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The Delaware Court of Chancery

Selected Business Valuation Case Summaries

Selected Summaries of 2022 Decisions

Introduction

Kroll experts testify on commercial and shareholder disputes across the country, including in the Delaware Court of Chancery (the "Court" or the "Chancery Court"). The Chancery Court is widely recognized as one of the nation's leading business courts in terms of volume of complex business-related cases. As a result, the Court has developed significant case law in this area.

This high volume of business cases results in the Court issuing numerous opinions, many of which address business and security valuation and economic damages.

In this Court case update, we focus on five opinions from 2022 to highlight how certain valuation and damages analysis topics are viewed by the Court.

In our review of the cases herein, we do not summarize every relevant issue but rather focus primarily on certain topics related to valuation and damages. We recommend that interested readers review the full Court opinions to gain a complete understanding of all the issues addressed and each judge's position. We have included a hyperlink to each decision below its case caption.

In this Court case update, we summarize the following cases:

Delaware Court of Chancery

BCIM Strategic Value Master Fund, LP v. HFF, Inc.
C.A. No. 2019-0558-JTL (Del. Ch. February 2, 2022)
Vice Chancellor Laster
Issues: discounted cash flow (DCF) method, unaffected market price, deal price, synergies
Click here to view the opinion

In re Cellular Telephone Partnership Litigation
C.A. No. 6885-VCL (Del. Ch. March 9, 2022)
Vice Chancellor Laster
Issues: guideline companies method, comparable transactions method, DCF method, tax rate, discount rate, long-term growth rate
Click here to view the opinion

In Re BGC Partners, Inc. Derivative Litigation
C.A. No. 2018-0722-LWW (Del. Ch. August 19, 2022)
Vice Chancellor Will
Issues: event study, guideline companies method, comparable transactions method, dividend discount model
Click here to view the opinion

Ramcell, Inc. v. Alltel Corporation d/b/a Verizon Wireless
C.A. No. 2019-0601-PAF (Del. Ch. October 31, 2022)
Vice Chancellor Fioravanti
Issues: DCF method, projections, discount rate, terminal value
Click here to view the opinion

Edward Deane, et al. v. Robert A. Maginn, Jr., et al.
C.A. No. 2017-0346-LWW (Del. Ch. November 1, 2022)
Vice Chancellor Will
Issues: DCF method, projections, guideline companies method, option pricing model
Click here to view the opinion

Case Summary

***BCIM Strategic Value Master Fund, LP v. HFF, Inc.*, C.A. No. 2019-0558-JTL (Del. Ch. February 2, 2022)**

In this matter, BCIM Strategic Value Master Fund, LP ("BCIM" or "Petitioner") owned shares of common stock in HFF, Inc. ("HFF" or "Respondent"). On July 1, 2019, Jones Lang LaSalle ("JLL") acquired HFF through a reverse triangular merger (the "Merger"). Under the terms of the Merger, each share of common stock was converted into the right to receive $24.63 in cash and 0.1505 shares of JLL stock. When the parties agreed on a price in February 2019, the exchange ratio implied a value of $24.83 per JLL share, resulting in aggregate deal consideration of $49.46 per share ($24.63 in cash, plus $24.83 in JLL stock). When the parties announced the executed Merger agreement on March 19, 2019, JLL's implied stock price had declined to $24.53. By the date of closing, JLL's implied stock price had declined further to $21.24, resulting in aggregate deal consideration of $45.87 per share.

The Petitioner pursued its right to an appraisal and proffered two valuation methodologies to establish HFF's fair value: a traditional discounted cash flow ("DCF") methodology resulting in a fair value of $56.19 per share and an analysis of HFF's unaffected trading price adjusted to reflect changes attributable to the company's performance after announcement of the Merger resulting in a fair value of $58.68 per share. The Petitioner placed 90% weight on the DCF methodology and 10% weight on the adjusted trading price analysis, resulting in a fair value determination of $56.44 per share. Alternatively, JLL argued in favor of using the deal price at the time of signing, adjusted to reflect the amount of net synergies allocated to HFF resulting in a fair value of $44.29 per share.

The Court noted that it has endorsed using the deal price in an arm's-length transaction as an indicator of fair value. However, while a deal price that results from a reliable sale process often will provide the best evidence of fair value, the Court also noted that it has maintained that "there is no presumption in favor of the deal price." As such, JLL bore the burden of proving its reliability in this case. The Court found that while the sale process was not perfect, it was proven to be "sufficiently effective" and therefore the deal price operated as a "ceiling on the fair value of [HFF] at the time of signing."

The Court then considered adjustments to the deal price, including "an estimate of the amount of synergies that were included in the deal price." JLL's expert opined that the deal price incorporated a net synergy value of $4.87 per share.

The principal dispute regarding an adjustment for synergies involved how to treat retention payments that JLL agreed to make to the company's senior managers and sales professionals in connection with the Merger. The Petitioner argued that "those payments represent consideration that otherwise would have gone to the stockholders and hence should be added to the deal price." Under this approach, the Court would add 100% of the value of the retention payments to the adjusted deal price. JLL's contention was that "the payments were a cost

that the acquirer had to incur to close the transaction and generate the net synergies it shared with the Company." Under this approach, the payments are factored into the calculation of net synergies, and then a percentage of that amount is allocated to the company and deducted from the deal price.

The Court found that "treating the retention payments as a dis-synergy is the more persuasive methodology" and "JLL's approach also recognizes that the retention payments were a cost that JLL had to pay to achieve the net synergies in the deal, which warrants treating the retention payments like other transaction costs." To value the net synergies, JLL's expert used a DCF model and calculated a present value of the synergies of $371.2 million. Petitioner's expert argued that this DCF model "failed to account for the recognized fact that revenue synergies are harder to realize than cost synergies" and that JLL's expert should have "either used different discount rates for the different synergies or probability-weighted his estimate." The Court noted that, while the Petitioner's argument had "conceptual appeal," the evidence demonstrated that JLL carefully documented its synergies, and it was not necessary to value the categories of synergies differently. To allocate the synergies, JLL's expert relied on a 2018 study by the Boston Consulting Group ("BCG") that found that shareholders of target companies capture 54% of the value of synergies on average. The Court explained that precedent supports the use of this methodology because in three prior cases, "this court has accepted expert opinions that allocated synergies based on the BCG study or a predecessor version of the report." As a result, JLL's expert determined that the deal consideration included $4.87 per share of synergies by multiplying the value of the net synergies ($371.2 million) by 54%, then dividing that amount ($200.4 million) by HFF's 41.165 million shares outstanding.

The Court determined that the deal price, as adjusted by synergies, "provides a persuasive indication of fair value at the time of signing." However, the operative question was "whether and how to adjust the deal price to reflect any changes in value between signing and closing." Petitioner's expert constructed an econometric model to generate an implied price for HFF's stock by running a regression analysis of the abnormal change in its stock price against the percentage by which its earnings per share beat or missed the consensus of the analysts who covered it in 2017 and 2018. Petitioner's expert also estimated the abnormal change in the HFF's stock price by conducting an event study that compared the change in the market price of its stock to the S&P 500 index and the Dow Jones U.S. Real Estate Index.

In the regression analysis, Petitioner's expert found a statistically significant relationship between the earnings surprise and the abnormal return. To generate an implied stock price, Petitioner's expert started with HFF's unaffected stock price of $46.51, using the closing price on the day before the merger announcement, then adjusted the stock price to reflect the performance of the indices. The model indicated that HFF's stock price would have traded at $58.68 after it beat earnings. JLL's expert replicated this analysis by using a larger data sample and his own index of peer companies, rather than the Real Estate Index. The Court adopted the Petitioner's analysis as adjusted by JLL's expert, which implied that the fair value of HFF rose by $2.30 at the time it beat earnings.

Petitioner's expert also relied on a DCF model. The Court determined that the Petitioner failed to prove the DCF model provided a sufficiently reliable indicator of the fair value. First, the DCF model suffered "because of a lack of management projections." HFF only prepared a one-year budget, so Petitioner's expert had to create projections. The Court found that Petitioner's expert "created a credible set of projections, but they were his own projections, and they were developed for purposes of litigation." Delaware cases express a strong preference for management projections prepared in the ordinary course of business and available as of the date of the merger. Petitioner's expert also utilized "middle-of-the-fairway" assumptions which the Court found acceptable and supported by precedent and finance theory, including (i) a perpetuity growth rate based on the midpoint of projected inflation and projected nominal GDP; (ii) interest rate on the 20-year U.S. Treasury Bond to calculate the

risk-free rate; (iii) various betas, taking into account standard error; (iv) a supply-side equity risk premium; and (v) a size premium.

Ultimately, the Court adopted the "more conservative" version of the adjusted market price analysis as adjusted by JLL's expert to estimate the change in HFF's value after signing. The Court found that the value of HFF increased between signing and closing by $2.30 per share, resulting in a fair value of $46.59 per share. This amount is less than the value that the parties negotiated at signing, but more than the value that the Petitioner would have received at closing.

Case Summary

In re Cellular Telephone Partnership Litigation, C.A. No. 6885-VCL (Del. Ch. March 9, 2022)

This matter involved Salem Cellular Telephone Company (the "Partnership"), a Delaware general partnership that held a license to provide cellular telephone services in a geographic area centered around Salem, Oregon. AT&T Mobility Wireless Operations Holdings LLC ("AT&T"), a wholly owned subsidiary of AT&T Inc., owned 98.119% of the Partnership, and the Plaintiffs were minority partners who collectively owned a 1.881% minority interest in the Partnership.

In October 2010, AT&T caused the Partnership to transfer its assets and liabilities to New Salem Cellular Telephone Company, LLC (known collectively with AT&T as the "Defendants"), an affiliate of AT&T Inc. recently formed as of the transfer date, for $219 million in cash. The Partnership then dissolved, and the Plaintiffs were provided their pro rate share of the liquidating distribution. After the transaction, the Defendants continued to operate the business of the former Partnership, with the transaction functioning as a freeze-out of the minority partners ("Freeze-Out").

The Plaintiffs asserted that AT&T breached its fiduciary duties by effectuating the Freeze-Out through an unfair process and by paying an unfair price. The parties agreed that the Freeze-Out was subject to the entire fairness standard of review; therefore, the Defendants bore the burden of proving that the Freeze-Out was entirely fair to the Plaintiffs. The Court ruled in favor of the Plaintiffs, as discussed herein. The Court opined that the fair value of the Partnership for purposes of the remedial award was $714 million, resulting in damages of $9.3 million.

The Court determined that AT&T failed to prove that it followed a fair process. Reasons included a lack of procedural protections to ensure fairness to the minority partners and the hiring of an outside valuation firm that, despite AT&T's claims that the firm was independent, had a longstanding relationship with AT&T and whose valuation outcome was "influenced" by AT&T personnel. The "influence" included AT&T withholding "important pieces of information" from the valuation firm and certain changes that were made after the valuation firm met with AT&T.

To prove the fairness of the Freeze-Out price, the Defendants relied on an expert rather than the Freeze-Out's contemporaneous valuation. The Court ruled that neither the original valuation firm nor the Defendants' expert "used persuasive valuation methodologies." The Court noted that the credibility of the basis for the Freeze-Out price was undermined because the Defendants presented an expert's valuation rather than presenting the contemporaneous valuation.

The Defendants' expert generated a valuation range for the Partnership of $171.34 million to $224.1 million based on a weighting of a comparable companies analysis, a comparable transaction analysis and a DCF analysis. The expert assigned a 50% weight to the DCF and a 25% weight to each of the other two methods.

The Court determined that the price was unfair because (i) the price failed to account for the value to which the Partnership was contractually entitled under a Management Agreement, as well as the litigation asset based on the Defendants' past breaches of the Management Agreement; (ii) contemporaneous documents generated by the Defendants indicated that the Partnership was worth considerably more than the Freeze-Out price; and (iii) the Defendants relied on unpersuasive valuation methodologies. We address point (iii) herein.

The Court detailed that the Defendants' expert's comparable companies and transaction analyses failed to generate reliable indicators of value. The Court stated that the comparable companies failed to compare to the Partnership because they were either too large, did not pursue the same line of business, were in different stages of their business life cycle, operated under a different business model, did not resemble the sale of a discrete entity with the same primary asset, or a combination of those factors. In addition, the Court stated that the Defendants' expert "rendered her [transaction] analysis suspect" by failing to use the actual transaction price and instead using an adjusted-transaction-price approach. For the public company transactions, the expert took the target company's stock price pre-transaction, applied a 15% control premium and deducted net debt. The Court stated that the Defendants failed to justify the use of the 15% control premium, as the Defendants' expert simply claimed that she had "been using that figure for years." For one of the private company transactions, the Court noted that the Defendants' expert's approach of combining historical data with "purely speculative" announced synergies for one company resulted in a depressed multiple. For another private company transaction, the Court stated that the expert's adjustments rested on a "mistaken reading of internal [buyer] documents and rendered her analysis unusable." The Court also referenced a report from the Defendants' expert in another case in which she provided "persuasive reasons" to disregard a comparable transaction analysis.

In the DCF analysis, the Defendants' expert utilized a flowshare model, which the Court described as a standard methodology used in the wireless industry to forecast market share. The Court determined that two of the starting inputs in the Defendants' expert's flowshare model were unreliable: (i) the number of existing subscribers at the beginning of the initial period and (ii) the population of the Partnership's market at the beginning of the initial period. Additionally, the Court noted that the Defendants' expert relied on a churn estimate used by the valuation firm in connection with the Freeze-Out, an estimate that the valuation firm itself "lacked confidence in." The Court also criticized certain revenue and cash flow assumptions made by the Defendants' expert.

In addition to the issues with projections described above, the Court determined that the Defendants' expert's perpetuity growth rate in the terminal period was "unreasonably low" because it was lower than forecasted inflation.

As a remedy, the Plaintiffs sought damages based on the present value of distributions that they would have received as minority partners but for the Freeze-Out, reflecting the value of their interests in the Partnership at the time of the Freeze-Out. While the Court adopted the Plaintiffs' basic approach to damages, it used a DCF model rather than the present value of forecasted distributions to quantify damages.

The Court used the DCF model prepared by the valuation firm in connection with the Freeze-Out, which was modified by the Defendants' expert. While the Court acknowledged that "embracing this model…creates some tension with [the Court's] earlier finding" that the outputs of the model did not provide fair price, the Court noted that this was due to errors in application. The Court made several adjustments to this DCF model to determine an estimate of damages. These adjustments impacted the projected cash flows, the tax rate, the discount rate and the growth rate used in the terminal period.

In adjusting the cash flows, the Court adjusted for certain "erroneous and unreliable" assumptions.

For the tax rate, the Defendants argued that AT&T's corporate tax rate should be used. The Plaintiffs

argued that no tax rate should applied given that the Partnership was a pass-through entity. Both sides argued that applying the *Delaware Open MRI* approach of a hypothetical tax rate was inappropriate in this matter. The Court acknowledged that the *Delaware Open MRI* method is one way of approximating the benefits of a pass-through entity status in a judicial valuation, but determined that in this case, both sides advanced "persuasive reasons" for not applying the method. The Defendants and their expert highlighted differences in the Partnership's investor base from the investor base in Delaware Open MRI. The Plaintiffs argued that the operative reality at the time of the Freeze-Out was that the investors in the Partnership could expect to receive distributions into perpetuity from an entity that did not pay entity-level tax. The Plaintiffs argued that applying a tax rate to the pass-through entity would result in a transfer of value from the eliminated minority investors to the controlling investors, which the Court stated is contrary to settled remedial principles. The Court acknowledged that while a "legitimate debate" exists about how to tax-effect a pass-through entity's cash flows, "[w]hat is not up for debate is the impropriety of using a corporate tax rate to tax effect a pass-through entity's cash flows." The Court concluded that a tax rate of 0% should be applied, noting that the Court's "ultimate task is not to value the plaintiffs' interest based on a hypothetical arm's-length sale of the Partnership...[but to] value a hypothetical alternative in which the investors could remain holders of Partnership interests based on the operative reality of the Partnership at the time of the Freeze-Out." The Court acknowledged that while the resulting damages award "risks overstating the value of the Partnership...it generates a responsible estimate," noting that once a breach of duty is established, "uncertainties in awarding damages are generally resolved against the wrongdoer" and this approach assures that AT&T would not enjoy the benefit that the Freeze-Out created.

In determining the discount rate, both experts used the Partnership's after-tax weighted average cost of capital (the "WACC"), but disagreed about five components: (i) the pre-tax cost of debt; (ii) the equity risk premium; (iii) whether to include a size premium; (iv) the Partnership's beta; and (v) the after-tax cost of debt.

Pre-Tax Cost of Debt

For the pre-tax cost of debt, both experts used Moody's average bond yields to calculate rates. The Plaintiffs' expert used the rate on A-rated debt securities, based on AT&T's A credit rating, and calculated AT&T's anticipated average cost of debt over the next five years, while the Defendants' expert used the rate on Ba1-rated debt securities as of the date of the Freeze-Out. The Court rejected the Plaintiffs' expert's approach, which did not use the rate as of the time of the Freeze-Out, and also rejected the Defendants' expert's rate, which was based on a "fictional" credit rating for AT&T. Instead, the Court used the pre-tax cost of debt for AT&T of 5.2%, based on the Freeze-Out valuation firm's valuation report for a different partnership that was prepared approximately 10 weeks before the Freeze-Out.

Equity Risk Premium

For the equity risk premium, the Court noted that each expert used a figure that was more favorable to the other side. The Defendants' expert used a rate of 5.2% from the "2010 Ibbotson SBBI Yearbook;" the Plaintiffs' expert used a rate of 6% from the "2011 Ibbotson SBBI Yearbook." While this opinion does not note which specific equity risk premium each expert used, the Court used the Plaintiffs' expert's rate, stating that the "2011 Ibbotson SBBI Yearbook" reported 2010 data, which "would have been in effect when the Freeze-Out took place."

Size Premium

The Court adopted the Defendants' expert's size premium of 2.99%, which was calculated as the 3.99% micro-cap size premium less 1% to reflect AT&T's involvement in the Partnership. The Plaintiffs' expert did not apply a size premium. While the valuation firm used in connection with the Freeze-Out also did not apply a size premium, the Court noted that it "achieved a similar result" through a higher beta that was adjusted to account for additional risk.

Beta

The Defendants' expert used the average 5-year weekly unlevered beta of a set of comparable companies, relevered using AT&T's capital structure. The Plaintiffs' expert used AT&T's five-year weekly levered beta. The Court agreed that AT&T's beta should be used, given that the Partnership was so intertwined with AT&T.

After-Tax Cost of Debt

In calculating the after-tax cost of debt, the Court adopted the Plaintiffs' expert's use of AT&T's marginal tax rate, rather than the Defendants' expert's use of AT&T's effective tax rate over a five-year period.

Lastly, the Court applied a perpetuity growth rate of 2.7%, reflecting the high end of the range for real growth in GDP. As discussed above, the Court rejected the Defendants' expert's use of a growth rate lower than forecasted inflation. The Court also rejected the Plaintiffs' expert's growth rate of 3%, stating that "conventional wisdom holds that a perpetuity growth rate should not exceed real growth rate.

Case Summary

In Re BGC Partners, Inc. Derivative Litigation, C.A. No. 2018-0722-LWW (Del. Ch. August 19, 2022)

This matter is a derivative action challenging the fairness of BGC Partners, Inc.'s ("BGC" or "Defendant") acquisition of Berkeley Point Financial, LLC from an affiliate of Cantor Fitzgerald, L.P. BGC is a publicly traded brokerage and financial technology company based in New York. Berkeley Point Financial, LLC was a private commercial real estate finance company. It was one of the few pre-approved agency lenders. Howard Lutnick was Chairman and CEO of both Cantor and BGC and had voting control of BGC. BGC purchased Berkeley Point Financial for $875 million and simultaneously invested $100 million in a Cantor Fitzgerald affiliate's mortgaged-backed securities business. The theory of the lawsuit is that Howard Lutnick caused BGC to undertake a deal that benefitted him at the expense of BGC's stockholders.

The key issue in this litigation was the underlying fairness of the transaction. Namely, Lutnick was on both sides of the transaction and had an incentive for BGC to overpay for the acquisition of Berkeley Point. A key element of the assessment of fairness was whether the price was fair.

Berkeley Point was acquired for $964.2 million, which included an $875 million initial deal, $66.8 million adjustment and $22.4 million true-up payment. The focus of the analysis was the initial deal price.

Defendants used an event study, comparable company analysis, and a dividend discount model to estimate a valuation of Berkeley Point between $772 and $1,489 million. Plaintiffs used a guideline transaction analysis to estimate that the maximum price of Berkeley Point should have been $725 million.

For the event study, Defendants considered BGC's stock price reaction to various events including the transaction announcement and close, and financial reports. Defendants concluded from this that there were no statistically significant stock price declines on the transaction announcement and close, suggesting that it was a fair price for the transaction. Plaintiffs countered this by stating that the market did not have enough information to fairly assess the transaction. The Court found that event studies were an imperfect method and gave little weight to the approach.

For the comparable company analysis, Defendants used three separate scenarios. The first was a comparable company analysis based on eight

companies. The Court disregarded this analysis due to Defendants not justifying the inclusion of the comparable companies. The second was a regression on a larger number of companies. The model was created by regressing price to book multiples on return on equity for the selected companies. Once again, the Court found that Defendants did not justify their selections and therefore the analysis was excluded. The last approach was an examination of one comparable company. It was generally accepted that this company was the closest comparable to BGC. Despite Plaintiffs' counterarguments, the Court found this analysis to be relevant.

The Defendants' final method was a dividend discount model, which is based on the Gordon Growth Model ("GGM"). GGM attempts to estimate value by assuming a dividend stream into perpetuity and discounting cash flows back at a given cost of equity. The Court disregarded this method as the GGM is not often used for real estate finance firms, BGC did not pay dividends, and Defendants' model neglected to account for many aspects of the mortgage loan origination and servicing business.

The Court also analyzed Plaintiffs' analysis using the guideline transactions method that values a business through financial ratios from comparable companies. Plaintiffs used one transaction, CRRE's 2014 acquisition of the subject company, Berkeley Point. Plaintiffs used four multiples: two EBITDA multiples, a book value multiple and a sector-specific multiple. The Court disagreed with the assumption that the market would have applied the same multiples as were used in CCRE's 2014 acquisition of Berkeley Point to the transaction at issue in 2017. In addition, the Court found only one of the four multiples (after adjustments) to be a fair measure of Berkeley Point's value, the Price to Book Value multiple. The Price to Book Value was determined to be appropriate as Berkeley Point marked its loans and servicing rights at market value. Plaintiffs included a cross-check of the guideline transaction approach by comparing it to the implied value of Berkeley Point based on buyout transactions in 2017 of CCRE interests. However, this was determined to not be a reliable indicator of value.

Based on the two analyses, the Court found the range of fair values to be between $805 and $1,164 million, which was more in line with the Defendants' range. The Court concluded that the purchase price of Berkeley Point was "economically fair."

Case Summary

Ramcell, Inc. v. Alltel Corporation d/b/a Verizon Wireless, C.A. No. 2019-0601-PAF (Del. Ch. October 31, 2022)

On October 31, 2022, the Court issued a decision in an appraisal case between Ramcell, Inc. ("Petitioner") and Alltel Corporation ("Respondent"), a subsidiary of Verizon Communications, Inc., regarding the fair value of Ramcell's shares of Jackson Cellular Telephone Co., Inc. ("Jackson"). On April 4, 2019, Alltel, which owned more than 90% of Jackon's outstanding common stock, effectuated a merger of Jackson into Alltel, canceling and extinguishing shares of Jackson stock, including the Petitioner's shares, for merger consideration of $2,963 per share.

The Petitioner and Respondent both valued Jackson using a DCF analysis, but differed in their inputs, namely the projections, discount rate and terminal value. The Respondent's expert estimated a fair value of $5,690.92 per share and the Petitioner's expert offered two appraisal ranges, with an overall range of $21,047 to $36,016 per share. The Court ultimately concluded on a fair value of $11,464.57 per share.

The Petitioner's expert opined that Jackson's historical financials could not be relied on as a predictor for future growth rates and instead prepared his own projections. The Petitioner's expert created two sets of projections: one in which Jackson's market penetration rates were projected

to trend towards the forecasted rate for Verizon, and one which assumed that Jackson had already reached the same market penetration that Verizon had reached nationally and that Jackson's growth would be in line with Verizon's national projections. The Court determined that the Petitioner's expert "did not convincingly demonstrate that management's forecasts should be rejected and that his forecasts, based on Verizon Wireless at a national level, are more reasonable." While the Court agreed with the Petitioner's expert's assessment that management's historical financials are "undoubtably wrong by some unknown percentage" due to a "flawed" system for tracking subscribers, the Court also concluded that the "data concerns identified by [the Petitioner's expert] do not justify throwing out management forecasts and replacing them with hypothesized numbers based on Verizon's national performance."

The Respondent's expert used management's projections created in anticipation of the merger and made adjustments, including model updates based on actual financial results that were available as of the valuation date, but not as of the date the model was created by management. The largest adjustment to Jackson's financials related to the treatment of certain accounts receivable, related to selling and financing of phones, as a cash flow adjustment. In management's model, an increase in these receivables would result in a decrease to free cash flow; the Respondent's expert treated changes in these receivables as a cash-neutral event because of Verizon's practice of securitizing these receivables. The Court accepted that these transactions were a cash flow neutral event. However, the Court noted that the Respondent's expert did not make any attempt to make revenue adjustments to account for the "outmoded and inherently unreliable" system for tracking subscribers.

The Court conducted its own analysis, finding that neither party "persuasively established that the projections used in their DCF model were reliable." The Court found the Respondent's expert's projections unpersuasive due to the failure to adjust for the subscriber tracking system; the Court found the Petitioner's expert's projections unpersuasive due to the "unsupported" assumption that Jackson's market penetration rates should be essentially the same as Verizon's national rates.

The Court found a blended share price to be the appropriate solution, using two iterations of a model: (i) 70% weight to the Respondent's expert's projections and (ii) 30% weight to a model using the Respondent's expert's projection spreadsheet with the Petitioner's expert's revenue projection for certain revenue streams. In the second iteration, the Court used the Petitioner's expert's scenario with higher revenue, stating that the first scenario with lower revenue reflected a "transition" from the Respondent's expert's "proposed state of the world" to the Petitioner's expert's "state of the world." The Court's 70/30 weighting reflected its "credibility determination" of the two projections.

In determining a discount rate, the Respondent's expert used Jackson's cost of equity of 12.9%, asserting that Jackson was a standalone entity. The Petitioner's expert used Verizon's WACC of 6.8%, asserting that Jackson was a fully integrated part of Verizon. The Court used a blended approach, to "take into consideration the reality that Jackson benefits from its relationship with Verizon."

Specifically, the Court used Verizon's capital structure and beta, stating that this approach "reflects the operative reality that Jackson was operated, branded, and financed by Verizon" and noting an "inconsistent approach" by the Respondent's expert in determining Jackon's beta when selecting comparable companies. The Court also compared this approach to the ones used in *In re Cellular* and *In re AT&T Mobility*. The Court also used Verizon's cost of debt, calculated by the Respondent's expert as the midpoint between the yields on Verizon's most recently issued long-term debt as of the valuation date. For the tax rate, the Court used a 26% corporate tax rate, which was used in both experts' rebuttal reports.

The Respondent's expert applied a size premium of 5.22%, using the 10th decile, while the Petitioner's expert argued that no size premium should be applied. The Court agreed that a size premium is appropriate, but that it should reflect Jackson's integration and heavy reliance upon Verizon. The Court cited the

In re Cellular decision, in which the Court accepted a size premium calculated as the micro-cap decile minus 1-percentage point to reflect the parent company's involvement. In this matter, the Court used a similar approach, applying a 2-percentage point reduction to the 10th decile size premium to arrive at a size premium of 3.22%.

In calculating the terminal value, both experts used a perpetual growth method, but differed on the growth rates and models used. The Petitioner's expert used the GGM and a growth rate of 2.77%, based on the average of industry growth forecasts discounted for Jackson location-specific characteristics. The Respondent's expert used the McKinsey Value Driver ("MVD") model and a growth rate of 2.00%, effectively assuming no inflationary growth but a small amount of real growth. While the Court adopted the Petitioner's expert's approach of using industry data for the growth rate, the Court removed an outlier to arrive at a growth rate of 2.20%. Respondent's expert had pointed out that the outlier growth rate was higher than the WACC, which would result in a negative capitalization rate and an "irrational" terminal value. In discussing the terminal value model, the Court noted that it has accepted both models as valid means for calculating terminal value and noted benefits and drawbacks of each model. The Court stated that, in this case, the Respondent's expert's presentation of the MVD model was "more persuasive," citing the "need to account for the investment necessary to sustain the long-term growth rate into perpetuity" and set the return on new invested capital ("RONIC") equal to the WACC given that Jackson was a "mature, capital-intensive company in a competitive industry."

The Court's DCF resulted in per-share values of $9,679.29 and $15,630.23 using the two scenarios. The Court averaged these to conclude on a fair value of $11,464.57 per share.

Case Summary

Edward Deane, et al. v. Robert A. Maginn, Jr., et al., C.A. No. 2017-0346-LWW (Del. Ch. November 1, 2022)

Defendant was the managing member of, and Plaintiffs were members of, New Media II-B, a vehicle created to facilitate investments in Jenzabar, Inc., a private company founded by the Defendant, which provided software services for the education sector. New Media II-B held warrants with rights to purchase shares of Jenzabar common stock. Plaintiffs alleged that Defendant advantaged himself at the expense of the members of New Media II-B.

At the expiration of the New Media II-B warrants, in June 2012, a special committee at Jenzabar approved the issuance of new warrants to New Media II-C (the "II-C Warrants"), which the special committee believed was a successor to New Media II-B. However, New Media Investors II-C was an entity solely owned by the Defendant. The Defendant then borrowed money from New Media II-B to purchase these warrants. The opportunity to buy the new warrants was not disclosed to New Media II-B's remaining members ("the Plaintiffs").

The Court of Chancery determined that the Defendant breached his duty of loyalty and therefore awarded damages to the Plaintiffs in the form of rescissory damages. The Court determined that a pro rata recovery to the members of New Media II-B was appropriate, and a subsequent decision would address the method of identifying and distributing damages to New Media II-B's members. The Court agreed with the Plaintiffs' position that rescissory damages should be measured by the total profits Maginn received from the II-C Warrants as of December 2020. Maginn received 6,500,000 common voting shares and 65,000,000 non-voting shares of Jenzabar as a result of ultimately exercising the warrant, and the Court therefore had to determine the value of these shares. Each party relied on an expert to value the shares.

The Defendant's expert determined the fair market value ("FMV") of Jenzabar's equity by weighting a DCF analysis and a comparable company analysis, following the format of a 2020 409A Valuation performed by KPMG.

In reviewing the analyses, the Court commented that the Defendant's expert did not explain the logic for increasing the weighting on the DCF analysis relative to KPMG's analysis. Additionally, the Court noted that the Defendant's expert's DCF relied upon uncertain and unreliable projections, specifically an unexplained drop in revenue in the first two years of the projection period. Therefore, the Court gave no weight to the Defendant's DCF analysis.

The Defendant's expert produced eight peers for his comparable companies of Jenzabar. These companies were agreed upon by the Plaintiffs' expert and the Court as appropriate. The Defendant's comparable company analysis equally weighted market value of invested capital ("MVIC") to revenue multiples as of (i) the last 12 months ("LTM"), (ii) the next fiscal year ("NFY") and (iii) NFY plus 1. However, the Court found that the Defendant's analysis was overly pessimistic" due to his reliance on flawed revenue projections.

The Plaintiffs' expert calculated Jenzabar's FMV through the use of a comparable company analysis, which calculated a total enterprise value ("TEV") to revenue multiple for the previous NFY prior to the valuation date. TEV was calculated as MVIC less cash and cash equivalents.

The Court found that the Plaintiffs' expert's analysis was unreliable as he provided no data to support his TEV to revenue multiple, only assuming Jenzabar would trade at a premium over one of the selected peers.

The Court ultimately concluded that it was reasonable to select the median of the Defendant's LTM MVIC to revenue multiples for Jenzabar's peers. The Court then calculated Jenzabar's equity value by applying this multiple to Jenzabar's fiscal year revenue, adding investments/subtracting debt and applying the median of the two expert's liquidation discount (which was applied to Jenzabar's marketable securities).

The Defendant's expert applied a 25% discount for lack of marketability ("DLOM"); however, the Court declined to apply this discount because the Court sought to value the entity itself rather than its shares in the hands of a particular shareholder.

The Court then considered the allocation of equity value to the different Jenzabar securities since there was preferred stock that had liquidation preferences. Both experts used an option pricing model to allocate equity value. Both approaches yielded similar results and the Court took the average allocation result of each model. The Court also adopted a 2% discount for non-voting shares.

The Court ultimately calculated a value per warrant of $12.895, determining that the Defendant profited $80,697,500 on these warrants, after consideration of the exercise price and purchasing costs.

The Plaintiffs held 31.5% of these warrants, and therefore the Court ruled the total damages to be $25,451,992, which was to be paid pro rata to the Plaintiffs.

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