of the company or the bank, or engaged in any business activity during the period between its formation and the merger. Thus, the defendants did not violate the non-compete clause of the Buy-Sell Agreement.

Since there is no genuine issue of material fact as to either alleged breach of the Buy-Sell Agreement, I will grant the defendants' motion for summary judgment on the plaintiffs' contract claim.

* * *

An order denying summary judgment on the fiduciary claim and granting summary judgment on the contract claim accompanies this opinion.

ORDER

For the reasons stated in the memorandum opinion filed with this order, it is ordered that the defendants' motion for summary judgment is denied as to Count I of the Second Amended Complaint and granted as to Count II.

HINTMANN v. FRED WEBER, INC.

No. 12,839

Court of Chancery of the State of Delaware, New Castle

February 17, 1998

Petitioners, shareholders of common stock in a holding company that merged with its operating company and ceased to exist, filed a motion for statutory appraisal of their shares. Petitioners claimed respondent's expert undervalued their shares and requested the court to determine fair value on the date of the merger. Petitioners also claimed that a control premium should be added to the holding company's valuation and that they were entitled to attorneys' fees and costs because respondents acted in bad faith.

The court of chancery, per Chancellor Steele, concluded that respondent's calculations would be used to determine the value of the stock; however, petitioners were entitled to a control premium and would receive interest. The court found no evidence of bad faith and refused petitioners' request for attorneys' fees and costs.

1. Corporations ⟹ 182.4(2), 189(12)

Evidence of wrongdoing or of bad faith is pertinent in an appraisal action where it may reflect upon the credibility of witnesses.

2. Corporations ⟹ 182.4(5)

In determining fair value of minority shareholder's stock, using discount cash flow analysis, chancery court will accept a weighted-average cost of capital as a basis for determining the discount rate.

3. Corporations ⟹ 182.4(6)

In calculating the cost of equity when performing a valuation of a corporation, the court accepts the capital asset pricing model as an appropriate method.

4. Corporations ⟹ 584

A holding company's ownership of a controlling interest in its subsidiaries is an independent element of value that must be taken into account in determining a fair value for the parent company.

5. Corporations ⟹ 182.4(2), 182.4(6)

A control premium may be added to a corporate valuation not only when a third party acquires a majority interest, but also as a means of making the valuation of a company more realistic.

6. Corporations ⟹ 182.4(6)

A control premium assigns value at the corporate level, to reflect the intrinsic value of the parent corporation; the nature of ownership at the shareholder level is irrelevant to that determination.

7. Corporations ⟹ 182.4(2)

In valuation of a holding company for determining post-merger fair compensation to its shareholders, court determined it was appropriate to add a control premium where the company held 100% of the common stock in the corporation into which it was merged.

8. Contracts ⟹ 153
Corporations ⟹ 182.4(6), 584

Properly expressed terms of certificate of designation of preferred stock may establish consideration to which holders of stock will be entitled

in event of merger, and when documents creating security do so, that amount so fixed or determined constitutes fair value of stock for purposes of dissenters' rights under section 262 of the Delaware General Corporation Law. DEL. CODE ANN. tit. 8, § 262 (1990).

9. Contracts ⟹ 153
Corporations ⟹ 174

A purchaser of preferred shares may contract away his or her right to have a court determine the shares' fair value; such a waiver will be found, however, only when clearly and affirmatively expressed in the document creating the security.

10. Contracts ⟹ 155
Corporations ⟹ 174

Ambiguity as to whether contract provisions creating class of securities waive shareholders' statutory rights is to be resolved against issuer of securities.

11. Corporations ⟹ 182.4(5)
Interest ⟹ 12

The award of interest serves two, equally important purposes: first, the award compensates petitioner for the loss of the use of the fair value of his shares during the pendency of the proceeding; second, the award forces the corporation to disgorge any benefits it obtained from the use of the fair value of petitioner's shares during the pendency of the proceeding.

12. Corporations ⟹ 182.4(6), 189(14)

In the absence of an equitable exception, the plaintiff in an appraisal proceeding should bear the burden of paying its own expert and attorneys. DEL. CODE ANN. tit. 8, § 262(j) (1990).

Donald E. Reid, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware; and Russell M. Pelton, Esquire of Oppenheimber Wolff & Donnelly, Chicago, Illinois, of counsel, for petitioners.

Daniel A. Dreisbach, Esquire, of Richards Layton & Finger, Wilmington, Delaware; and Lawrence C. Friedman, Esquire, and Kevin A. Sullivan,

Esquire, of Thompson Coburn, St. Louis, Missouri, of counsel, for respondent.

STEELE, *Vice-Chancellor*

On September 15, 1992, Weber Industries, Inc. ("Industries"), a holding company created to hold shares in an operating company, Fred Weber, Inc. ("FWI"), merged into the operating company and ceased to exist. In this statutory appraisal action under 8 *Del. C.* § 262, the petitioners ask this Court to determine the fair value of 13,205.6649 shares of Industries common stock on the date of the merger. Because Industries was a holding company whose primary asset was 100% of FWI's Class A common stock, the value of the petitioners' shares depends upon the value of FWI's Class A common stock, which, in turn, requires the valuation of FWI as a whole. One petitioner also asks this Court to appraise the fair value of 1,886 shares of FWI Class B common stock on the date of the merger. This is the Court's decision on the petition.

I. BACKGROUND

FWI is engaged in the construction, construction materials and landfill businesses in Missouri. FWI has two divisions, a construction division, which specializes in highway construction, and a materials division, which specializes in the mining and processing of construction aggregates. Industries was formed in 1986 to hold FWI Class A common stock. Industries ceased to exist on September 15, 1992, when it merged into FWI.

On the date of the merger, FWI was capitalized with two classes of common stock, Class A and Class B. Industries owned 100% of the Class A shares, and 129 FWI employees owned 100% of the Class B shares. Industries had one class of common stock. The Fred Weber, Inc. Employee Stock Ownership Plan ("ESOP") owned 95% of Industries' common shares for the benefit of FWI employees. The ESOP participants who voted in favor of the merger received $127.50 in cash plus one share of newly-issued FWI non-voting preferred stock with a stated value of $132.50[1] for each share of Industries common stock -- for a total consideration of $260 per share.

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[1]Dividends accumulate daily on the stated value of the preferred shares at the rate of 10% per annum, payable quarterly. The preferred stock participates in any increase in the value of FWI's Class A common up to a maximum value of $180 per share. Shareholders have the option of converting their preferred shares to FWI Class A common.

Before the merger, Industries' board requested fairness opinions from two companies, A.G. Edwards & Sons, Inc. ("A.G. Edwards") and Rubin, Brown, Gornstein & Co. A.G. Edwards had valued Industries' shares annually, in accordance with ERISA requirements,[2] for six years preceding the merger. In its most recent annual valuation before the merger, completed January 31, 1992, A.G. Edwards had calculated a value of $260 per share. Both companies concluded that the merger provided fair consideration to the ESOP participants.

Notwithstanding the fairness opinions, Michael W. Hintmann, Carolyn Ottenad, Marion R. Medic and Edward F. Devine (collectively "Petitioners") voted their shares against the merger[3] and instituted this appraisal action. Petitioner Devine also seeks appraisal of his FWI Class B common shares. The parties' appraisal experts noted that, because Industries was a holding company whose primary asset was 100% of FWI's Class A common stock, the value of Petitioners' shares depended upon the value of FWI's Class A common stock, which required the valuation of FWI as a whole.[4] Thus, the experts expressed their opinions concerning the value of Petitioners' shares in terms of the value of FWI's Class A common shares.

Petitioners' expert, Ben Buettell, of Houlihan, Lokey, Howard & Zukin, Inc. ("HLHZ"), valued FWI's Class A common stock at $391 per share on the date of the merger. Respondent's expert, Richard Braun, of Willamette Management Associates ("WMA"), valued FWI's Class A common stock at $271 per share on the date of the merger. Both experts computed the value of FWI by calculating the simple average of the results of discounted cash flow and market capitalization[5] analyses. Both testified that their approaches were substantially similar and that the discounted cash flow and market capitalization valuation methods were generally accepted in the field. The experts averaged the results of the two approaches and subtracted the value of FWI's Class B common shares to

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[2]The Employee Retirement Income Security Act of 1974 ("ERISA") governs qualified retirement plans such as FWI's ESOP. FWI structured the merger to allow ESOP participants to seek appraisal. Therefore, I encounter no federal preemption issues.

[3]The shares were actually voted by a trustee at the direction of an ESOP Advisory Committee, which made most decisions involving the shares. Employees could direct the ESOP trustee's vote only in limited circumstances, which included a merger involving FWI.

[4]Petitioners argue that Respondent's expert did not value FWI as a whole, but valued only the Class A common shares. Petitioners are mistaken. As will be explained, *infra*, both experts determined the value of FWI as a going concern and subtracted the value of the Class B common shares to reveal the value of the Class A common shares.

[5]Although the two experts testified that they used the same valuation methods, Braun called his market approach valuation by a different name, the Guideline Publicly Traded Companies Method.

determine the value of the Class A common shares. They divided that value by the number of outstanding Class A shares to arrive at the per share value.

The fair value of Petitioners' shares, as determined in this action, will be placed into their ESOP accounts. The fair value of the Class B common shares shall be paid to Petitioner Devine directly. Additional facts relevant to the Court's disposition are discussed below.

II. MOTION *IN LIMINE*

Before trial, Respondent moved to exclude certain evidence it suspected Petitioners would attempt to introduce at trial. Respondent requested that the Court exclude evidence of the following: "(i) [The a]lleged breach of fiduciary duties by FWI officers and directors or members of the ESOP Advisory Committee; (ii) The adequacy, accuracy and/or timeliness of the disclosure to the shareholders of the Merger; (iii) The allegedly pretextual reasons for the Merger; (iv) Management compensation; (v) The reincorporation of FWI in Delaware; and (vi) The treatment of the Petitioners prior to and during the Merger (unrelated to the consideration offered in the Merger)."[6] Respondent argued these claims of wrongdoing have no place in an appraisal action. Petitioners conceded that they do not seek to recover for any possible breaches of fiduciary duty. Nevertheless, Petitioners oppose Respondent's motion on the ground that this Court is required to consider "all relevant evidence" when determining the fair value of shares.[7] The Court reserved decision on Respondent's motion and took Petitioners' evidence as a proffer.

[1] Evidence of wrongdoing or of "bad faith" is pertinent in an appraisal action where it may reflect upon the credibility of witnesses.

> [I]t should not be concluded that in an appraisal the Court will blind itself to or ignore, the manner and procedures by which the merger price was arrived at. If corporate fiduciaries engage in self-dealing and fix the merger price by procedures not calculated to yield a fair price, those facts should, and will, be considered *in assessing the credibility of the Respondent corporation's valuation contentions*. Equity and logic require no less.[8]

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[6]Respondent's Motion *in Limine* to Exclude Evidence at 1.

[7]*Rapid-American Corp. v. Harris*, Del. Supr., 603 A.2d 796, 802 (1992).

[8]*Pinson v. Campbell Taggart*, Del. Ch., C.A. No. 7499, 1989 WL 17438 at *7, mem. op., Jacobs, V.C. (Nov. 28, 1989)(footnotes omitted)(emphasis added); *see also Rapid-*

The Motion *in Limine* is granted. Evidence of this nature may be relevant in an appropriate case, however, I have considered the entirety of the evidence presented in support of the theory pressed in the proffered evidence, concluded that no proof advanced suggests any reasonable relationship between the witnesses' testimony and issues of price or value, and have found that it has no impact on the key witnesses' credibility. Therefore, the irrelevant evidence has no bearing upon my assessment of the fair value of the shares at issue in this action.

III. VALUE OF INDUSTRIES' COMMON SHARES

Both parties' experts testified that they used substantially the same valuation approaches and that their results were similar in many respects. The parties' experts also agree on the significant differences in their respective approaches, and I address those differences below.

A. Discount Rate

[2] Petitioners' expert, Buettell, used a discount rate of 15% in his discounted cash flow analysis, while Respondent's expert, Braun, used a discount rate of 21%. The differing discount rates account for approximately $100 of the $120 per share difference between the two experts' valuations.[9] Both experts based their discount rates on FWI's weighted-average cost of capital ("WACC"), "an average of the costs of all sources of capital ... for the company, with each source weighted by its respective percentage share in the capital structure of the company."[10] This method of calculating the discount rate has been accepted by this Court.[11] Buettell concluded that the discount rate should equal the WACC, while Braun concluded that the discount rate should equal the WACC plus a "company specific risk premium" of 3%.

American, 603 A.2d at 808 (citing *Alabama By-Products Corp. v. Neal*, 588 A.2d 255, 258 & n.1 (1991)).

[9]Trial Transcript at 455, Direct Examination of Richard S. Braun (June 10, 1997). Braun explained that this $100 per share valuation difference overlaps the valuation differences created by the addition of a control premium (discussed in section III(C) of this opinion) and the treatment of cash and cash equivalents (discussed in section III(B) of this opinion).

[10]Weber Industries, Inc., Valuation Analysis as of September 15, 1992, at 26 (hereinafter "HLHZ Valuation Report").

[11]*See, e.g., Le Beau v. M.G. Bancorporation, Inc.*, Del. Ch., C.A. No. 13414, 1998 WL 44993 at *2, mem. op., Jacobs, V.C. (Jan. 29, 1998)(rejecting petitioners' valuation on other grounds); *Wacht v. Continental Hosts, Ltd.*, Del. Ch., C.A. No. 7954, 1994 WL 525222 at *7, mem. op., Chandler, V.C. (Sept. 16, 1994)(valuation in a non-appraisal case).

[3] FWI's sources of capital on the merger date, which were weighted and averaged by both experts to determine FWI's WACC, were common equity and debt. Buettell calculated FWI's cost of equity by employing the capital asset pricing model ("CAPM"), which he termed "[t]he most widely used method of estimating the cost of common equity."[12] The CAPM has been accepted by this Court as an appropriate method by which to determine a company's cost of equity for the purposes of calculating its WACC.[13] The CAPM generally employs 3 factors: (1) risk free rate of return, which is the expected return on an investment that poses no risk of default, (2) the equity risk premium, which compensates investors for risks inherent in common stock investments generally, and (3) beta, which is a measure of a stock's volatility as compared with the stock market as a whole. Buettell used the yield, as of the merger date, on newly issued, long-term U.S. Treasury bonds as the risk free rate of return, and he used "the historical average premium of common stock total returns over long-term Treasury bond yields"[14] as the equity risk premium. This Court has previously stated that these are appropriate figures to plug into the CAPM formula.[15]

The remainder of Buettell's calculations, however, were not clearly explained in his Valuation Report or at trial. Although Buettell stated that the numbers he used to represent FWI's beta and cost of debt "were based on the comparative analysis summarized in the Market Capitalization section of [the] report,"[16] the actual numbers used do not appear to be listed in, or calculable from the information that is listed in, Buettell's Valuation Report. Neither were these numbers provided at trial. Although, for privately held companies, beta *must* be an estimate based on the betas of comparable, publicly traded companies,[17] the same is not true for the cost of debt. Buettell did not indicate why he felt it would be more appropriate to estimate FWI's cost of debt based on the cost of comparable companies' debt than to use FWI's actual cost of debt.

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[12]HLHZ Valuation Report at 27.

[13]*See, e.g.*, ***Le Beau***, 1998 WL 44993 at *2, *4 (rejecting petitioners' and respondents' valuations on other grounds); ***Gilbert v. MPM Enters., Inc.***, Del. Ch., C.A. No. 14416, 1997 WL 633298 at *7 n.30, mem. op., Steele, V.C. (Oct. 9, 1997).

[14]HLHZ Valuation Report at 28.

[15]*See, e.g.*, ***MacLane Gas Co., L.P. v. Enserch Corp.***, Del Ch., C.A. No. 10760, 1992 WL 368614 at *1, mem. op., Chandler, V.C. (Dec. 11, 1992). *See also* SHANNON P. PRATT ET AL., VALUING A BUSINESS 174-75 and Ex. 9-7 (3d ed. 1996).

[16]HLHZ Valuation Report at 28.

[17]"[B]ecause of a lack of regularly quoted market prices for their stocks, betas for closely held companies cannot be measured directly." PRATT ET AL., VALUING A BUSINESS 135. *See also, e.g.*, ***Gilbert***, 1997 WL 633298 at *8.

Similarly, I cannot discern exactly how Buettell chose to weight FWI's cost of equity and debt, although this decision was also based on the capital structures of comparable companies.[18] Finally, Buettell's overall conclusion was vague. The Valuation Report stated: "In summary, our analysis yielded an estimated cost of equity for Weber ranging from 18 percent to 20 percent, and a WACC ranging from 14 percent to 16 percent."[19] Buettell provided no supporting explanation or analysis for his conclusion. For instance, I do not know why Buettell's calculations yielded a range rather than a single number. Based upon the range of WACCs, Buettell decided that the appropriate discount rate was 15%. Given the dearth of information he provided, however, I cannot assess the quality of Buettell's assumptions and cannot accept his suggested discount rage.

Braun calculated FWI's WACC twice, using two different methods to calculate the cost of equity, and averaged the two results to determine the total WACC. Braun's discount rage equals the total WACC plus 3%. Braun first calculated FWI's cost of equity using the CAPM, the same method Buettell used. Like Buettell, Braun used the U.S. Treasury bond rate as of the merger date as the risk free rate, and "the average historical spread between common stocks and long-term government bonds,"[20] as the equity risk premium.[21] Braun used the median beta of comparable companies as FWI's beta. This is the customary method of determining a beta for a privately held company.[22] Unlike Buettell, Braun also added a small stock risk premium to his CAPM. A small stock premium is appropriate to reflect that "on average, smaller companies have higher rates of return than larger companies."[23] This Court has accepted the addition of

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[18]Trial Transcript at 199, Direct Examination of Ben A. Buettell, June 9, 1997 ("[We] selected what we thought was an appropriate blend of debt to equity based on the comparable companies.").

[19]HLHZ Valuation Report at 28.

[20]Weber Industries, Inc., Fair Market Value Opinion, at 31 (hereinafter "WMA Valuation Report"). Braun obtained these figures from the Ibbotson and Sinquefeld treatise *Stocks, Bonds, Bills & Inflation* 1992 yearbook (Chicago: Ibbotson Associates, 1992). *Id.*

[21]I use Buettell's label, "equity risk premium," instead of Braun's label, "market risk premium," for readers' convenience.

[22]"The most common procedure in using CAPM to develop a discount rate for a privately held company is to derive an estimate of betas from publicly traded guideline companies, most often guideline companies in the same industry as the subject company." PRATT ET AL., VALUING A BUSINESS 175. *See also, e.g., Gilbert*, 1997 WL 633298 at *8.

[23]PRATT ET AL., VALUING A BUSINESS 171 (footnote omitted). "A substantial body of published research indicates that the size of the company is important in that stocks of smaller companies are riskier than larger ones and that small-company stocks command a higher expected rate of return in the market." *Id.* at 176. Pratt suggests using the Ibbotson and Sinquefield treatise that Braun used to determine the appropriate size premium. *Id.*

small stock premia.[24] Braun used "the average historical spread between small stock total returns and common stock total returns,"[25] as the small stock risk premium. These inputs yielded a cost of equity of 16.8%.

Braun then calculated FWI's cost of equity a second time, using a "bottom up" or "build up" method. This method differed from the CAPM in only one respect: it did not employ beta. Using exactly the same numbers, other than beta, Braun concluded that FWI's cost of equity was 19.5%. Braun offered no explanation for his use of this method. The CAPM would seem to be more useful than the "build up" method because it offers more complete information. Specifically, the CAPM includes a measure of a stock's systematic risk, or its tendency to rise and fall relative to the market. I can see no reason, and Braun provided none, why this information should not be considered if it is known. Thus, I exclude from consideration the cost of equity Braun calculated using the "build up" method. For the reasons stated above, however, I find support for all of Braun's inputs under his CAPM calculation. Accordingly, I accept that FWI's cost of equity, for the purposes of calculating its WACC, is 16.8%.

Braun next determined FWI's cost of debt. Unlike Buettell, however, Braun purported to use FWI's "Actual Cost of Debt per Weber's Financials"[26] rather than an estimated cost of debt based on comparable companies' cost of debt. The number Braun used as FWI's "actual" cost of debt was 9%. I agree that, if known, it is desirable to use a company's actual cost of debt.[27] However, for reasons that shall be explained below, in section VI(A) of this opinion, I find that FWI's "actual" cost of debt was not 9%. The parties shall calculate FWI's actual cost of debt, for purposes of FWI's WACC, in the same manner as FWI's actual cost of debt for purposes of an award of post-merger interest.[28]

Finally, Braun weighted FWI's cost of debt and equity in accordance with FWI's actual capital structure on the date of the merger: 98% equity and 2% debt. As with all other areas of business valuation, this Court

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[24] *Le Beau*, 1998 WL 44993 at *2, *9 (rejecting petitioners' and respondents' valuations on other grounds).

[25] WMA Valuation Report at 31. Braun obtained these figures from the Ibbotson and Sinquefeld treatise *Stocks, Bonds, Bills & Inflation* 1992 Yearbook (Chicago: Ibbotson Associates, 1992). *Id.*

[26] WMA Valuation Report Ex. VII(B).

[27] As Braun realized, the WACC should be calculated using the tax-free cost of debt. WMA Valuation Report at Ex. VII(B). *See also, MacLane*, 1992 WL 368614 at *1. In his CAPM-based WACC, however, it appears that Braun forgot to use the tax-free cost of debt, plugging in 9% rather than 5.8%. WMA Valuation Report at Ex. VII(B). However, this was likely an oversight, as the appropriate rate was used in his "build up"-based WACC. *Id.* at Ex. VII(C).

[28] I have provided direction on this point in section VI(A) of this opinion.

prefers to use a company's actual information when possible, unless it is shown that the actual information would yield unreliable results.[29] As no one has suggested any reason that FWI's actual capital structure should not be relied upon in determining its WACC, I accept Braun's weighting method.

Braun added a 3% "company specific risk premium" to the WACC. An investment specific premium may be appropriate to account for risks not captured in the equity risk premium and the small size premium.[30] Unlike those two premia, which are commonly determined by reference to the published results of empirical research, a company specific risk premium "remains largely a matter of the analyst's judgment, without a commonly accepted set of empirical support evidence."[31] Thus, the factors relied upon in assessing an investment specific premium should be carefully explained to the Court. As with all aspects of a party's valuation for purposes of section 262, the proponent of a company specific premium bears the burden of convincing the Court of the premium's appropriateness.[32]

Braun's support for the extra premium was limited to two differing, conclusory statements. Braun's Valuation Report merely states that this extra premium was necessary to reflect "the risk we believe was inherent in management's projections."[33] At trial, Braun's argument in support of the company specific premium changed entirely, and he stated that this was necessary because FWI was "much more geographically constrained than was the case in the public companies that we looked at...."[34] Braun did not explain, however, exactly how either of his proposed reasons for adding the extra premium translated into greater risk. Moreover, if a company specific risk premium is to be added at all, it is to be added in as a cost of equity, to be given its appropriate weight in a company's capital structure and averaged with the cost of debt; it is not appropriate to tack the full premium onto the WACC.[35] I find that Respondent has failed to carry its burden of proving the appropriateness of adding a 3% company specific risk premium.

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[29]*See In re Radiology Assocs., Inc.*, 611 A.2d 485, 493 (1991)(using actual debt to equity ratio rather than hypothetical based on industry average).

[30]PRATT ET AL., VALUING A BUSINESS 164.

[31]*Id.*

[32]*Gilbert*, 1997 WL 633298 at *2, *4; *Pinson*, 1989 WL 17438 at *6.

[33]WMA Valuation Report at 32.

[34]Trial Transcript at 453, Direct Examination of Richard S. Braun (June 10, 1997).

[35]PRATT ET AL., VALUING A BUSINESS 174-78.

B. Treatment of Cash and Cash Equivalents

In preparing their respective company valuations, both parties' experts relied on financial statements produced by FWI, without making their own assessments of the statements' accuracy. According to those statements, FWI had approximately $14 million in cash and cash equivalents on its balance sheet as of the merger date. Respondent's expert, Braun, concluded that the cash was needed to meet future working capital requirements and treated the cash as an operating asset. Petitioners' expert, Buettell, however, concluded that the amount of cash far exceeded FWI's typical working capital requirements. He therefore treated $10 million as a non-operating asset. That is, Buettell temporarily excluded the $10 million from consideration when calculating FWI's value using the market capitalization approach and the discounted cash flow approach. Buettell then added the entire $10 million to *both* the market capitalization value and the discounted cash flow value, which were then averaged to obtain FWI's total value as a going concern. This treatment of FWI's cash and cash equivalents accounts for approximately $52 of the $120 per share difference between the two experts' valuations.[36]

Braun based his conclusion that the cash was needed to meet future working capital expenses on information he acquired from FWI's management. Wunderlich, FWI's CFO, explained in a letter to WMA that the particular nature of FWI's business required the company to accumulate cash beginning in 1991. Specifically, FWI accumulated cash to prepare itself for the potentially significant effects of two pieces of environmental legislation that would be considered in the next two years, for the purchase of additional quarry locations and for capital improvements such as upgrading an aggregate crushing facility and purchasing necessary equipment.[37] Braun also discerned from FWI's financial records that the historic level of cash on its balance sheet was between $6 million and $17 million at any point in time. Because $14 million fell within that historical range, Braun found it reasonable to treat the cash as an operating asset consistent with past practices.

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[36]Trial Transcript at 483, Direct Examination of Richard S. Braum (June 10, 1997). Braun explained that this $52 per share valuation difference overlaps the valuation differences created by the differing discount rates (discussed in section III(A) of this opinion) and by the addition of a control premium (discussed in section III(C) of this opinion).

[37]Letter from John D. Wunderlich, Executive Vice President and Chief Financial Officer, Fred Weber, Inc., to Scott D. Levine, Willamette Management Associates (Nov. 27, 1996).

Buettell, who had relied on the financial statements' accuracy for all other aspects of his valuation, decided that the company's cash on hand was excessive. Buettell did not have the benefit of a meeting with FWI's management, and he provided scant support for his treatment of the cash as "excess" in his Valuation Report. He stated only that: "Through an analysis of the Comparables' cash and working capital positions, we determined that Weber's excess cash level was approximately $10,000,000 as of the Valuation Date." Thus, on initial reflection, Braun's conclusion appears to have more factual support and to be more logically based than the conclusory view of Buettell.

Petitioners, however, argue that Buettell's decision to treat $10 million of FWI's cash as "excess" happens to be supported by two statements in AGE's January 31, 1992 Valuation Report. In that report, AGE stated that for the foreseeable future, FWI's annual expenses for "property, plant and equipment" would be slightly larger than its historical expenses and that the company's cash on hand exceeded "the seasonal cash requirement of the business by $11-13 million."[38]

A.G. Edwards did not compile its report to determine the fair value of Industries' shares in the context of an appraisal action following a merger. It prepared an annual valuation for ERISA purposes. Furthermore, the statement that the expenses would be slightly larger than historical would seem to support Respondent, as the $14 million cash on hand as of the merger date certainly fell within the historical range of cash commonly kept on hand for expenditures. Finally, I do not believe A.G. Edwards intended the statement that the cash on hand exceeded FWI's "seasonal cash needs" to constitute a conclusion that some of FWI's cash was "excess" or "non-operating." When the statement is read in context, it is clear A.G. Edwards merely concluded that having a cash amount that exceeded "seasonal" requirements reflected FWI's excellent general financial condition, not that the cash was "excessive" in the context of share valuation.[39] For these reasons, I cannot fairly draw the inferences Petitioners wish me to draw from the two selected statements in A.G. Edwards' ERISA valuation. Therefore, A.G. Edwards' statements have no significance to the determination of the fair value of Petitioners' shares.

Petitioners also argue that Wunderlich's claim that FWI needed to accumulate cash in 1992 is inconsistent with FWI's post-merger actions. Specifically, Petitioners note that FWI repaid its $17 million loan from Boatmen's Bank within 15 months after the merger and awarded employee

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[38]Analysis to Determine the Fair Market Value of the Common Stock of Weber Industries, Inc., as of January 31, 1992 at 11, 19.

[39]*Id.* at 19.

bonuses of approximately $1.5 million three months after the merger. Respondent concedes that, although the funds were initially accumulated to cover capital expenditures, FWI's board, in its sound business judgment, decided that the funds would be better spent retiring debt and paying employee bonuses. Respondent explained that these actions were consistent with FWI's history of maintaining very low levels of debt and of rewarding employees for the company's success.[40] The pending environmental legislation did pass, as management had feared, and FWI did make the anticipated expenditures after it repaid the Boatmen's Bank loan. Thus, these post-merger actions do not cause me to discount Braun's or Wunderlich's otherwise persuasive testimony supporting the view that the cash was needed to meet future expenses and could not fairly be treated as "excess" for share valuation purposes.

C. Control Premium

Industries was a holding company whose primary asset was 100% of FWI's Class A common stock, which represented approximately 90% of FWI's value. Petitioners' expert, Buettell, determined that Industries' value was equal to the value of the Class A common shares, plus a 20% control premium to reflect Industries' controlling interest in FWI. The addition of a control premium accounts for approximately $65 of the $120 per share difference between the two experts' valuations.[41]

[4] ***Rapid-American Corporation v. Harris***[42] presented an analogous situation. That case concerned the appraisal of an operating company, Rapid-American Corporation ("Rapid"), that received "99% of its net sales and most of its operating profits from three wholly-owned subsidiaries."[43] When Rapid's shareholders sought appraisal of their shares after a merger, the trial court valued each subsidiary separately by assessing the market price of shares in comparable, publicly-traded companies. However, the trial court refused to include a control premium to compensate the shareholders for their 100% ownership in the three subsidiaries. The shareholders appealed to the Supreme Court, arguing, among other things, that a control premium should have been added to the lower court's

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[40]On the merger date, FWI was capitalized with only 2% debt. WMA Valuation Report at 30.

[41]Trial Transcript at 446, Direct Examination of Richard S. Braun (June 10, 1997). Braun explained that this $65 per share valuation difference overlaps the valuation differences created by the differing discount rates (discussed in section III(A) of this opinion) and by the treatment of cash and cash equivalents (discussed in section III(B) of this opinion).

[42]Del. Supr., 603 A.2d 796 (1992).

[43]*Rapid-American*, 603 A.2d at 799.

valuation. The Supreme Court agreed that the value of the parent was worth more than just the sum of its parts.

> Rapid was a parent company with a 100% ownership interest in three valuable subsidiaries. The trial court's decision to exclude the control premium at the *corporate level* practically discounted Rapid's entire inherent value. The exclusion of a "control premium" artificially and unrealistically treated Rapid as a minority shareholder. * * * [T]he trial court's rejection of the "control premium" implicitly placed a disproportionate emphasis on pure market value.[44]

Thus, this Court recently stated: "a holding company's ownership of a controlling interest in its subsidiaries is an independent element of value that must be taken into account in determining a fair value for the parent company."[45]

[5] Respondent contends that a control premium should not have been added to Buettell's valuation because the merger effected no change in control. The Supreme Court rejected this argument in ***Rapid-American***, explaining that a control premium may be added not only when a third party acquires a majority interest in a corporation, but also as a means of making the valuation of a company more realistic.[46] This is what I believe the Supreme Court meant when it said: "[O]ne of the most important factors to consider [when assigning value to a Delaware corporation for purposes of an appraisal] is the very 'nature of the enterprise' subject to the appraisal proceeding."[47]

[6] Respondent also argues that a control premium should not be added in this action because Industries' shares were owned by an ESOP. In support of this argument, Respondent states that: (1) "ESOP participants, including Petitioners, will not receive the cash value of Industries' stock held in their ESOP accounts until they reach the retirement age of 65,"[48] (2) "ESOP participants are unable to sell the stock, but are only entitled to receive cash distributions in the amount of the value of the stock held in their ESOP accounts,"[49] and (3) "the price at which the stock must be

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[44] *Id.* at 806-07 (emphasis in original).
[45] *Le Beau*, 1998 WL 44993 at *11 (discussing *Rapid-American*).
[46] *Rapid-American*, 603 A.2d at 807.
[47] *Id.* at 805.
[48] Respondent's Post-Trial Answering Brief at 26 (hereinafter "Resp. Ansr. Br.").
[49] *Id.*

redeemed by the company is determined by an annual valuation performed by an appraiser chosen by the ESOP who must follow valuation principles under ERISA guidelines."[50] I fail to understand, and Respondent has failed to explain, how these points are relevant to the issue of Industries' value as a whole on the date of the merger. In ***Rapid-American,*** the Supreme Court explained that a control premium assigns value at the corporate level, to reflect the intrinsic value of the parent. The nature of the ownership of Industries' shares at the shareholder level seems irrelevant to that determination.

[7] I conclude that it is appropriate to add a control premium under the facts of this case and that Petitioners' expert, Buettell, chose an appropriate premium of 20%. I find no support for Respondent's contention that Buettell "fail[ed] to distinguish the rationale behind [his] 'control premium' and fail[ed] to justify the selection of 20%...."[51] Buettell analyzed the control premia paid for publicly-held companies between July 1, 1991 and June 30, 1992. He found that the mean premium was approximately 45% and that the median premium was approximately 55%. Because a portion of those premia reflected post-merger values expected from synergies, Buettell adjusted the premium down to 20%.[52] Buettell realized, of course, that the 25% to 35% discount could be considered somewhat arbitrary and subjective, as are many of the judgments appraisers make when valuing a corporation, but I agree with his expressed decision to select a 20% control premium because it was "based on all the relevant information"[53] available to him and is therefore a reasoned conclusion with factual support.

IV. VALUE OF FWI'S CLASS B SHARES

In their calculations, both parties' experts assumed that the value of the Class B stock was to be determined pursuant to Section 5.9 of FWI's by-laws. That section states that upon death, termination of employment or retirement, all Class B common shares must be offered to FWI for redemption,

> and [FWI], if it is legally able to so redeem such stock, must so redeem it at the book value thereof (with good will valued

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[50] *Id.*

[51] *Id.* at 29.

[52] *See Rapid-American,* 603 A.2d at 805 ("[A] court cannot assign value to any 'speculative' events arising out of the merger or consolidation."); *see also Cede & Co. v. Technicolor, Inc.,* Del. Supr., 684 A.2d 289, 297-99 (1996).

[53] Trial Transcript at 308, Re-Direct Examination of Ben A. Buettell (June 10, 1997).

> at One Dollar ($1.00)) as determined by the books of [FWI] as audited by its regular certified public accountant, as of the close of its last fiscal year prior to any such event requiring the offering of such stock for redemption.[54]

The by-laws also specify that FWI may, at its option, pay the employee in ten annual installments at 4% interest per annum. Deloitte & Touche, FWI's independent auditor, determined that the book value of the Class B stock was $202.83 per share on the most recent valuation date before the merger. The parties' experts multiplied this value by the number of outstanding Class B shares and subtracted the total from the aggregate value of FWI to arrive at the value of the Class A common shares.

In early September of 1992, Petitioner Devine informed FWI that he wished to redeem his 1,886 shares of Class B common stock. Although Devine had not been terminated and did not intend to quit or retire at that time, FWI agreed to redeem the shares at book value, or $202.83 per share. When FWI and Devine began to dispute whether he would be paid a lump sum or in installments, the redemption talks stalled. As of the merger date, Petitioner Devine still owned his Class B shares, and he voted them against the merger. Approximately one month after the merger, FWI informed Devine that it was still willing to redeem his Class B shares for book value, payable in ten installments at 4% interest.

Devine still has, and seeks appraisal of, his Class B common shares. Respondent concedes that Devine voted his shares against the merger and has otherwise complied with all of the requirements of Section 262. Nevertheless, Respondent argues that in an appraisal action, "the Court must take into account contractual limitations and restrictions of the stock being appraised."[55] Relying on this Court's decision in ***In re Appraisal of Ford Holdings, Inc., Preferred Shares***,[56] Respondent contends that Section 5.9 of FWI's by-laws specifies the formula by which "fair value" is to be calculated. Petitioners, also relying on ***Ford Holdings***, contend that FWI's by-laws apply only to redemptions and do not control the means by which "fair value" will be calculated in an appraisal action.

Ford Holdings involved the appraisal of various series of preferred stock, which, for ease of reference, shall be lumped into two groups: Cumulative Preferred and Auction Preferred. The preferred shares were cashed out in a merger, and certain holders dissented and sought appraisal of their shares. The respondent corporation argued that the method for

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[54]By-Laws of Fred Weber, Inc., § 5.9(2).
[55]Resp. Ansr. Br. at 30.
[56]698 A.2d 973 (1997).

calculating the "fair value" of the preferred shares in the event of a merger had been specified in the shares' Certificates of Designation and that the petitioners were entitled to no more. The petitioners argued that "fair value" cannot be fixed by contract because the right to have this Court determine the fair value of shares in an appraisal proceeding is mandated by statute. Alternatively, the petitioners argued that "fair value" had not been fixed by the Designations at issue.

[8-10] Chancellor Allen concluded that the "fair value" of preferred shares, for the purposes of an appraisal action, may be fixed in the Certificate of Designation.

> [P]roperly expressed terms of a Certificate of Designation of preferred stock may establish the consideration to which holders of the stock will be entitled in the event of a merger and, when the documents creating the security do so, that the amount so fixed or determined constitutes the "fair value" of the stock for the purposes of dissenters' rights under Section 262 of the Delaware General Corporation Law.[57]

Thus, in effect, a purchaser of preferred shares may contract away his or her right to have this Court determine the shares' fair value. Such a contractual waiver will be found, however, only when clearly and affirmatively expressed in the documents creating the security, and ambiguities will be resolved against the issuer.[58] When considered in light of these standards, Chancellor Allen found that only "the Designations of the Cumulative Preferred clearly [and unambiguously] describe[d] an agreement between the shareholders and the company regarding the consideration to be received by the shareholders in the event of a cash-out merger."[59]

It is not clear whether ***Ford Holdings*** applies to this case, where the shares being appraised are common, as opposed to preferred, and where the "contractual provision" at issue is found in a corporation's by-laws rather than in the document creating the security.[60] The Court need not reach those issues today, however. Even if ***Ford Holdings*** otherwise applied, the

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[57]*Ford Holdings*, 698 A.2d at 974.

[58]*Id.* at 977-78.

[59]*Id.* at 978.

[60]Respondent explained that the method for calculating fair value in a redemption was not only fixed in the by-laws, but was initially included on the back of the Class B securities as well. Petitioners, however, note that the Class B shares were re-issued in 1992 without the restriction. Given the Court's decision in this case, these facts are irrelevant.

by-law provision Respondent relies upon here would not satisfy the requirement that the waiver clearly and unambiguously fix the fair value of Class B shares for purposes of an appraisal action. The provision expressly applies to redemptions and only redemptions; it does not contemplate a merger and later appraisal. Thus, Section 262 general methodology controls, and Petitioner Devine is entitled to have this Court determine the fair value of his FWI Class B shares.

At present, there is no evidence in the record from which this Court can make such a determination. Furthermore, both parties' experts relied on the value of FWI's Class B shares to determine the value of its Class A shares. Although the parties and their experts can now calculate FWI's fair value as a going concern on the merger date consistent with the findings in this opinion, it is not clear to the Court how the fair value of the Class A and B shares will then be determined. Specifically, the parties and their experts must consider the value of a Class B share relative to a Class A share or, stated another way, whether a Class B share has the same, a higher, or a lower value than a Class A share. I recognize that the parties and their experts may have differing views on this point, and I will accept further briefing on the issue, if necessary, in accordance with a briefing schedule agreeable to the parties.

V. MORE RECENT FINANCIAL DATA

Respondent's expert, Braun, considered FWI's financial data as of July 31, 1992. These figures were more recent than the financial data Petitioners' expert, Buettell, considered. Buettell's figures reflected FWI's condition as of April 30, 1992. Petitioners argue that this fact is of no consequence to the experts' respective valuations because Respondent failed to identify any significant differences in the two sets of data and because Buettell testified, after reviewing the more recent data, that it did not affect his valuation. Because the Court's goal in an appraisal action is to determine the fair value of stock on a specific date, it prefers to consider data reflecting the issuing company's value as close to that date as possible. This is true unless it can be proved that, because of some irregular event, the more recent data is not as representative of the company's value. In this case, there has been no allegation that the July 31, 1992 figures contain irregularities that would warrant their exclusion from consideration. Buettell suggested only that the more recent information may not have been made available to him. That information is available to Buettell now, however, and both parties shall consider the July 31, 1992 figures when preparing the proposed final Order in this action.

VI. INTEREST

Petitioners contend that this Court should award post-merger interest at the rate that would have been earned by a prudent investor during the pendency of this action. Petitioners explain that, at the time of the merger, ESOP participants were able to allocate their assets among four funds. Petitioners argue that a prudent investor would have allocated his assets among the funds in this manner: 15% in the Money Market fund, 15% in the Bond fund, 35% in the Index fund, and 35% in the Value Equity fund. Based on the actual rates of return on these four funds since the merger, Petitioners argue that the prudent investor's rate of return would have been 12.5%. Petitioners also ask the Court to award compound interest "based both on the evidence in the record and on the Court's recent precedent."[61]

Respondent proposes an interest rate calculated by the equal weighting of (1) the prudent investor rate, (2) FWI's cost of debt, and (3) the legal rate of interest. Respondent suggests that the prudent investor rate should be 9.3%, "the actual rate of return achieved by the ESOP participants on an aggregate basis over the period of time in which this action was pending."[62] As of August 1, 1996, ESOP participants were able to allocate their assets among seven funds, not just four. Accordingly, Respondent's prudent investor rate includes returns on investments in all seven funds. Respondent contends that I should find FWI's cost of debt to be 6.97% because Wunderlich, FWI's CFO, testified that FWI's actual, weighted cost of debt between January of 1993 and January of 1997 was 6.97%. It is not clear why Wunderlich did not consider FWI's actual cost of debt between September 15, 1992, the merger date, and January of 1993. Finally, Respondent asks me to award simple interest.

If I should find that the appropriate interest rate should be determined by blending the prudent investor rate and the corporate cost of debt, Petitioners ask that I find the corporate cost of debt to be 9%, the amount listed in WMA's Valuation Report as FWI's "Actual Cost of Debt per Weber's Financials."[63] As explained earlier in this opinion, the method by which Braun determined this rate was not explored at trial or in his Valuation Report. Alternatively, Petitioners argue that the cost of debt should approximate the amounts FWI paid to commercial lenders in arm's length transactions during the relevant period. Petitioners argue that FWI paid arm's length transaction rates that varied from prime to a point or two over prime during the relevant period. Thus, Petitioners argue for the

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[61]Petitioners' Post-Trial Reply Brief at 21 (hereinafter "Pet. Reply Br.").
[62]Resp. Ansr. Br. at 33.
[63]WMA Valuation Report, Ex. VII(B).

higher end of the range and suggest a rate of at least 8.5%, or "two points over the average prime rate during the applicable period."[64] Petitioners also ask that the rates be blended 2/3 prudent investor rate to 1/3 corporate cost of debt, to reflect "that the Prudent Investor rate is the more important factor."[65]

[11] This Court has explained recently that an award of interest serves two, equally important purposes:

> First, the award compensates petitioner for the loss of the use of the fair value of his shares during the pendency of the proceeding. Second, the award forces the corporation to disgorge any benefits it obtained from the use of the fair value of petitioner's shares during the pendency of the proceeding.[66]

Petitioners' suggested interest rate addresses only the first of these goals. Respondent's suggested rate comes closer to fulfilling the dual goals of an award of interest. This Court has made clear, however, that the legal rate of interest is only used as the default rate when the parties fail to relate an adequate record.[67] Thus, subject to the additional parameters specified below, I award Petitioners interest on the fair value of their shares from the merger date to the payment date equal to the simple average of FWI's cost of debt and the prudent investor rate. The two rates shall be weighted equally because that most appropriately reflects that the dual goals of an award of interest are of equal importance.[68] The interest shall be adjusted and compounded monthly.[69]

A. Interest Determination for Industries Common

At the time of the merger, all ESOP participants could allocate their assets among four funds: the Money Market Fund, the Bond Fund, the Index Fund and the Value Equity Fund. Three additional funds were made available to ESOP participants between 1994 and 1996. The non-

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[64]Pet. Reply Br. at 20.

[65]*Id.*

[66]*Gilbert*, 1997 WL 633298 at *9.

[67]*See Grimes v. Vitalink Communications Corp.*, Del. Ch., C.A. No. 12334, 1997 WL 589036 at *1, mem. op., Chandler, C. (Sept. 17, 1997).

[68]There may be conditions under which the two factors should not be equally weighted, but those conditions are not met here. *See Grimes v. Vitalink Communications Corp.*, Del. Ch., C.A. No. 12334, 1997 WL 538676 at *9, mem. op., Chandler, V.C. (Aug. 26, 1997).

[69]*See Grimes*, 1997 WL 589036 at *1, *Le Beau*, 1998 WL 44993 at *12-13; *Gilbert*, 1997 WL 633298 at *9.

dissenting employees of FWI, thus, recently have been able to allocate their assets among as many as seven funds. Because I cannot know how Petitioners would have allocated their assets had the funds been available, and cannot speculate, I will assume an allocation of Petitioners' assets among the four original funds in the precise manner they were allocated on the date of the merger, and the prudent investor rate shall be the actual interest rate earned on those funds since the merger date, adjusted and compounded monthly.[70] Management fees, and any other applicable fees, shall be charged against Petitioners' accounts in the same manner that they were applied to the accounts of all other participants in the same four funds. This approach will most precisely compensate Petitioners for their loss of use of the fair value of their shares, with the least amount of speculation on the Court's part.

While it is generally appropriate to consider a company's actual cost of debt when determining an award of interest, the "actual" cost of debt advanced by Wunderlich, 6.97%, is inappropriate for two reasons. First, it inexplicably fails to account for the period between the merger date and January of 1993. Second, it includes "all of the redemption rates of interest for the Class A and Class B stock that were determined not by an arm's-length negotiation with a bank but by a predetermined rate spelled out in the bylaws."[71] This rate does not reflect solely FWI's cost of debt, and its inclusion in Wunderlich's calculation distorts his suggested rate. Wunderlich's proposed rate should be adjusted to reflect the actual rates FWI has paid to banks, commercial lenders and other persons or entities, in arm's length transactions, since the merger date.

B. Interest Determination for FWI Class B Common

Petitioners have not addressed the interest that should be awarded to Petitioner Devine on his shares of FWI Class B common. Respondent argues that the rate must be set at 4%, the rate to be paid, pursuant to the by-laws, to former employees when the redemption value of their shares is to be paid in installments. I have already explained that the by-laws do not control any aspect of the Court's appraisal of Devine's Class B shares.

The interest rate shall be the same as that applied to the fair value of Petitioners' Industries shares -- an equal weighting of FWI's cost of debt and the prudent investor rate, adjusted and compounded monthly -- except that: the prudent investor rate will undoubtedly differ from the rate

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[70]By this I mean the actual interest rate earned on each, individual fund.

[71]Trial Transcript at 387, Cross Examination of John D. Wunderlich (June 10, 1997).

calculated for the purpose of valuing Industries' common shares. As there is no evidence in the record concerning the rate a prudent investor would have earned if he had the use of the fair value of the FWI Class B common shares since the merger date, the parties shall confer and agree on the appropriate rate or submit their supplementary support for their respective, differing views.

VII. ATTORNEYS' FEES AND COSTS

Petitioners argue that "as a matter of equity and because of [FWI's] bad faith, [FWI] should be ordered to pay Petitioners' attorneys' fees and costs."[72] In the alternative, Petitioners ask "that all of those fees and costs be charged pro rata against the value of all ESOP owned Industries' shares entitled to an appraisal in this case and paid from the common fund before payment to the ESOP."[73] Respondent disputes Petitioners' allegations of bad faith but agrees in principle to Petitioners' proposal for paying their attorneys' fees and costs out of the funds awarded as fair value, provided certain conditions are met. Petitioners are confident that Respondent's conditions can be met and that the parties will be able to reach an agreement.

[12] The general rule is: "In the absence of an equitable exception, the plaintiff in an appraisal proceeding should bear the burden of paying its own expert witnesses and attorneys."[74] Petitioners argue that Respondent's bad faith is the equitable exception applicable to this case. I find that Petitioners have failed to establish Respondent's bad faith by a preponderance of the evidence and that there is no basis upon which I may award attorneys' fees and costs other than as the parties may agree. I shall not, however, prevent the parties from working out some other arrangement for the payment of Petitioners' attorneys' fees and costs. If the parties can reach an agreement on this issue, they may include those terms in a proposed final Order, and I will approve it. I shall express no opinion, however, on the enforceability of those terms under ERISA or other applicable federal law.

VIII. CONCLUSION

The parties shall confer and submit an agreed form of Order containing a valuation consistent with the following findings:

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[72]Pet. Reply Br. at 22.
[73]Petitioners' Opening Post-Trial Brief at 20.
[74]*Cede*, 684 A.2d at 301.