IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

ROBERT MICHAEL LANE, Petitioner, v. CANCER TREATMENT CENTERS OF AMERICA, INC., formerly known as RSJ, INC., Respondent.	: : : : : : : : : : :	**C.A. No. 12207-NC**

MEMORANDUM OPINION

Date Submitted: March 6, 2003
Date Decided: July 30, 2004

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NOBLE, Vice Chancellor

Petitioner Robert Michael Lane ("Lane") filed this appraisal action pursuant to 8 *Del. C.* § 262, seeking a determination of the fair value of the common stock of Respondent Cancer Treatment Centers of America, Inc. ("CTCA" or the "Company"), as of March 20, 1991 (the "Merger Date"), the date on which CTCA merged (the "Merger") into RSJ, Inc. ("RSJ").[1] Under the terms of the agreement implementing the Merger, Lane, the owner of 100 shares of CTCA common stock, which represented 10% of CTCA's outstanding shares of common stock, was to receive $260.00 per share. Objecting that the Merger consideration was inadequate, Lane made a timely demand for appraisal and satisfied all requirements of 8 *Del. C.* § 262. For the reasons discussed below, I find that CTCA had a fair value of $1,345,000 as of the Merger Date and, thus, Lane is entitled to $134,500 plus interest at the annual rate of 9.14%, compounded monthly.

I. BACKGROUND

A. The Genesis of CTCA.

The story of CTCA begins at the American International Hospital ("AIH"), a 95-bed hospital located in Zion, Illinois. AIH was (and is) controlled by Richard J. Stephenson ("Stephenson") who, along with several family trusts, indirectly owns AIH in its entirety. Besides providing general medical and

[1] The surviving corporation thereafter assumed the name of Cancer Treatment Centers of America, Inc. Its current name is Cancer Leasing, Inc., but "CTCA" will be used for convenience.

surgical services to the local community, AIH, after 1982, focused on cancer care and treatment. Specifically, AIH set out to develop a compassionate, patient-focused treatment model that included alternative therapies.[2] To this end, AIH maintained bed capacity for between 40 and 45 cancer patients on two floors, while a third floor was reserved for providing its general medical and surgical services.

By 1988, AIH was facing serious financial problems. The facility, which had been constructed in 1958, was outdated and ill-suited to furnishing quality patient care. AIH's reputation had been severely damaged by the negative treatment it had received in the local press due to its connection with a controversial cancer treatment drug, Laetrile. As a result, the average daily census for cancer patients ("ADC") had reached only 20.5 during the last half of 1987. Operating at well below capacity, AIH had difficulty in meeting its obligations.

Stephenson recruited Lane in order to help turn the tide at AIH. Lane had experience in the fields of health care administration and hospital management.[3] In January 1988, Lane joined AIH as its President and Chief Executive Officer. Yet Lane accepted Stephenson's overtures with more in mind than revitalizing

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[2] Tr. at 895-99, 994, 998.

[3] During the period of 1976 through 1978, Lane served as Administrative Assistant for Bon Secours Hospital, a 320-bed hospital in Michigan. Subsequently, from 1978 until his hiring at AIH, Lane was the Assistant Executive Director of Timken Mercy Medical Center, a 520-bed medical facility in Ohio, and additionally served as the Manager of Strategic Planning, the Director of Strategic Planning and Research, and the executive responsible for market research at Hospital Corporation of America.

AIH; for Lane, an enticing opportunity presented by AIH was participating in the creation of what Stephenson portrayed as a national network of cancer treatment centers. The plan was to reverse the decline of AIH and then use the funds generated by a resurgent AIH to build a national cancer care network of between 12 and 20 treatment centers which would employ the alternative therapies espoused by AIH. These centers were to be established within five years. During the spring of 1988, Lane, Stephenson, Randall L. Pittman ("Pittman") and Robert Mayo ("Mayo") convened to create and develop CTCA.

B. The Formation and Business Plan of CTCA

CTCA was incorporated in June 1989 in Delaware. Subchapter S status was elected for tax purposes. Lane was to serve as the President of CTCA. Pittman and Mayo were to serve as the Executive Vice President of Operations and Finance and the Executive Vice President for Development, respectively. Stephenson funded the start-up costs associated with CTCA through advances from AIH.[4] Lane, Pittman and Mayo each received a 10% interest (100 shares of CTCA common stock) in CTCA as an incentive,[5] and Stephenson owned the

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[4] Lane presents a much different story surrounding the early financing of CTCA. He claims that CTCA was originally formed as a joint venture (the "Joint Venture") among Stephenson, Lane, Pittman and Mayo, and that soon after its formation, the Joint Venture assumed responsibility for certain services of AIH, generating a profit for its efforts.

[5] There is some debate as to what percentage of CTCA Lane initially received. Lane claims that he originally subscribed to and purchased, for $110 in addition to the nearly $250,000 he contributed through the Joint Venture, 110 shares of CTCA common stock, and that this amount was later unilaterally altered by Stephenson. However, Lane does not challenge that alleged reduction in this proceeding, and

remaining 70% of CTCA's outstanding common stock. CTCA was staffed by former AIH employees who continued to perform their previous jobs but for a different employer – CTCA.

The CTCA business model evolved from the cancer treatment model pioneered at AIH: primarily providing care on an inpatient basis, a CTCA multidisciplinary team would oversee a varied regimen of treatment options, including holistic treatments, aimed "not only [at] the patient's physical well-being but also [at] their spiritual well-being, their emotional well-being and their nutritional well-being."[6] Thus, the perceived uniqueness of CTCA lay in its comprehensive, and sometimes experimental,[7] cancer treatments and personal attention to the individual.

The CTCA business model sought to capture a niche in the cancer treatment market, namely, those pre-treated cancer patients who had failed their initial round(s) of cancer treatment and who often had been advised of the terminal nature of their illness. This target market largely consisted of potential patients from outside Illinois who were willing to travel to receive treatment on an inpatient basis and who were covered by private commercial insurance and could

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"there is no dispute that Mr. Lane's equity interest in CTCA was 10% as of the Merger [D]ate." Opening Post-Trial Br. of Pet. Robert M. Lane at 8 n.2.

[6] Tr. at 47.

[7] Treatments offered at CTCA facilities came to include experimental chemotherapies, such as fractionated dose chemotherapy, as well as other kinds of treatments such as whole body hyperthermia, radiation treatments, psychological services, immunomodulating supportive therapies and nutritional services. Tr. at 47-52.

afford those expenses not paid by insurance. No marketing study was ever conducted in order to determine the size of this market segment.[8]

CTCA was also formed in order to provide marketing, managerial, operational, and administrative outsourcing services to an anticipated national cancer treatment network. CTCA aggressively pursued its own marketing by advertising in a variety of media[9] and enhanced customer satisfaction through the use of the "patient travel" package.[10] A CTCA senior medical director and a CTCA chief medical officer, who remained abreast of recent developments in the

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[8] This market niche may have shielded CTCA from certain macroeconomic trends and industry specific changes occurring during the formation of CTCA and continuing until the Merger Date. By the early 1990's, the economy of the United States was suffering through a recessionary period characterized by high interest rates and rising unemployment. The health care industry was experiencing a move toward managed care and a change in reimbursement rates by Medicare unfavorable to the interests of hospitals. Additionally, a clear trend had emerged that favored providing care on an outpatient basis. However, it was thought that such trends would have a limited impact upon CTCA because of its niche-market focus. *See* MediTrends Report, RX 74 at 6 (relied upon by both parties and predicting that "most inpatient oncology cases will be limited to experimental treatments and . . . major surgical procedures."). Moreover, cancer cases were expected to rise over the next decade.

CTCA has suggested that competitors of CTCA included the Mayo Clinics, Memorial Sloan Kettering, and M.D. Anderson, each a well-known and well-respected cancer treatment facility with a national focus. However, I am not satisfied that these institutions squarely competed against CTCA due to the experimental and, to an extent, unique nature of treatments offered by CTCA and the ultimate stage of cancer progression of the typical CTCA patient.

[9] CTCA largely ignored the more traditional method of attracting patients through physician referrals, focusing instead upon direct advertising.

[10] The cancer patients, who would in many instances travel long distances to the treatment center, were picked up at the airport and, during the ensuing limousine trip to the facility, watched an informational video concerning their stay, their treatment and the hospital staff who would tend to their needs. Every stage of the

field of cancer care, were available to help supervise hospital operations. CTCA also would oversee a variety of functions at the hospitals it serviced, including maintenance, equipment and supplies management, medical record keeping, securing insurance coverage and reimbursement, and quality assurance.

CTCA additionally developed sophisticated accounting services and was solely responsible for all billing and collection efforts. It supplied clinical case management services for preapproval and precertification cases, arranging with third-party health insurance companies in order to ascertain the level of coverage prior to implementing treatment. Significantly, CTCA, in conjunction with American Express, devised a management information system that could function as the "platform for developing multiple centers."[11] Into this system, care providers entered notes and orders at bedside terminals. This diagnostic and medical services information was integrated with revenue cycle functions, resulting in increased information flows and, ultimately, efficient billing and collection.

Thus, CTCA sought not only to supply outsourcing services to, but also to own and operate the facilities of, a national network of cancer treatment centers. These centers were to target an undetermined number of end-stage, affluent cancer

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journey was paid for by CTCA, which had established long-term contracts with a major airline for the necessary air travel.

[11] Tr. at 52. Lane claimed that this system was "one of the first fully integrated clinical and financial information systems" to be implemented in a hospital setting. *Id.*

patients who, with a strongly inelastic demand for treatment, were willing to travel extensive distances and obtain care that generated substantial profit margins for the unique treatments offered by CTCA. Critical to meeting the goals of the founders of CTCA would be continued expansion to new geographic markets through the opening of new facilities.

C. CTCA and AIH

On July 1, 1989, CTCA and AIH more formally memorialized their business relationship in the Management Services Agreement (the "MSA").[12] By its terms, the MSA lasted for one year and would be renewed automatically on a year-to-year basis on the same terms unless either party provided notice to the contrary no less than 90 days prior to the end of any term. While the MSA was in effect, CTCA was compensated for services provided to AIH on the basis of actual costs plus a 20% markup, with a possibility for a bonus payment.[13]

Under the leadership of Lane, and aided by CTCA, AIH rebounded. In 1988, the ADC for AIH increased by 11.5 patients to 32, and then further to 38.9 in 1989. Collection rates soared from $.53 on the dollar to about $.95 on the dollar.[14] Clearly, the situation at AIH, though not completely resolved,[15] had improved dramatically. But the appetites of Stephenson, Lane and their colleagues aspiring to create a national network of cancer treatment centers

[12] PX 6.
[13] *Id.* at 4–5.
[14] Tr. at 54.
[15] *See* discussion *infra* Part I.E.

through CTCA would not be satisfied by merely enhancing the performance of a lone hospital in northern Illinois. Thus, from 1988 through 1990, CTCA urgently pursued what would ultimately be regarded as a disastrous search for a suitable site to open a second cancer treatment center.

D. CTCA Expands, Albeit with Great Difficulty.

Throughout 1988 and 1989, CTCA fruitlessly searched for a second hospital to serve as a cancer treatment center. With the passage of time, the attempts of CTCA to find a new location only grew more frantic. In mid-1989, CTCA thought it had finally succeeded in its efforts; the target site was the recently-closed City of Faith Hospital, associated with Oral Roberts University in Tulsa, Oklahoma. The City of Faith Hospital was a general medical and surgical hospital, with a licensed capacity of 294 beds. Its facilities were in good condition. However, the City of Faith Hospital came with certain baggage: it did not enjoy a good rapport with the local practitioners and populace, in part attributable to the diverging opinions regarding its prior efforts. Despite these reputational concerns, CTCA decided to expand to Tulsa. CTCA became obligated as lessee on a 15-year lease for a portion of the City of Faith facility (the "Lease") with Oral Roberts University,[16] and formed Memorial Medical Center and Cancer Institute, Inc. ("MMC") as a separate corporation to operate the

[16] The Lease also contained an option to renew for an additional 15 years. RX 27.

facility.[17] Under an oral agreement (the "MMC Oral Contract"), MMC was to reimburse CTCA at cost for services provided. Initial forecasts for MMC prepared by Phillip Picchietti[18] ("Picchietti") at Pittman's instruction reflected an initial source of cash as "CTCA management fee from AIH."[19]

On April 12, 1990, Stephenson sent a letter (the "April 1990 Memorandum") to Lane, Mayo, and Pittman addressing certain issues regarding CTCA and the MMC expansion. Stephenson informed his fellow shareholders of his views on eight different topics. Stephenson first addressed the mission of CTCA:

> 1. We must first have a clear idea, and a commitment shared by all of us as to our objectives and their respective priorities. I have viewed this venture as having three primary objectives which have respective priority as follows:
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> > a. The first priority is to protect the American International Hospital operations and keep them viable and profitable. AIH is the "cash cow" that makes possible its own survival and growth, and the opportunity presented to you vis a vis CTCA, et al. Unless we protect it, both AIH and CTCA development will be in jeopardy. We cannot afford to do anything that would deprive AIH of requisite income, interfere with its banking relationships, impede further program enhancement, or prevent the financing of the new hospital. Although this is the primary objective, I believe that AIH is at greater risk than I had ever expected. For example, looking at present levels, think about what would happen to AIH if its net income went back to 1988 levels?

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[17] Stephenson, Lane, Pittman and Mayo each held the same percentage in MMC as they owned in CTCA. MMC was incorporated under the laws of Oklahoma on May 3, 1990.

[18] At the time of trial, Picchietti was CTCA's chief financial officer. He had also served as the assistant vice president of finance for both AIH and CTCA.

[19] RX 5.

> b. The second objective is the development of CTCA-Tulsa which is a major operation and will take a great deal of effort and ingenuity. It is still not clear to me how, or why, we are proposing to manage Tulsa in the way we are, where and how we are going to attract our patients, what the front money cash need will be, etc. I need to have a clear handle as to how much money is to be invested as well as answers to the other queries raised.
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> c. As planned, I think the timely development of other centers is also extremely critical. We all know that the market has a preference for treatment near home. Unless we find ways to cater to this preference within the narrow window of opportunity available to us, we are not going to maximize the profit potential that I have so long envisioned.[20]

Stephenson then went on to express his opinions regarding the nature and status of the future funding of CTCA:

> 5. I thought it was clearly understood that the proposed equity sharing arrangement (70% - 30%) was intended to reflect a claim on the profits and/or "value" of the CTCA operation. It was understood that AIH would provide to CTCA a determinable amount of money to give CTCA a start. However, such investment would be first returned to me before profits of CTCA would be distributed under the proposed CTCA equity sharing arrangement. I did not intend a permanent assignment of a big portion of AIH cash flow, nor an indirect sharing of AIH profits triggered by said assignment.[21]

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[20] RX 34 at 2. Stephenson reiterated his fear of the MSA disturbing the progress and upgrading of AIH:

> 8. I am very much concerned that the proposed consulting agreement as drawn will cause very serious problems with AIH's bank and the financing arrangements necessary to build the new hospital building. Of course, that would not be acceptable to me and I assume that there exists agreement among all of you that I should not have this risk.

Id. at 5.

[21] *Id.* at 4.

Throughout the April 1990 Memorandum, Stephenson opined that issues of control, and recognition of his dominant position, were not being adequately addressed. Furthermore, Stephenson directed that "all of the money paid out under the proposed consulting agreement with AIH . . . must be invested solely in the CTCA operations and will not be available to you, except to pay taxes, until profits are distributed from those operations or a sale of the CTCA operations is concluded."[22] The weight of those convictions of Stephenson, the majority shareholder in both AIH and CTCA, would not be lost upon Lane, Mayo, and Pittman.

MMC commenced business operations in May 1990. Immediately, MMC was beset by problems. From the beginning, MMC was greeted by a chilly reception from the local medical community and general populace. It had inherited some of the discontent from its association with Oral Roberts and the City of Faith Hospital. Additionally, at the time of MMC's opening, there already existed excess hospital capacity in Tulsa. Local media provided coverage that could only be described as negative. Thus, the local market viewed MMC, at best, as an interloping competitor in a tight market or, at worst, as a competitor who was the successor entity of the maligned City of Faith Hospital. Despite the efforts to bridge this gap, which included marketing efforts aimed at local chiropractors, physicians, and church organizations, the hostility continued.

[22] *Id*. at 5.

The ADC of MMC further suffered from what Lane claims was a bias toward directing patients to AIH instead of MMC. Lane testified that, although it was originally agreed that patients would be steered in equal numbers to MMC and AIH, in fact, in order to boost census counts at AIH, a disproportionate number of patients were directed to Zion instead of Tulsa.[23] Indeed, the April 1990 Memorandum stated: "The first priority is to protect the American International Hospital operations and keep them viable and profitable. AIH is the 'cash cow' that makes possible its own survival and growth and the opportunity presented to you vis a vis CTCA."[24] Furthermore, though subject to certain constraints, patients treated at AIH, by virtue of the contracts with CTCA, generated a higher return for CTCA than those treated at MMC. However, this alleged steering of patients to Zion does not go unchallenged.[25]

Even aspects of the expansion which at first appeared benign or even favorable soon metamorphosed into nightmares. CTCA was obligated to pay approximately $2 million for capital equipment it had purchased at a steep discount from Oral Roberts University. Upon further inspection, though, some of the equipment turned out to be unusable.[26] Moreover, while the terms of the Lease

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[23] Tr. at 92.
[24] RX 34 at 2.
[25] CTCA claims the exact opposite: that patients were being shifted from AIH to MMC in order to boost ADC counts at, and the attractiveness of, MMC. *See* Post-Trial Resp. Br. of Resp't Cancer Treatment Centers of America, Inc. at 11. I need not resolve this issue.
[26] It is impossible to tell from the record how much of the equipment CTCA purchased from Oral Roberts University was of little or no value.

were initially favorable to MMC,[27] payments due under the Lease dramatically increased after the fifth year.

The already grave situation in Tulsa would be further complicated by the deterioration in the relationship between MMC (and CTCA) and Oklahoma Blue Cross. Oklahoma Blue Cross's reimbursements accounted for approximately 28% of MMC's revenues, and it was the largest insurer in the local area. Initially, CTCA had failed to ascertain the reimbursement rates of Oklahoma Blue Cross; in fact, the reimbursement rates paid by Oklahoma Blue Cross for the treatment provided by MMC were significantly lower than those paid to AIH by comparable insurers. Furthermore, another blow to the credibility and reputation of MMC occurred when MMC was discovered to have substantially overcharged Oklahoma Blue Cross for nutritional supplements. Thus, MMC was faced with the near-Herculean task of negotiating for favorable rates from a disadvantageous starting point against a large, hostile insurer.

In 1990, CTCA unsuccessfully attempted to secure a line of credit for itself and MMC from LaSalle National Bank. Notably, during negotiations with LaSalle National Bank, representatives of CTCA and MMC, when asked pointedly about their perception of continuing the status quo under the MSA, replied that no change was foreseeable. Documents prepared for and presented to LaSalle

[27] The payments were at the outset favorable to MMC when judged on a per-square foot basis. There is some debate whether the negotiated rates were as favorable when compared on a per patient basis. *See* Tr. at 1152.

National Bank depicted the markup under the MSA as a subsidy to MMC; the amounts represented as flowing from AIH through CTCA to MMC were reflected as debt owed to CTCA.[28]

This procession of unfavorable developments was eventually reflected in the operational and financial statistics of MMC. In May 1990, MMC had an ADC of 3.[29] By December 1990, it was 10.[30] This pace of patient development paled in comparison to management projections of up to 60 by December 1990.[31] MMC also suffered from relatively large (in comparison to AIH) marketing expenses per patient admitted; during the first year of operations, per patient marketing expenses nearly doubled from $6,329 to $11,544. Moreover, MMC needed additional computer equipment that would cost $800,000.

For 1990, MMC lost more than $5 million. Operating under the MMC Oral Contract, MMC, as reflected in its financial statements, owed CTCA approximately $2.9 million by the end of 1990. And this figure was an understatement, for in addition to the amount derived from services provided pursuant to the oral agreement, CTCA had advanced $3.6 million to MMC for working capital by the end of 1990. However, at the end of 1990, $3.2 million of these loans were removed from the books by a CTCA assignment of notes for that amount to the CTCA shareholders, who in turn reassigned their notes to MMC.

[28] RX 44; Tr. at 803.
[29] Tr. at 177; RX 70 ex. B.
[30] RX 70 ex. B.
[31] Tr. at 783-84; RX 5.

Thus, in the 1990 financial statements for MMC, its auditors, Arthur Andersen & Co., cautioned: "The accompanying financial statements have been prepared assuming that [MMC] will continue as a going concern. As discussed in Note 1 to the financial statements, [MMC] has suffered a loss from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern."[32]

E. Developments at AIH and MMC During Early 1991

In Illinois, while the situation at AIH had shown marked improvement, tensions were increasing between Stephenson and the AIH board of directors. By 1991, AIH was operating at or beyond the capacity of its aging building. However, it was confronted with a more pressing issue: due to the condition of the AIH facility, AIH was threatened with the loss of its Medicare certification, its Joint Commission on Accreditation of Health Care Organizations accreditation, and its Illinois licensure. The AIH board of directors, faced with the necessity of upgrading and expanding AIH, came to resent at some level the monies paid to CTCA by AIH under the MSA's 20% markup, and the existing relationship between AIH and CTCA was coming under strain.[33]

Nevertheless, AIH decided to press forward with its plans for constructing a new hospital building. Accordingly, by the end of 1990, negotiations with the

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[32] RX 57 at R000347.

[33] The parties dispute the degree to which the AIH board of directors was offended by the payments made to CTCA. Suffice it to say, there existed some tension over

City of Zion were well underway for the issuance of bonds to finance AIH's undertaking. In order to obtain the necessary approvals for its expansion, AIH needed to submit a Certificate of Need ("CON") application to authorities in Illinois and also to seek bond financing in conjunction with the City of Zion.[34] AIH submitted its CON application on December 28, 1990. In the CON application AIH projected its ADC as:[35]

1991	1992	1993	1994
41	45	53	58

Concurrently, as AIH found itself in limbo in Zion, MMC continued to decline in Tulsa. For the first two months of 1991, MMC lost approximately $1 million,[36] and estimated that in order to continue operations, another $1.4 million was needed. Vendors began to insist upon immediate payment and operations were disrupted.[37] The condition of MMC had deteriorated to such an extent that its auditors expressed substantial doubt about its viability as a going concern.[38]

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the subject of the MSA. Two AIH directors did take the preliminary step of retaining a lawyer to meet with Stephenson regarding their concerns.

[34] TR. at 901–02, 913–17.

[35] RX 56 at HCC00261.

[36] RX 26. Lane notes that the financial statements indicating this loss were unaudited.

[37] Picchietti noted: "We had drug vendors, medical supply vendors, our airlines, gas stations, all put us on credit hold and COD. In many cases we had to put off surgeries, and the financial state of affairs were jeopardizing patient care at the time." Tr. at 837.

[38] *See supra* note 32 and accompanying text.

Thus, by the end of 1990 or the early part of 1991, some consideration was given to shutting MMC's doors. A CTCA management team visited Tulsa in early 1991 to decide whether MMC could be salvaged. Ultimately, Joseph Gagliardi ("Gagliardi"), a turnaround expert, was retained to oversee operations at MMC.

F. Turmoil at CTCA, the Merger, and Subsequent Actions

On December 5, 1990, Stephenson, Picchietti, and Hopkins met in order to discuss the financial situation at CTCA. At the meeting, an ADC of 45 for AIH and an ADC of 24 for MMC were projected for 1991. The forecast anticipated the opening of a new facility in October 1991[39] and assigned an ADC of 4 for the initial few months after opening.[40] Two weeks later, the forecast was presented to the MMC board of directors. At that meeting, the proposed 1991 budget, dated December 14, 1990,[41] based on that forecast, was rejected.

For 1990, CTCA received $10.6 million in revenues, of which $2.6 million consisted of fees and interest owed by MMC, and incurred $9.2 million in expenses. Under the MSA, in 1990, AIH paid $7,934,900 in management fees to CTCA. Thus, for 1990 CTCA earned $1.4 million in net income.[42] The debt owed by MMC to CTCA totaled $3.5 million, a figure which, as previously noted,

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[39] Picchietti, who prepared the budget, stated that Pittman directed him to include a third facility with an ADC of 4, despite Picchietti's voicing of his concerns over the failure of MMC and the lack of available financing options for any expansion. Tr. at 854.

[40] The testimony concerning Stephenson's acceptance of this forecast was contradictory.

[41] RX 67; Tr. at 834-35.

[42] RX 58. The income statement for CTCA for 1990 is set forth *infra* note 133.

underestimated the true amount of debt to CTCA that had been incurred by MMC.[43]

Operationally, CTCA lost focus upon its mission and core competencies. Much of the time of CTCA managers, including Lane, was directed at saving MMC. Absorbed in the task of rescuing MMC, Lane failed to develop a management staff to operate CTCA. Instead, Pittman, who served primarily as a financial officer, was tapped to supervise operations at CTCA.

Dissatisfied with the perceived abandonment of developing a national cancer treatment network and at the perceived favoritism displayed by Stephenson toward AIH over CTCA and MMC, by the end of 1990 Lane concluded that any expansion of CTCA, while still possible, would only be achieved through internally-generated cash flows. Though there are conflicting accounts, I find that Lane offered his resignation on December 31, 1990, but was initially rebuffed by Stephenson. Subsequently, on January 2, 1991, Stephenson terminated Lane's employment relationship with CTCA. By this time Pittman had also left the Company; he had resigned on December 31, 1990. Thus, with the departure of these two key managers, CTCA was without upper level management, a condition which remained through the Merger Date.

[43] Lane admits to having assigned the notes on December 31, 1990. However, Lane disputes that this write-off was ever reflected on the books of CTCA. Pet'r's Opening Br. at 24.

A budget, dated March 11, 1991, for MMC incorporated the projected ADC figures that had been presented to the MMC board (and not accepted by it) in December 1990 (the "Revised Budget").[44] This budget projected an ADC of 24 for MMC for 1991. Although this document bears the date of March 11, 1991, it is not known if management adopted this budget at that time, or if the date is merely a function of when it was reprinted.

The Merger was accomplished through a written consent executed by Stephenson and was never considered by the CTCA board of directors. Under the Merger, CTCA merged into RSJ, an entity wholly-owned by Stephenson.[45] At about the same time, MMC merged into SRJ, Inc., an Oklahoma corporation owned and controlled by Stephenson (the "MMC Merger").[46] The MMC Merger eliminated the minority shareholders in MMC. Ultimately, Stephenson wholly-owned both MMC and CTCA.

Pursuant to the Merger's terms, CTCA common stockholders could receive $260.00 for each of their CTCA common shares. The aggregate amount of consideration in the Merger was apparently derived by multiplying the book value of CTCA by 50%. The CTCA board of directors (or Stephenson individually)

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[44] PX 29.

[45] PX 34 at LP0000636; PX 35.

[46] PX 34 at LP0000646. Although the Merger Date is a day after the MMC Merger, neither party has suggested that this is material and, for convenience, the mergers will be considered as occurring at the same time.

neither commissioned an independent determination of the fairness of the terms of the Merger nor sought to ascertain the inherent value of the Company.

G. It is Not All Bad News

Despite the problems that CTCA was encountering, there were positive signs. First, CTCA had net income of $1.4 million in 1990. Second, although MMC was not turning toward profitability in early 1991, its ADC was increasing to a number which, at least some thought, could lead to profitability. Finally, the projections of ADC set forth in AIH's CON anticipated a growth in patients that could provide the groundwork for the national network envisioned by Stephenson, Lane and the others.

In short, the Merger occurred during a time of crisis for CTCA. Depending upon several potential developments after the Merger, such as the possibility turning MMC around or finding new sources of funding (including, perhaps, an even greater contribution by Stephenson), CTCA might prosper or it might decline. The nature of the statutory appraisal process limits the analysis to that which is known or can be reasonably projected at the time of the Merger. The future of CTCA was an open question at that time; with its limited history and its uncertain prospects, CTCA's value may be subject to robust debate.

H. Procedural Background

Lane and Pittman dissented from the Merger and filed this appraisal proceeding on July 18, 1991.[47] Similarly, they dissented from the MMC Merger and sought appraisal under Oklahoma law. On February 24, 1998, the Oklahoma Court concluded that "MMC had no value as of March 1991."[48] This decision was based upon the perceived credibility of the parties' experts, and that the

> court took no comfort in the 1991 budget numbers prepared under the direction of plaintiffs. Plaintiffs['] projections had never been achieved from day one. Th[e] court believe[d] that a willing buyer would have been confronted with massive debt and no immediate future for the turn-around of the corporation in March of 1991.[49]

The Oklahoma Court concluded that the transferring of MMC debt from CTCA to the shareholders and the subsequent contribution of it to MMC was merely designed to allow for certain tax deductions and thus added no value to MMC. The Oklahoma Court also found that MMC lost $5 million in 1990, and, despite the "best efforts" of "a previously proven marketing company – CTCA –" MMC could not attract patients to Tulsa. Finally, the Oklahoma Court discredited the Revised Budget:

> The 1991 budget was not accepted in the Dec. 1990 board meeting and it was a work in progress. . . . The plaintiffs were involved in

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[47] Mayo, who was the other minority shareholder in CTCA and who was promoted to President of CTCA after the Merger, did not pursue an appraisal action.

[48] *Lane v. Mem'l Med. Ctr. & Cancer Inst., Inc.*, No. CJ931630, slip. op. at 6 (Dist. Ct. Tulsa County Okla. Feb. 24, 1998), *aff'd*, No. 91,058 (Okla. Civ. App. May 11, 1999).

[49] *Id*.

> [attracting patients to MMC] and in revising numbers as 1990 worn [sic] on with no success in sight.[50]

Any projected numbers, the Oklahoma Court noted, "proved to be wrong."[51]

After the appellate proceedings in the Oklahoma appraisal action were resolved, CTCA sought dismissal of this action pursuant to Court of Chancery Rule 41(e) on June 15, 1999, for Lane's failure to prosecute. This Court, after initially granting that motion,[52] subsequently granted the Plaintiff's Motion for Reargument.[53] In 1999, Pittman and CTCA reached a settlement, thereby leaving Lane as the lone Petitioner in this matter.

II. EXPERTS' TESTIMONY

All too often in appraisal actions, the Court is presented with two competing experts espousing "wildly divergent" interpretations of the circumstances confronting the corporation.[54] This case is no exception. Lane's expert, Robert J. Cimasi ("Cimasi"), contends that the fair value of CTCA was

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[50] *Id.*
[51] *Id.*
[52] *Lane v. Cancer Treatment*, 1999 WL 1204848 (Del. Ch. Nov. 17, 1999) (*Lane I*).
[53] *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2000 WL 364208 (Del. Ch. Mar. 16, 2000) (*Lane II*). Lane retained new counsel on March 29, 2000; CTCA again moved to dismiss this action under Court of Chancery Rule 41(e) on February 21, 2001. That motion was denied on April 11, 2001. *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2001 WL 432445 (Del. Ch. Apr. 11, 2001).
[54] *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23104613, at *2 (Del. Ch. Dec. 31, 2003).

$16,400,000 as of the Merger Date.[55] In stark contrast, CTCA's expert, Richard S. Baehr ("Baehr"), concludes that the fair value of CTCA was zero.[56] In order to understand the divergence of their conclusions, the views of the experts must be reviewed.

A. *Cimasi*

Cimasi is an accredited senior appraiser through the American Society of Appraisers and a certified business appraiser through the Institute of Business Appraisers. He has two decades of experience with a focus on financial and economic aspects of health care. The recipient of an Associate Degree in Real Estate Appraisal from Meramec Community College and a Bachelor of Arts in Valuation Science from Lindenwood College, he is president of Health Capital Consultants, which he founded in 1993. Before then, he had worked for Physicians International where he had devoted most of his efforts to the business aspects of medical practices.

Cimasi utilized three approaches to determine the fair value of CTCA. The three methodologies employed by Cimasi were a discounted cash flow ("DCF") analysis, a comparable transactions approach, and a guideline publicly traded company method. Cimasi then assigned the resulting fair values generated by each approach a weight he deemed appropriate and calculated a weighted average in order to arrive at the fair value for the common stock of CTCA.

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[55] PX 41 § 7, at 2.
[56] RX 87 at 3.

1. Business Reality Confronting CTCA at the Time of the Merger

In conducting his analyses, Cimasi first made certain generalized assumptions about the business of CTCA and, more particularly, the effect of certain industry-specific and macroeconomic trends on CTCA as a niche market player, the foreseeable future of the relationship between CTCA and MMC, the continued existence of the MSA, and the prospects for the national expansion of CTCA. While acknowledging the general trend toward outpatient care, Cimasi minimized its consequences for CTCA because of the market targeted by CTCA. The inelastic demand, and, to a lesser degree, the relative affluence, of the niche market would also counteract any negative effects of a slumping economy. Moreover, the combined ADC of AIH and MMC had been growing, and cancer diagnoses were anticipated to increase greatly. Finally, the expanding influence and pressure exerted by third-party payors created a competitive advantage for CTCA, proven by its 90% to 95% reimbursement rate, which exceeded industry norms. Therefore, although recognizing the existence of certain negative macroeconomic and industry trends, Cimasi concluded that any impact upon CTCA would be negligible and that the combined ADC of MMC and AIH would increase.

Cimasi then turned to establishing the rate at which CTCA would grow. The growth rate would be driven by increases in the combined ADC; Cimasi computed the annual ADC growth from the beginning of 1988 until the Merger Date to be approximately 12, or an annual ADC increase of 12 patients during that

time period.[57] He then reduced this calculated annual ADC growth by 40%, arriving at an annual ADC growth of 7 patients. Thus, for the first projected year, Cimasi assumed a combined ADC for CTCA of 65.38 – an average of 41 patients at AIH and 24.38 at MMC.[58]

Cimasi asserted that, despite the bleak picture painted by CTCA, MMC was not to be closed any time soon. No evidence suggested any intention to close MMC, and any such closing of MMC would be contrary to the business model of CTCA. Additionally, Cimasi noted that MMC, as a start-up, was expected to operate at a loss for some time. Finally, the facts demonstrated the success of MMC: combined ADC had risen from 48.3 in January of 1991 to 57.3 in March of 1991 and had risen despite Stephenson's steering of patients from MMC to AIH. Thus, the ADC of MMC was quickly nearing Lane's claimed projected break-even figure for MMC of 14.7. Surprisingly, Cimasi further claimed that were MMC to close down, CTCA would suffer no ill effects.[59]

As to the development of national cancer treatment centers, Cimasi predicted that not only would MMC remain open, but that CTCA would establish

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[57] Tr. at 323-24.
[58] *Id*. at 325.
[59] Cimasi posited that because CTCA, and not MMC, was the lessee for the Tulsa facility, "if MMC would have closed, then CTCA would have had a choice. They could have either the very next day opened up XYZ because they held the lease and another provider entity would have slipped right in. . . . Or they could have taken the patients up to Zion until Zion was maxed out and then found another facility where the circumstances would have been different." Tr. at 381. According to Cimasi, this transfer of patients would have increased cash flow due

three new cancer treatment centers within the next five years, a projection he characterized as "conservative."[60] Cimasi noted that all evidence, in terms of the business model[61] and CTCA projections,[62] stressed the importance of expanding. This forecast was based upon his experiences with rollups that had doubled their number of sites each year, Lane's experiences at Hospital Corporation of America, which had added over 100 sites to its network over a four-year period,[63] and the market's capacity and demand for such services, as evidenced by the historical increases in aggregate ADC.

Cimasi addressed the status of the MSA and the MMC Oral Contract. He concluded that the MSA, with its 20% return over costs, would remain in place for the foreseeable future. This belief was based upon the lack of concrete action to alter the terms of the MSA and the MSA's automatic renewal feature. Cimasi, relying upon Lane's interpretations and perceptions, discounted the impact of the April 1990 Memorandum.[64] Finally, he hypothesized that had AIH given proper

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to the increased rate of return (20%) achieved at AIH. "[S]econdly, you would have much sooner gone into the operated centers in our model." *Id.* at 385.

[60] Tr. at 607.

[61] For instance, Stephenson noted in his April 12, 1990 letter that "the timely development of other centers is . . . extremely critical." RX 34 at 2.

[62] Cimasi particularly notes that the December 14, 1990 budget reflected the opening of a new center by fall 1991, and the testimony of Dr. R. Michael Williams ("Dr. Williams"), then CTCA's senior medical director and chief medical officer, that he sought a California medical license in anticipation of the opening of a facility in Brea, California.

[63] Tr. at 26.

[64] Lane testified that he "was never aware of any discussion to change the cost plus 20 percent arrangement" and that "[i]t would not have made any sense for Cancer Treatment Centers to have built up a staff, invested several million dollars in a

notice under the MSA of its intention to terminate the agreement, CTCA could have moved all of its patients elsewhere and withdrawn the vital services that had been outsourced to CTCA.

Cimasi also theorized that the MMC Oral Contract would be altered from one reimbursing costs to one providing the same rate of return under the MSA, that is, a 20% markup of actual costs. Cimasi characterizes the 20% markup as a "typical deal" in the industry[65] and, thus, saw it as reasonable based on his experience.[66] Furthermore, Cimasi relied upon the testimony of Lane that it was always contemplated that MMC would pay CTCA a 20% markup on services provided.

2. DCF

Working from these general assumptions, Cimasi predicted the performance of CTCA over a five-year interval beginning immediately after the Merger Date. Cimasi developed cost projections for AIH and MMC (collectively, the "managed centers") as well as for three new centers which CTCA would directly operate. The revenues were then calculated by marking up the expenses by 20% and allocating the resulting revenue figure to the individual centers on the basis of the ratio of projected ADC of an individual center to the projected total

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computer system to develop all of the new ads and make major investments if an arrangement to earn a reasonable profit was temporary." Tr. at 1290.

[65] Tr. at 296.

[66] *Id*. at 444. Cimasi testified he had been involved in several deals with an arrangement "far in excess of 20 percent." *Id*. at 443-44.

ADC of the combined centers. Thus, the key assumptions under Cimasi's approach are those associated with the projected expenses.

To derive projected expenses, Cimasi presented various growth rates regarding different categories of expenses and extrapolated from historical data. Thus, for example, Cimasi assumed an annual growth rate of 4% for salaries and employee benefits on the basis of inflation and increases in patient census. In contrast, Cimasi assumed projected annual declines in professional fees and advertising of 7% to 2% on the assumption of economies of scale. Cimasi did not deduct any expenses related to interest upon the debt of CTCA, as the valuation he conducted was assumed to be debt free.[67] Cimasi then subtracted taxes, at a rate of 40%, to arrive at net income.

To calculate projected yearly cash flows, Cimasi then added to net income amounts for the non-cash expenses of depreciation and amortization. Next, Cimasi adjusted the resulting figure for increases in working capital and fixed assets.[68] Thus, Cimasi arrived at a projected net cash flow for each of the five projected years following the Merger Date.

Cimasi then discounted his projections by a Weighted Average Cost of Capital ("WACC") equal to 27.43%. Cimasi determined a discount rate through

[67] Depreciation and amortization were deducted as expenses and later added to arrive at cash flow. However, in comparison to Baehr's amounts for depreciation and amortization, Cimasi's values, based on the assumption of the opening of the operated centers, are high. *See* discussion *infra* Part III.C.3.

[68] Again, these projected values substantially deviate from those projected by Baehr due to the assumption of the opening of the operated centers.

the Adjusted Capital Asset Pricing Model, which Cimasi claimed is ideally suited for small, closely-held companies. This model is "based on several risk and return conditions, that when totaled, result in an estimate of the rate of return that an investor would most likely require."[69] Accordingly, Cimasi utilized five variables to arrive at this sum. First, Cimasi included a risk-free rate at the Merger Date of 8.36%. To this he added an equity risk premium of 7.1% and a "health care industry risk premium adjustment" of 2.01%. Finally, he included a "size premium" and a company-specific risk premium, equal to 5% and 12%, respectively. The summation of these five components equals 34.47%.

To arrive at the WACC, Cimasi next needed to determine the cost of the debt. To do so, Cimasi averaged three values: CTCA's cost of debt (11.19%), the cost of debt for (guideline) public companies (10.32%) and Moody's Corporate Baa bond rate (10.09%). The result of this computation was 10.53%. Because CTCA's target capital structure was 25% debt and 75% equity, the WACC was calculated to be 27.43%.

For a terminal value, Cimasi increased (by 5%) the net cash flow of projected year 5, and assumed that this amount, with an annual growth rate of 5%, would be returned in perpetuity. Cimasi next capitalized the projected terminal cash flow by 22.43%. This terminal value was then discounted accordingly (at 27.43%) to arrive at a fully discounted (as of the Merger Date) terminal value.

[69] PX 41 § 6.9.

With the summation of these discounted cash flows, Cimasi derived a present fair value of the business enterprise of $18,309,901.

Cimasi next departed significantly from the analysis of Baehr and included a "control premium." The control premium, Cimasi claimed, was justified because of the inclusion of an inherent minority discount due to the use of market prices in establishing the WACC. Accordingly, Cimasi added 20% of the present fair value of the business enterprise ($3,661,980) to the present fair value of the business enterprise to arrive at a total present fair value of the business enterprise of $21,971,881. To determine the present fair value of CTCA, Cimasi subtracted $4,052,300 in interest bearing debt and arrived at $17,920 per share.

3. Comparable Transaction Approach

In addition to relying upon the DCF analysis, Cimasi also employed a comparable transaction methodology to determine the fair value of CTCA. To do so, Cimasi initially selected hospital management and specialty hospital companies which he considered comparable to CTCA and which had been involved in transactions evidencing their enterprise value. Next, he derived, for each comparable company, the arithmetic mean, the average, the weighted mean and the median for a series of ratios for each of the companies, which included a price-to-revenue ratio, a price-to-earnings before interest and taxes ratio and a price-to-earnings ratio. Cimasi, taking the weighted mean for each ratio, computed a fair value for CTCA of $9,836,000, or $9,836 per share.

4. Guideline Publicly Traded Companies Methodology

The final methodology utilized by Cimasi for determining the fair value of CTCA was the guideline publicly traded companies methodology. Pursuant to this approach, Cimasi selected comparable companies that were categorized in the same Standard Industrial Classification ("SIC") Code[70] as CTCA.[71] For the set of comparable companies, Cimasi then calculated the weighted price-to-revenue, weighted price-to-EBITDA, weighted total invested capital ("TIC"), and weighted TIC-to-EBITDA ratios; he then chose to rely equally upon only the weighted TIC and weighted TIC-to-EBITDA ratios. Analyzing both the data presented in the 10K and 10Q reports of the chosen comparable companies, and again applying a 20% adjustment to correct for a perceived minority discount inherent in market-based price data, Cimasi averaged the two values so derived. The result was a fair value for CTCA of $18,259,000, or $18,259 per share.

5. The Fair Value of CTCA

Cimasi weighted the resulting value of each approach and arrived at a single figure representing the fair value of CTCA. He afforded the DCF analysis a 50% weighting, the comparable transactions approach a 20% weighting and the comparable companies approach a 30% weighting. The end result was a fair value for CTCA as of the Merger Date of $16,400,000, or $16,400 per share.

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[70] These codes appear in a company's EDGAR filings and indicate the company's type of business.

[71] Cimasi judged the similarity between CTCA and the subset of companies based upon the services provided, market capitalization, and amount of revenues.

Accordingly, under Cimasi's analysis, Lane would be entitled to $1,640,000 for his holdings in CTCA.

B. Baehr

Baehr has been engaged in health care consulting for more than a quarter of a century, and his work encompasses financial advice, strategic planning, and litigation support upon a variety of industry-related subjects. Before beginning work in the health care consulting industry, Baehr had received a graduate degree from the Sloan School at the Massachusetts Institute of Technology. After graduating in 1975, Baehr worked for Amherst Associates, ultimately serving as the Chief Operating Officer and the Chairman of the Board of Directors from 1982 to 1988. From 1988 until 1992, he was employed by Ernst and Young, becoming the partner heading its Midwest Finance and Planning practice in Chicago. Baehr founded his own consulting firm, Richard A. Baehr & Associates, in 1992. Additionally, he has served as a director of several health care-related entities.

In reviewing the general condition of CTCA as of the Merger Date, Baehr first explored macroeconomic and industry trends, noting that as of the Merger Date the economy was in a recession, an established trend toward outpatient care existed,[72] a falling number of cancer patients treated on an inpatient basis, technological enhancements leading to earlier detection of cancer and a reduced need for extended patient stays, and the overall increased competition between

[72] Baehr acknowledged, though, the exceptions to this trend recognized in the MediTrends Report, *supra* note 8.

cancer treatment institutions for both regional and local market share. He next focused upon three aspects of CTCA: its relationship with AIH, its relationship with MMC, and its prospects for expansion.

Baehr observed that AIH faced great uncertainty. AIH had entered negotiations with the City of Zion for issuing bonds in order to finance its facilities' expansion. Furthermore, ADC at AIH had remained flat since mid-1988. Baehr characterized the 20% markup under the MSA as "unrealistic"[73] and concluded that a reasonable, informed investor[74] would not assume that the status quo under the MSA would continue indefinitely, especially given the state of AIH, the above-market return the MSA represented, and the restrictions that would

[73] Tr. at 1135.

[74] Baehr's reference to what "a reasonable, informed investor" would assume may be criticized as potentially reflecting a failure to appreciate the differences between a statutory appraisal action to determine "fair value" and the more common undertaking of seeking to determine "fair market value." *See*, *e.g.*, *Union Ill. 1995 Inv. L.P. v. Union Fin. Group, Ltd.*, 847 A.2d 340, 355 (Del. Ch. 2004). The goal, of course, is to ascertain the corporation's intrinsic value as a going concern without consideration of factors such as lack of marketability, a minority interest discount, or synergies that might result from the combination. I am satisfied, however, that Baehr's phraseology (here and in the few other instances in which he employed words more appropriate for a "fair market value" analysis) is the product of imprecise word choice and not the result of a lack of understanding about the process for which he was engaged. His methodology is generally acceptable. His analysis of the facts and the projections which he draws from those facts regarding, in this instance, the future of the markup under the MSA are not unreasonable in this context.

inevitably be imposed by the bond financing.[75] Nonetheless, Baehr projected that the payments by AIH to CTCA would increase annually by 5%.[76]

Baehr next reviewed the relationship between CTCA and MMC. He noted that MMC was locked in a downward spiral, unable to meet management's ADC projections and losing money. Furthermore, no written agreement existed between MMC and CTCA. Finally, a significant portion of the debt owed by MMC to CTCA had been written off but MMC was still perceived as unable to meet its remaining obligations. He concluded that MMC ultimately detracted from the health and prospects of CTCA. Moreover, Baehr observed that CTCA was obligated on the lease for the City of Faith hospital in Tulsa, and that, after five years, the terms of that lease became very unfavorable to CTCA.

Regarding CTCA's own future, Baehr did not believe it was reasonable to predict that CTCA would open any new cancer treatment centers in the near future. At the time of the Merger, there were no specific plans to open a new facility and what little management existed was consumed with turning MMC around and managing AIH. Thus, the growth of CTCA would be minimal.

[75] In particular, CTCA notes that provisions prohibiting financial dealings with affiliated entities would have precluded AIH from subsidizing CTCA.

[76] Baehr supported the reasonableness of this projection by noting that the payments made by AIH to CTCA had decreased by $2.5 million, or 30% in fiscal year 1990-1991. Tr. at 1139-40.

Unlike Cimasi, Baehr only utilized a DCF analysis in order to determine a fair value for CTCA.[77] Baehr proposed four scenarios for determining the fair value of CTCA, labeled 1a, 1b, 2a, and 2b. The differences in the scenarios depended on the choice of the following inputs: whether MMC would close at the end of 1991 (1a and 1b) or remain open indefinitely (2a and 2b), and whether the reimbursement rate from AIH would remain constant at a 20% markup (1b and 2b) or be reduced to 10% (1a and 2a). Then, within each of the four scenarios, Baehr conducted a DCF analysis based upon that scenario's defining constraints and certain assumptions (including ADC growth, expenses and capital investments) in order to determine cash flow over a five-year projection period.

In order to calculate the net income before interest and taxes, Baehr projected both the revenues (in the form of management fees received) and the expenses of CTCA for a five-year period. In scenarios 1a and 1b, Baehr assumed that ADC at AIH would peak in 1992, and remain constant thereafter. Some of the patients from the then-closed MMC would be transferred to AIH. Meanwhile, in scenarios 2a and 2b, in which MMC would remain operational, combined ADC was predicted to peak in 1992 and remain constant thereafter. The ADC of MMC would grow at a modest rate, while that of AIH would decline, thus resulting in a redistribution of relative ADC. The management fees paid under the MSA and the

[77] Baehr did conduct a comparable companies analysis, but used it only as a check against the results of his DCF analysis. A discussion of this effort appears in Part III.D., *infra.*

MMC Oral Contract are, in part, functions of an allocation of CTCA home office costs; Baehr allocated these costs based upon projected patient days at the two entities. AIH was then presumed, depending upon which particular scenario, to pay either a 10% or 20% markup over costs. MMC, however, was presumed to pay only costs allocated to it.[78] Finally, a constraint was placed upon the management fees received by AIH: Baehr accepted that, "[i]n the case of AIH, management fees [are] assumed to be subject to a ceiling. Namely, it has been assumed that AIH will, in future years, pay no more than it did in the year ended December 31, 1990, with an allowed increase for inflation of 5.0 percent per year."[79]

Operating expenses for CTCA were projected, based upon various assumptions, from the expenses for the fiscal year ended December 31, 1990.[80] The various categories of expenses were themselves divided into fixed and variable components. A rate of inflation was calculated for each specific category of expense, and those categories were adjusted accordingly.

Baehr then also deducted interest and depreciation. The interest expense was based upon the CTCA schedule of payments noted in the 1990 audited financial statements. Similarly, amounts for depreciation and amortization were

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[78] MMC was also presumed "to pay additional fees associated with directly attributable indebtedness and depreciation and pay lease payments for [Oral Roberts] as a pass-through separate from management fees." RX 87 at 28.
[79] *Id.*
[80] Certain expenses were based upon 1991 budgeted amounts.

based upon the audited financial statements of 1990. Notably, the depreciation expenses for assets attributable to MMC were considered to be included in the fee paid by MMC, with any remaining expense allocated on the same basis as operating expenses.

Baehr then deducted taxes at a tax rate of 38%. To derive cash flow, Baehr added back depreciation and amortization and also added back interest expense.[81] Baehr finally adjusted the amount thus derived to provide for capital expenditures in each projected year and changes in working capital. Having done so, Baehr arrived at a projected net cash flow.

Baehr proceeded to discount the projected stream of net cash flows. Baehr calculated a WACC of 27.9%. For the cost of equity component, Baehr utilized the Capital Asset Pricing Model with a relevered beta of 1.47, a risk-free rate of return equal to a long-term Treasury bond (twenty year maturity) as of March 20, 1991, of 8.36%, and a market premium over the risk-free rate of 7.1%. Baehr also added a small stock premium of 6.34% and a specific risk premium of 10%.[82]

Finally, Baehr calculated a terminal value. Baehr assumed that CTCA achieved a steady state by 1995, and that a residual growth rate of 0% would apply in perpetuity. Thus, Baehr divided the projected net cash flow for 1995 by 27.9% and discounted that by 27.9% to March 20, 1991, to determine the terminal value.

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[81] This was done to "obtain a 'debt-free' cash flow in each year." RX 87 at 29.
[82] This specific risk premium provides for additional risks posed by uncertainties concerning operational performance, financial status, and management capabilities.

After adding the discounted net cash flows to the terminal value, Baehr subtracted the debt owed by CTCA, calculated from the obligations of CTCA as of December 31, 1990, which equaled $3,993,000.

Thus, in all but one scenario, that of 2b, Baehr derived a negative value for CTCA. Specifically, in scenarios 1a, 1b and 2a, Baehr calculated a fair value of CTCA of ($4,084,878), ($4,084,878), and ($767,114), respectively. Only in scenario 2b, with the assumptions that AIH would continue to pay a markup under the MSA of 20% (subject to 5% cap) and that MMC would continue to operate and pay all obligations (including the escalating Oral Roberts lease obligation), did CTCA have a positive fair value of $622,915. Therefore, based on his perception of the implausibility of the assumptions underlying scenario 2b, Baehr concluded that CTCA had a going concern value of $0 as of the Merger Date.

III. ANALYSIS

Having satisfied the requirements of Section 262 of the Delaware General Corporation Law, Lane is entitled to his *pro rata* share of the fair value of the common stock of CTCA as of the Merger Date.[83] "The underlying assumption in an appraisal valuation is that the dissenting shareholders would be willing to maintain their investment position had the merger not occurred."[84] Thus, as is

[83] 8 *Del. C.* § 262.
[84] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 553 (Del. 2000).

often recited, Section 262's concept of "fair value" denotes a '"proportionate interest in a going concern."'[85]

In determining the fair value to which Lane is entitled, "the Court shall take into account all relevant factors."[86] Moreover, "the parties to an appraisal action must be afforded the opportunity to present evidence of fair value consisting of 'any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court.'"[87] But the broad scope granted to the Court in determining fair value is constrained by the theoretical underpinnings of the appraisal action, for the determination of fair value is to be "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."[88] It is this narrow statutory exclusion, and its subsequent interpretation, which constitutes the principal limit imposed upon the Court's quest to divine fair value.[89] Thus, while the Court has been accorded broad latitude under Section 262 of the DGCL in its inquiry to determine

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[85] *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989) (quoting *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950)); *see also Paskill Corp.*, 747 A.2d at 553; *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at *6 (Del. Ch. Apr. 25, 2002); *Nagy v. Bistricer*, 770 A.2d 43, 55 n.23 (Del. Ch. 2000) ("[T]he purpose of an appraisal is to provide stockholders who are no longer owners of the previous entity with their fair share of its value as a going concern as of the date of the merger.").

[86] 8 *Del. C.* § 262(h).

[87] *In re Shell Oil Co.*, 607 A.2d 1213, 1219 (Del. 1992) (quoting *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983)). In fact, the Court may, instead of accepting the methodologies proposed by the parties, create its own model. *See Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996) (*Technicolor IV*).

[88] 8 *Del. C.* § 262(h).

[89] *In re Shell Oil Co.*, 607 A.2d at 1219.

fair value, the exclusionary language of Section 262 precludes the Court from considering every element which may influence the value of an entity.

> Only the speculative elements of value that may arise from the "accomplishment or expectation" of the merger are excluded. We take this to be a very narrow exception to the appraisal process, designed to eliminate use of *pro forma* data and projections of a speculative variety relating to the completion of a merger. But elements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.[90]

With these guiding principles in mind, I turn to ascertaining the fair value of CTCA's common stock. I begin with a consideration of the consequences of the Oklahoma decision. Next, I elaborate on my findings as to the business reality confronting CTCA at the time of the Merger.[91] With the foundation laid, I calculate the fair value of CTCA under a DCF approach and assess the usefulness of the comparable companies and transactions approaches.

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[90] *Weinberger*, 457 A.2d at 713. *See also Technicolor IV*, 684 A.2d at 296–97.

[91] Lane points to the arbitrary manner by which Stephenson determined the compensation to be paid to Lane for his shares at the time of the Merger (and a few other examples of conduct that suggest less than a full commitment by Stephenson to his fiduciary duties) as a basis for the Court to reject his testimony and the testimony of his affiliates. *See Neal v. Ala. By-Products Corp.*, 1990 WL 109243, *5 (Del. Ch. Aug. 1, 1990), *aff'd*, 588 A.2d 255 (Del. 1991) ("If corporate fiduciaries engage in self-dealing and fix the merger price by procedures not calculated to yield a fair price, these facts should, and will, be considered in assessing the credibility of the respondent corporations' valuation contentions.") Stephenson, however, did not materially mislead the other shareholders, as the petitioners in *Alabama By-Products* had alleged. Instead, book value, an unreliable measure, was used. I have considered this factor, but my assessment of Stephenson's credibility, as reflected in my factual findings, is primarily the product of my consideration of his testimony and its relationship to the documentary evidence.

A. The Oklahoma Decision

On February 24, 1998, the District Court of Tulsa County, Oklahoma, rendered a judgment in the appraisal action pursued by Lane and Pittman as the result of the MMC Merger. That matter was concluded with affirmance on appeal. Previously, this Court concluded "that the factual findings of the Oklahoma Court are, as a general matter, properly considered . . . in this proceeding pursuant to the principles of collateral estoppel."[92]

Several factual findings of the Oklahoma Court are relevant to the task of determining the fair value of CTCA. First, the Oklahoma Court found that MMC had no fair value as of the date of the MMC Merger,[93] as "a willing buyer would have been confronted with massive debt and no immediate future for turn-around of the corporation in March of 1991."[94] Thus, I am precluded from assigning any value other than no value to the fair value of MMC. In reaching its result, the Oklahoma Court also found, "[a]ll of the projected census numbers [for MMC] proved to be wrong and all advertising efforts had failed."[95] Clearly, under principles of collateral estoppel, I must accept the failure of the advertising campaign, and the inability of MMC to meet its own forecasts. I must also accept that the Revised Budget was unfinished and, thus, subject to revision. However,

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[92] *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2002 WL 1732381, at *2 (Del. Ch. July 3, 2002).
[93] *Mem'l Med. Ctr. & Cancer Inst., Inc.*, No. CJ931630, slip. op. at 6.
[94] *Id*.
[95] *Id*.

as will be explored further, even under theories of collateral estoppel, the application of these previously-found facts to resolving issues presented in the current controversy is not entirely free from ambiguity.

B. The Business Reality Confronting CTCA at the Time of the Merger

In gauging CTCA's business prospects from the evidence available as of the Merger Date, the parties primarily disagree about three issues. First, the parties disagree about the continuing status of the MSA. Second, the parties assert differing predictions regarding the future performance of MMC. Third, the parties espouse competing views on the prospects for CTCA's expansion in the foreseeable future.

1. The MSA

The parties adopt differing stances on the continued payment of the 20% markup under the MSA. In his analysis, Baehr reduced what he considered an artificially high 20% markup[96] to 10%, but presumed that the amounts paid under the MSA would grow by 5% annually for the projected period. CTCA justifies Baehr's altering of the terms of the MSA on several grounds. First, the April 1990 Memorandum expressly and unambiguously disclaimed the eternal subsidization of MMC under the MSA. No notice to terminate the MSA was given before the

[96] Baehr substantiated his criticism of the 20% markup as high on the grounds that past contracts (in the 1970's) of AIH with management service companies provided lower levels of compensation, and that outsourcing arrangements presumed that the third party could accomplish the outsourced task more efficiently and less expensively than the customer.

Merger Date but the absence of such notice only means that the MSA would continue for at least one year, as the MSA continued on a year-to-year basis until notice to terminate was given. Second, AIH would likely be unable to continue payment of the 20% markup fee after completing the bond offering with the City of Zion. CTCA argues that AIH would be unable to afford the 20% markup while bringing its facility up to the required standards,[97] and that legal restrictions, in the form of contractual provisions policing payments made by AIH to related entities which, Baehr claimed, are standard in typical bond arrangements, would preclude continued payment of the 20% markup under the MSA. Thus, Baehr concluded that his adjustments were reasonable.

Cimasi presumed that the 20% markup, a return he characterized as reasonable, would proceed unabated for the foreseeable future. In support of the permanency of the status quo and against Baehr's analysis, Lane makes several arguments. Primarily, Lane notes that no evidence was presented to the effect that efforts were underway to modify the terms of or terminate the MSA.[98] While the April 1990 Memorandum specifically noted that "AIH surpluses" would not continue *ad infinitum*, it did not address the continued existence of the 20%

[97] *See* Tr. at 711–12. Robert Hopkins, CTCA's Assistant Vice-President of Accounting from 1989 to 1993, testified that "it would have been difficult to push money [from AIH] to MMC and CTCA at the present [cost plus 20%] rate" if it would have to float a bond to pay for the renovations. *Id.*

[98] With equal vigor, Lane contends that nothing in the record supports the conclusions of Baehr in selecting 10% as the new return under the MSA and 5% as the annual growth rate of amounts received under the MSA. Answering Post-Trial Br. of Pet'r. Robert M. Lane at 28-29.

markup in the MSA, which constitute "management fees."[99] Lane also disputes the effect the bond financing of the AIH improvements would have upon the existing terms of the MSA. First, he notes that nothing in the record questions AIH's ability to pay the 20% markup.[100] Second, he rejects any notion that the bond agreements would necessarily curtail the payment of the management fees by virtue of policing payments to related parties and, furthermore, asserts that any such reasoning, if adopted by this Court, would amount to an impermissible minority discount. Finally, Lane hypothesized that AIH could not simply terminate the MSA because, were it to do so, CTCA could move all of the cancer patients to the Tulsa facility. However, because I find both of the parties' theories flawed, I decline to adopt either one wholesale, and instead arrive at an independent answer.

I conclude that the relationship between AIH and CTCA would continue indefinitely. No evidence is to be found in the record supporting any inference that the MSA would be terminated, or that CTCA was to be replaced, as of the Merger Date. No readily available alternatives to CTCA's continued service

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[99] Presumably, this semantic distinction formed the basis of both Lane and Hopkins's testimony that they did not consider the April 1990 Memorandum as a warning that the markup was temporary.

[100] Indeed, Lane notes that Baehr testified that "there clearly would have been legal restrictions as opposed to what appeared to be business considerations by AIH and their board to limit either the growth or the actual level of expenditure or the margin of the business that was being provided by CTCA." Tr. at 1125. Thus, Baehr's expectation that the fee would be reduced had nothing to do with ability to pay.

under the MSA, in the form either of competitors to CTCA or the internal development by AIH of those services provided by CTCA, have been identified. Stephenson, as the majority shareholder of CTCA and the controlling shareholder of AIH, cannot reasonably be expected to abandon his significant investment in CTCA by depriving CTCA of its most important "customer." Hence, while the MSA could be terminated by either party upon notice within 90 days of the end of a contract term, no motivation for such action can be ascertained from the facts at hand.[101] Given the evidence existing at the time of the Merger Date, the only reasonable inference is that the MSA would continue indefinitely. Thus, the issue before me is not whether the MSA would continue beyond the Merger Date, but, more precisely, what are the projected terms, notably the percentage markup of the MSA.

At the heart of the dispute between the parties are differing views on the nature of the 20% markup under the MSA. Lane characterizes these payments as negotiated compensation for the provision of various services by CTCA to AIH. In contrast, CTCA portrays the 20% markup as a device by which AIH, the established entity, could deliver start-up funding for MMC and otherwise

[101] I reject Lane's proposition that AIH could not terminate the MSA, or lacked the power to alter its terms, because of the implicit threat by CTCA to move the cancer treatment patients to the Tulsa facility. Lane's assertion presumes much about the "ownership" of the cancer treatment patients. Moreover, nothing in the record shows that the patients could be simply moved from Zion to Tulsa. However, while AIH could terminate the MSA, it could not do so immediately, having to abide by the termination provisions of the MSA and being constrained by the operational realities of finding an adequate replacement for CTCA.

subsidize CTCA; in other words, the MSA served as a conduit for the capital necessary to build a national network of cancer treatment centers. I conclude that the 20% markup was not primarily consideration for services rendered by CTCA, but, instead, was a vehicle enabling AIH to funnel capital to CTCA to finance its eventual national expansion. The direct evidence in the record, in the form of statements contained in the April 1990 Memorandum,[102] the representations made while seeking a line of credit from LaSalle National Bank, and the depiction of the 20% markup under the MSA as a subsidy for MMC in the initial projections for MMC, supports this characterization.

My decision that the parties chose, for whatever reason, to subsidize the national expansion of CTCA in the form of a 20% markup under the MSA is buttressed by the very structure of those Stephenson-controlled entities. CTCA's funding from the beginning came from AIH.[103] No outside investors were brought

[102] *See* April 1990 Memorandum, RX 34 at 2. In this memorandum, Stephenson wrote to Lane and the others that "AIH is the 'cash cow' that makes possible its own survival and growth, and the opportunity presented to you vis a vis CTCA, et al. Unless we protect it, both AIH and CTCA development will be in jeopardy." *Id.* He further explained that "[i]t was understood that AIH would provide to CTCA a determinable amount of money to give CTCA a start. However, such investment would be first returned to [him] before profits of CTCA would be distributed under the proposed CTCA equity sharing arrangement. [He] did not intend a permanent assignment of a big portion of AIH cash flow, nor an indirect sharing of AIH profits triggered by said assignment." *Id.* at 4.

[103] And, regardless of his proclaimed differences surrounding the initial financing of CTCA, even Lane admits that start-up funds for CTCA could be traced to profits derived from services provided to AIH. Tr. at 54 (Lane testified that his "task was to turn around the operation of [AIH] and to make it much more profitable and basically to use the monies generated by that success to fund the development of this national cancer center.").

into CTCA; the AIH "cash cow" was the only realistic source of financing the development of a national network of cancer treatment centers. Finally, that the 20% markup was a subsidy of CTCA's attempt at national expansion is confirmed by the fact that CTCA only charged MMC at-cost under the MMC Oral Contract. Thus, the structure of the relationships among AIH, CTCA and MMC corroborates the affirmative portrayals of the 20% markup as a method to subsidize the initial expansion of CTCA.

The perception that the 20% markup was to serve as seed money for the expansion of CTCA has an important ramification. By its nature, start-up (or venture capital) funding is frequently limited in duration, with the specific purpose of providing a cash infusion into a newly formed entity in order to enable it to reach some level of financial and operating independence. Thus, the April 1990 Memorandum noted that "[i]t was understood that AIH would provide to CTCA a determinable amount of money to give CTCA a start. . . . I [Stephenson] did not intend a permanent assignment of a big portion of AIH cash flow, nor an indirect sharing of AIH profits triggered by said assignment."[104] Furthermore, with the

[104] RX 34 at 4. Lane argues that he understood, at the time of first receiving the April 1990 Memorandum, that the funds referred to by Stephenson did not include the "management fee" comprised of the 20% markup under the MSA, but were separate, capital contributions to have been made by Stephenson. However, given that CTCA had been operating for nearly one year with no such contributions having been made by Stephenson, and that the only funds provided to CTCA during that period were under the MSA, I find Lane's belief unreasonable.

Cimasi contended that the "subsidization" he acknowledged in his testimony as being under the MSA referred to the bonus provision in the MSA. Tr. at 406. I note though that no monies were shown to have been paid pursuant to the bonus

realization that the 20% markup under the MSA was primarily a method to channel capital from AIH to CTCA, the debate of the parties as to whether a 20% return was reasonable becomes less important.[105] What must be determined is the likelihood of continued payment in light of its purpose in initially funding the creation of a national network of cancer treatment centers. In any event, it is clear that the 20% markup, although continuing for some time after the Merger Date, was not to be paid permanently.[106]

I am satisfied it is reasonable to project that the 20% markup would continue through the third year after the Merger. Such a time frame for the 20% markup would be consistent with its purpose of enabling the next stage of growth in a national network of cancer treatment centers. Moreover, a three-year timeframe would allow more than adequate time for Gagliardi to demonstrate that expansion was possible by reversing the deterioration of MMC. Additionally, I

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provision. Also, I note that, while the 20% markup may not have been the most efficient vehicle to subsidize CTCA, a bonus on that markup would have injected another layer of uncertainty.

[105] I note though that I find Baehr the more persuasive of the conflicting expert witnesses as to the reasonableness of compensating CTCA for services provided by a 20% markup over costs. In part, my opinion is formed from the inability of Cimasi to point to specific instances of a comparably sized fee. *See* Tr. at 443. The perception that 20% is an unreasonable amount for CTCA to be compensated for its services only reinforces my belief that such payments are best viewed as a financing vehicle, instead of a negotiated level of compensation.

[106] Lane insists that, because no affirmative steps were taken to terminate the MSA or alter its terms, the Court should assume that the status quo under the MSA would continue indefinitely. The absence of such evidence, however, fails to overcome the evidence demonstrating the nature of 20% markup under the MSA, and the consequences that likely flow from it.

am satisfied that, although not a definitive constraint, within three years significant burdens would be imposed upon AIH to justify the continued payment of the 20% markup under the MSA by the rigors of the already commenced bond financing. AIH, the foundation of the CTCA and MMC enterprises, needed to revamp the AIH facility in order to retain its operating licenses in Illinois. To this end, CTCA and the City of Zion had already entered into negotiations at the time of the Merger to accomplish this undertaking. The arrangements for bond financing with the City of Zion, while not by their very terms comprising a definitive limitation on funding of the related entities,[107] would to some degree constrain the ability of AIH to subsidize CTCA's growth due to operational realities in making scheduled payments. Therefore, I conclude that the 20% markup under the MSA would continue for a period of three years beyond the Merger Date, after which, with its mission of "giv[ing] CTCA a start," fulfilled, the level of remuneration provided for under the MSA would be revised downward. The question, thus, becomes: what markup can reasonably be forecast based on the information known as of the Merger Date? Baehr's projection of 10% as a going rate is not unreasonable. The markup, however, would not be completely based upon external market forces.

[107] To guess as to the precise terms and restraints that might be imposed upon AIH by the hypothetical bond agreements, upon a record lacking factual details, when the parties were still negotiating those covenants, would be to engage in the kind of speculation deemed impermissible by *Weinberger* and its progeny. *See supra* note 90 and accompanying text. It is both sufficient and necessary for these purposes to recognize that the AIH expansion would inevitably put pressure of AIH to reduce the markup/subsidy paid to CTCA.

Stephenson, while not interested in subsidizing CTCA through AIH indefinitely, was, as of the Merger Date, apparently still committed to CTCA. His decision, for example, to bring in Gagliardi to attack the MMC problem demonstrates his intent to pursue the effort to implement the CTCA business model. His effective control of AIH would have allowed him to resist, to an extent, the external pressures for downward revision of the MSA markup. The record does not allow for any precise calculation, but the lack of precision does not force the Court to choose between no revision (*i.e.*, remaining at 20%) and a revision to a pure product of market forces (perhaps 10%). Instead, the markup, within the time frame of this analysis, most likely would be the product of a compromise. I conclude, based upon the facts known as of the Merger Date, that a 15% markup starting the fourth year following the merger would be reasonable and likely under the circumstances.

2. MMC

The parties disagree about the status of the ongoing relationship between MMC and CTCA. Specifically, the parties dispute whether MMC would remain open for the foreseeable future, whether the terms of the MMC Oral Contract would define the future relationship, and the contribution, if any, of MMC to the enterprise value of CTCA. Compounding the difficulty of this Court's task are the ramifications of the Oklahoma Court's decision in light of the parties' different perspectives on that ruling. After considering these factors, I conclude that MMC

would not add anything to the enterprise value and, ultimately, the fair value of CTCA.

Initially, the Court must decide, based upon the evidence as of the Merger Date, whether the relationship between MMC and CTCA would continue into the foreseeable future. In two of his four scenarios, Baehr assumed that MMC would cease operating on December 31, 1991. In part, Baehr based that prediction upon the cautioning opinion of Arthur Andersen & Co. as to MMC's continued viability as a going concern. Additionally, CTCA notes that MMC had lost $5 million in 1990 plus another $1 million in the first two months of 1991,[108] that any revenues would be offset by a large amount of debt (at least $2.9 million) owed by MMC to CTCA, and that the Oklahoma Court found MMC to have no value at the time of the Merger. Despite acknowledging these financial shortcomings, Lane contends that MMC, which as an emerging company could be expected to sustain losses in its formative years, would remain open for the foreseeable future. He argues that closing MMC would run counter to the expansionary plans of CTCA and that nothing in the record supports the inference that MMC would be closed. Finally, Lane asserts that any move to close MMC would actually boost the enterprise value of CTCA.

I agree with Lane that, based upon the evidence as of the Merger Date, MMC would continue to operate for the foreseeable future. Nothing in the record

[108] RX 83.

reflects a definitive decision to close MMC.[109] In fact, Stephenson opted to recruit Gagliardi, a turn-around specialist, to lead the efforts to reverse the decline of MMC. This decision reflects the renewed commitment of Stephenson to his first executed expansion, a step which he recognized as critical to the long term viability of his business plan[110] and dreams of developing a national network of cancer treatment centers.[111] Thus, I conclude that the relationship between MMC and CTCA would remain in existence for the foreseeable future.[112]

The parties next dispute the foreseeable terms of the agreement between MMC and CTCA. At the time of the Merger, MMC, pursuant to an oral contract, reimbursed CTCA at cost for services rendered. Cimasi, however, predicted that this agreement would be modified to be in line with the 20% markup provided for

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[109] Similarly, though argued by CTCA, nothing in the record evidences that MMC was somehow financially precluded from continuing operations beyond 1991.

[110] In the April 1990 Memorandum, Stephenson prioritized in importance the problems at and plans for MMC as second only to protecting AIH.

[111] *See* April 1990 Memorandum, RX 34 at 2 ("As planned, I think the timely development of other centers is also extremely critical . . . . Unless we find ways to [expand] within the narrow window of opportunity available to us, we are not going to maximize the profit potential that I have so long envisioned.").

[112] I reject Cimasi's hypothesis that CTCA would benefit from a closing of MMC. First, I note that the closing of the first, new cancer treatment center beyond AIH would be a material setback to the business model of CTCA, which was premised upon creating a national network of cancer care facilities. Second, Cimasi's theory presumes the ability of CTCA to shift "its" cancer patients freely between treatment facilities in distant geographic locales, an assumption I have previously questioned. *See supra* note 101. Third, I note that shifting additional cancer treatment patients to AIH at the time of the Merger was not likely, given that AIH was operating at or near capacity.

under the MSA.[113] CTCA challenges any suggestion that the relationship between MMC and CTCA would resemble the funding relationship between AIH and CTCA, stressing that nothing in the record supports this change to the terms of the MMC Oral Contract. Furthermore, CTCA doubts whether MMC could afford to pay a 20% markup even if such an understanding were reached.

Once again, the conflict between the parties is resolved by focusing upon the evidence available at the time of the Merger. Nothing in the record, save Lane's testimony, evidences that any change would be made to the terms of the agreement between MMC and CTCA, or the timing of such a modification.[114] Moreover, any parity between the MMC Oral Contract and the MSA is illusory based upon the identified nature of the MSA's 20% markup as a subsidy. Lane has not demonstrated that, as of the Merger Date, MMC was expected (or, indeed, could) somehow to contribute to the further subsidy of CTCA's national expansion.

Finally, I note that special attention must be paid to the collateral estoppel effect of the Oklahoma Court's finding that MMC had a value of zero as of the Merger Date. This finding is not as wooden as CTCA argues, for a range of

[113] Cimasi's basis for his opinion was Lane's testimony that this revision to the compensation to CTCA by MMC had always been contemplated.

[114] One could argue that some return would be paid by MMC on services rendered after the expiration of the subsidies provided for under the MSA, as the status quo under the oral agreement between MMC and CTCA was a corollary to AIH's subsidization of CTCA's national expansion. However, the record does not afford a reasonable basis for any such projection.

possibilities exists in describing the operational status of MMC while still concluding that MMC had no value as of March 1991. From Lane's perspective, at best, this factual finding signifies that the profits of MMC would be completely and exactly offset by corresponding debt or expense obligations. Thus, for all future time periods, if every dollar earned in profit by MMC is negated by current payment obligations, the summation of these discounted values (zero in every period) fails to add any value to MMC. At best, a result of no value is dictated by the inability of MMC to produce a cumulative profit in the future.[115]

When one reviews the evidence existing at the time of the Merger, the more plausible interpretation of the Oklahoma Court's finding that MMC had no value as of March 1991 is that MMC would meet its current obligations, but no more, thus arriving at zero value. ADC at MMC, ignoring issues of patient steering toward AIH, was trending upward and could be expected to follow the pattern of initial increases in ADC exhibited by AIH. Additionally, some weight must be given to the decision by Stephenson, the majority shareholder who presumably enjoyed informational superiority, to attempt to revive MMC by bringing in

[115] Another possibility could produce the result of an MMC with no value: that of an initial period of profitability, lasting for an indeterminable period of time, but followed by a period of losses. However, if MMC became profitable over time, it seems unlikely that it would lose that profitability when its profits caught up with its losses; a continuation of profits after that point, however, would be inconsistent with the Oklahoma Court's finding.

In theory, there may be yet another alternative as well: a period of initial losses followed by a turn to profitability, one where profits and losses eventually net out. However, this alternative also seems unlikely based on the record before this Court.

Gagliardi; for Stephenson to increase, through CTCA, his substantial investments in MMC, he must have perceived MMC as having some measure of value, either in and of itself or in the context of the other related ventures. While I am foreclosed by the Oklahoma Court's decision from determining MMC had positive value as of the Merger Date, I am not precluded from drawing the inference from these positive aspects of MMC at the time of the Merger that the more optimistic of these interpretations should be adopted. Therefore, I find that MMC, while having no value, could best be modeled as paying current obligations, but never earning a profit.

In light of this interpretation, I turn to explore the relationship of MMC and CTCA at the time of the Merger. Even with the assumption that MMC will be able to pay current expenses, but no more, MMC will still be unable to pay off the remaining $2.9 million account payable to CTCA representing monies owed for services rendered. This conclusion is supported somewhat by CTCA's contention that the only reason the debt was this low was because CTCA had written off a large portion of it.[116] However, the effectiveness of this argument is limited because MMC had shown its ability to pay back some of its debt by paying CTCA $1.2 million in cash as of December 31, 1990.[117] The main reason for the Court's

[116] CTCA also points to the fact that the debt owed by MMC is, but for a questionable reshuffling, significantly larger than as portrayed on the financial statements of MMC. However, I must accept that the amount of the debt was $2.9 million.

[117] RX 87 at 18.

finding that MMC would not repay the $2.9 million owed to CTCA is that any other conclusion would be inconsistent with the import of the Oklahoma Court's decision. For instance, were MMC to repay the debt in ten equal payments over the decade immediately following the Merger, that would mean that in year eleven – once the debt was repaid – MMC would likely again have free cash flow (assuming other factors remain unchanged) and, thus, positive value.[118] This potential is effectively foreclosed by the collateral estoppel effects of the Oklahoma Court's decision, thus, I find that MMC would not be able to repay the debt that it owed to CTCA.

The interpretation of the Oklahoma Court's findings that I have adopted could theoretically accommodate a future increase in the amounts paid, only as reimbursement of costs, by MMC. While ADC, as noted by the Oklahoma Court, did not achieve management's projected levels, it was increasing from 1990 into 1991. If the ADC at MMC followed a similar pattern of growth as the ADC at AIH, one could expect larger initial annual gains, with the yearly increases tapering off over time.[119] These rising revenues, as the result of increasing ADC,

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[118] The possibility that MMC would be able to pay some, but not all, of the debt may exist, but that is an unlikely possibility because of the pressures that MMC was under at the time of the Merger. If MMC were to resolve its problems so that it could make payments beyond those needed simply to keep open, then it is difficult to see how it would not have been able to do even better and to have eventually emerged from the difficulties that it confronted – a possibility that the zero value determination by the Oklahoma Court does foreclose.

[119] Indeed, the very preliminary results of 1990 through 1991 could be thought of as one of the larger initial gains in this pattern.

could allow for an increased level of expenses that MMC could bear and might even, at least theoretically, allow for some markup. Thus, under this "best case" scenario, the determination by the Oklahoma Court that MMC had no value as of the Merger Date would not inescapably preclude a change in the amount CTCA was compensated.

That I acknowledge the existence of this theoretical possibility does not mean I have found as much. To the contrary based upon the information available at the time of the Merger, this "best case" scenario seems highly unlikely, at best, for several reasons. First, while ADC was increasing, MMC still had a long way to go until profitability would be achieved.[120] Thus, MMC would not earn a profit within the short-term. Second, within five years of the Merger Date, the payments under the City of Faith Hospital lease, which CTCA was obligated to make, increased dramatically. Accepting that MMC would pay its rent, while a favorable conclusion for purpose of CTCA's cash flow, further demonstrates the pressures under which MMC was operating. Thus, I conclude that this "best case" scenario only reinforces my view that the MMC Oral Contract would not change

[120] I reject Lane's assertion that, because he asserted at some point that an ADC of 14.7 was a breakeven point for MMC, and the other members of the CTCA management team did not object, that somehow this statistic is entitled to great weight. First, Lane's claimed break-even point seems improbable. Lane provided no statistics or financial data to buttress his conclusion. Second, and more importantly, Lane's claimed break-even point of 14.7 and his extrapolation that MMC would soon be profitable contradicts the finding of the Oklahoma Court that MMC had no value as to the Merger Date.

advantageously for CTCA in the foreseeable future, and the compensation afforded to CTCA for its services would remain at cost.

Given that the status quo under the MMC Oral Contract existing at the Merger Date would persist, I turn to consider what benefit, if any, MMC would contribute to CTCA. CTCA would continue to perform services for MMC, but would only be compensated at cost. Therefore, CTCA would not earn a profit (or free cash flow) on any business conducted with MMC. However, that is not to say that MMC would provide absolutely no benefit to CTCA: by merely existing and "breaking even," MMC could contribute to the establishment of a national cancer care network by reducing per unit costs and helping establish economies of scale. Because of other constraints confronting CTCA, this potential contribution would not materially enhance the value of CTCA.

3. CTCA's Expansion

Finally, Lane and CTCA disagree about CTCA's prospects for expansion in the foreseeable future. For his analyses, Baehr assumed that CTCA would not expand beyond the Tulsa and Zion markets. Conversely, Cimasi projected that CTCA would open three new cancer treatment centers in five years; these three new cancer treatment centers, Cimasi predicted, would contribute to the total ADC of the combined centers of CTCA as follows:

1991	1992	1993	1994	1995
65	78	114	141	158

Thus, the dispute between the parties regarding the expansion of CTCA can be divided into two issues: whether CTCA would expand, and what the effects of an expansion would be upon the value of CTCA.

CTCA initially challenges whether CTCA would expand at all.[121] It argues that "[a]n investor would not have assumed that CTCA would open any new centers in the foreseeable future because there were no current plans for new centers, and because its management was focusing on the building project at AIH and on attempting to turnaround MMC."[122] However, I reject CTCA's assertion that it had abandoned its plans to expand beyond the Zion and Tulsa markets. The record demonstrates that, as of the Merger Date, CTCA was willing to continue its path toward creating a national network. The April 1990 Memorandum reiterated the critical understanding that the business model demanded that CTCA continue to enter timely new geographic markets in order to achieve the critical mass necessary to sustain its business model. As long as CTCA is presumed to continue as a going concern, under its existing business model, CTCA will be presumed to intend to continue expanding to new markets.

However, intent does not equate to ability. I am satisfied that the evidence, in conjunction with my previous determination regarding the foreseeable nature and status of the MSA, demonstrates that CTCA would be financially unable to

[121] Baehr developed his models under the assumption that CTCA would not expand.

[122] Resp't's Opening Br. at 25.

expand in the foreseeable future. The full subsidy occurring under the MSA would expire within three years of the Merger Date. Although CTCA would have available sometime after the Merger a not insubstantial amount of free cash, it is questionable if this would have been adequate to open a new center, particularly an operated center. The record also shows that CTCA was unable to obtain outside financing, as evidenced by LaSalle National Bank's rejection of CTCA's efforts to secure a line of credit. Thus, the only remaining potential new sources for funding the expansion are MMC or Stephenson.[123] From the reasonable inferences drawn from the evidence existing at the time of the Merger, and from the determination of the Oklahoma Court that MMC had no value as of the Merger Date, it cannot be contended that MMC could meaningfully contribute to the national expansion of CTCA.[124] Lane can identify no specific plans for expansion existing at the time of the Merger that rebut the perceived inability of CTCA to fund the opening of any new cancer treatment centers.[125] Therefore, I conclude

[123] I reject Lane's argument that this is, in effect, a minority discount because it allows the majority shareholder the power to determine the Company's future, to the detriment of the minority shareholders. It is not a minority discount, but it is an acknowledgement of the structure of CTCA. After all, Stephenson was not obligated to provide additional funding. Perhaps Stephenson would have provided additional funding but that is, in part, a matter of speculation. More importantly, any prediction of the terms and conditions of any such financing would be nothing more than a guess.

[124] Again, I note that some contribution, in the form of cost savings and possible operational efficiencies, could be made by MMC.

[125] Lane urges that at the time of the Merger, CTCA was developing a cancer treatment facility in Brea, California, and points to Dr. Williams' licensing in that state as confirmation of this plan. However, nothing reflected in the minutes and documents of CTCA acknowledges the existence of such a planned expansion as

that CTCA was financially precluded from implementing its general plans to further expand beyond the Zion and Tulsa facilities.

Furthermore, even if CTCA were able to implement its general strategy to expand, there is no evidence that any expansion would be profitable. In order to determine the effect of CTCA's expansion in the foreseeable future, I must first determine how CTCA would expand if it could. Cimasi proposed that CTCA would add three new sites in five years, deeming this rate of growth "conservative" given his experience with "rollups" and Lane's experience at Hospital Corporation of America.[126] I arrive at the same answer as Cimasi in terms of how many cancer treatment centers would be added, were CTCA not otherwise financially precluded from doing so, but I reject his reasoning. The "rollups" Cimasi cited from his own experience were not demonstrated to be sufficiently similar to CTCA in order to draw a meaningful comparison.

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of the Merger Date. Furthermore, the licensing of Dr. Williams could have been attributable to factors other than the planned expansion of CTCA. Thus, while I accept that CTCA maintained its designs to expand at the time of the Merger, I cannot conclude that Brea was the specific target market, or that CTCA had developed any plans beyond a vague, guiding principle to expand.

Lane also notes that the projections submitted to the MMC board, with the Revised Budget, include the opening of a new cancer treatment center. However, testimony from those involved in formulating the forecasts indicates that the inclusion of the third facility was at the behest of Pittman, with no basis other than his desire that an additional facility be opened. Tr. at 854–55. Additionally, I note that the Oklahoma Court disparaged the reliability of the forecasts, noting that they were "a work in progress." *Mem'l Med. Ctr. & Cancer Inst., Inc.*, slip. op. at 6. Indeed, it would be difficult to reconcile the optimism reflected in that budget with the Oklahoma Court's finding that MMC has no value.

[126] Hospital Corporation of America added greater than 100 new hospitals to its system over a four-year period.

Furthermore, the growth rate of Hospital Corporation of America, a well-established corporation servicing a broader market than the niche market of CTCA, also is inapplicable to CTCA. Instead, based on the evidence existing at the time of the Merger, it took one-and-one-half years for CTCA to find a suitable site and to commence operations in opening MMC. Assuming, that the same timeframe would apply to opening additional facilities, within the next five years the maximum that CTCA could expand would be in three new markets.

That said, the effect of such expansion must be determined. Unfortunately, the available evidence which could shed light on this task is paltry at best. The only experience with expansion is the debacle at MMC. The many setbacks experienced by MMC have been previously noted and need not be rehashed here. Lane would have me start my analysis with one of the few positive aspects of the MMC expansion as of the Merger Date: ADC was showing a marked increase for the first two months of 1991. While this is true, I still encounter several formidable obstacles before reaching Lane's desired conclusion. First, MMC apparently lost $1 million in those first two months of 1991; thus the "success" of MMC is somewhat muted. Second, MMC was only paying CTCA on an at-cost basis. Under the MMC Oral Contract, CTCA would, assuming that MMC met its obligations, break-even for its efforts, and I have previously declined Lane's invitation to speculate about a turnaround at MMC with a change in the terms of

the MMC Oral Contract fueling an increase in CTCA's value.[127] Third, at the time of the Merger, CTCA was operating without experienced senior management. The employment relationships between CTCA and Lane (and Pittman), who were instrumental in the drive to develop a national network, had ended. It would be nothing more than a stab in the dark to hypothesize as to the capacities of incoming management to guide successfully the expansion of CTCA into new markets. Moreover, the benefits arising from the MMC learning curve were largely lost with the departure of Lane and Pittman. Management plays an important role in expansions of this nature; nothing in the record demonstrates the presence of personnel capable of managing the expansion of CTCA. Finally, I acknowledge the Oklahoma Court's finding that MMC had no value as of the Merger Date. Therefore, extrapolating from the only evidence of CTCA's expansion efforts available at the time of the Merger, I cannot conclude that any further expansion efforts would contribute to the value of CTCA.[128]

C. DCF Analysis

Both Cimasi and Baehr concentrated their efforts to calculate a fair value for CTCA in conducting a DCF analysis. One can reasonably have doubts about the ability of a DCF analysis to capture accurately the fair value of an emerging

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[127] *See supra* notes 113-14 and accompanying text. Given the business model of CTCA, and the necessary subsidy of new cancer treatment centers, it is reasonable to conclude that the new centers also would be subsidized for some time through the provision of services under at-cost contracts.

[128] Thus, even if CTCA had the financial wherewithal to open one new center (or, optimistically, two) there is no basis for projecting a timely and positive cash flow.

company with an earnings history of less than two years.[129] Yet, both experts advocated a DCF analysis as the optimal model for determining the enterprise value of CTCA.[130] In making this determination of the fair value of CTCA, I have essentially adopted Baehr's model, because I find it to be the more reasonable of the two presented. I have, however, deviated from his approach in the projection of costs, the estimate of long-term growth, and the terms of the MSA to incorporate my factual findings as to the business reality facing CTCA at the time of the merger. This DCF model shows that CTCA had a value of $1,008,000 as a going concern as of the Merger Date.

It is instructive to focus upon how the conditions confronting CTCA at the time of the Merger differ from the presumptions of both Cimasi and Baehr in their models. First, the Court found that CTCA would receive a 20% markup under the MSA for the initial three years; then it would be reduced to a more reasonable rate of 15%. Cimasi had assumed a continued markup under the MSA of 20% for the foreseeable future, while Baehr, in scenarios 1a and 2a, assumed a 10% markup and, in scenarios 1b and 2b, assumed a 20% markup. Next, the Court found, based upon the consideration of all relevant circumstances and the Oklahoma Court's

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[129] *See* discussion *infra* Part III.G.

[130] Baehr exclusively relied upon a DCF analysis in determining the fair value, or lack thereof, of CTCA. Baehr's comparable companies approach served only as a reality check for the value (zero) generated by his DCF approach.

Admittedly, Cimasi only afforded his DCF analysis a 50% weighting. This signified, however, that the DCF analysis enjoyed nearly double the importance than the next most meaningful methodology, the comparable companies approach to which he assigned a 30% value.

decision, that MMC had no value at the time of the Merger Date and that, while continuing in operation, would never pay more to CTCA than those costs for which it was charged. Cimasi assumed that MMC would pay 20% markup under the MMC Oral Contract, while in scenarios 1a and 1b, Baehr assumed that MMC would cease operations after 1991. Furthermore, the Court determined, as Baehr predicted, that MMC would not be able to repay the amounts owed to CTCA. Finally, the Court, in agreement with Baehr's analysis, determined that CTCA would not expand and open new sites in the foreseeable future. This finding directly contradicts the projections of Cimasi, who presumed that CTCA would open three new sites within five years of the Merger.

In analyzing the enterprise value of CTCA at the time of the Merger under a DCF analysis, it is helpful to think of the value of CTCA as being comprised of three separate streams of income: (i) the cash flows arising from the implementation of its business model, its further expansion, and the revenues generated from these new business activities; (ii) the revenues received for services provided to MMC; and (iii) the future cash flows provided under the MSA. However, the Court has already determined that the first two streams, that from expansion of CTCA into new markets and that from revenues generated by providing management services to MMC, would not add to the net income of

CTCA.[131] Therefore, only the third stream of revenues, those under the MSA, ultimately determines the value of CTCA.

The source of free cash flow for CTCA was the markup from the MSA which provided in part:

> Management fees provided [under the MSA] shall be not less than an amount equal to the direct and indirect costs incurred by [CTCA] in providing services [under the MSA] plus an amount equal to 20% thereof.[132]

The agreement also notes the potential bonuses, but there is no basis for projecting payment of bonuses under the circumstances. The markup was to be calculated by reference to CTCA's "direct and indirect cost," a broad concept, of performing its services for AIH. This broad basis for compensation would include most of the various line item expenses identified in CTCA's income statement. Although the "profitability" of CTCA's efforts at AIH in 1990 did not reflect a simple markup of expenses, that, over time, is the target toward which CTCA cash flow should gravitate. Thus, when all costs – indirect and direct – incurred by CTCA in providing services for AIH are subject to the markup, it is reasonable to predict that eventually the cash flow to CTCA would be the sum of those costs plus the markup. This model not only reflects the likely steady state financial model, but it also properly directs one's focus to the critical nature of the markup to CTCA's

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[131] It is assumed that all costs associated with MMC will be charged to and paid for by MMC, including the escalating rent due under the Oral Roberts Lease. Thus, the increased payments under the Oral Roberts Lease do not have any net effect on CTCA's cash flow.

[132] RX 23 at R1444.

financial viability. For purposes of evaluation of CTCA under the discounted cash flow approach, the AIH markup is the critical input.[133]

[133] CTCA's Income Statement for 1990 is as follows:

REVENUE	
Management Fees	
AIH	$7,934,900
MMC	$2,243,100
Total	$10,178,100
Interest Income	$470,100
Total Revenue	$10,648,100
EXPENSES	
Salaries and Wages	$2,613,300
Employee Benefits	$435,900
Professional Fees	$1,838,000
Advertising	$2,536,400
Department Supplies	$223,900
Rent, Utilities, and Other	$1,760,000
Interest Expense	$105,000
Depreciation and Amortization	$482,300
Charge backs	($753,500)
Total Operating Expenses	$9,241,300
Net Income Before Taxes	$1,406,800
Provision for Income Tax	$21,500
Net Income After Taxes	$1,385,300

RX 87 at ex. C. The 1990 revenues for CTCA cannot be tied precisely to the cost of serving AIH and MMC and the markup under the MSA on the AIH costs. Yet, that is the financial structure of CTCA that would result over time based upon its marketing arrangements as of March 1991. If the management fee from MMC is assumed to be the total cost (direct and indirect, but with no markup) of providing services there, the operating expenses at AIH would be $6,998,200 or the difference between total operating costs and MMC costs ($9,241,300 – $2,243,100). If the 20% markup for AIH costs is deducted from the AIH management fee, the Court's model would predict AIH operating expenses of $6,612,000 ($7,934,900 ÷ 1.2). The difference between the model and the actual for 1990 is less than 6%. With time, the deviation would be projected to diminish. It should also be noted that the interest income posted by CTCA in 1990 was not expected to reoccur.

1. Projection of Costs Generally

Two components determine CTCA's gross revenues: the reimbursed costs of services to AIH plus the markup and the reimbursed costs of services to MMC. Thus, any projection[134] of revenue depends on the anticipated changes in costs. The Court concludes that CTCA's costs, except for interest and depreciation and amortization, would escalate at 5% annually – a combination of inflation at 4% and growth at 1%.[135] Baehr's inflation assumptions are 2% to 5% annually.[136] Cimasi appears to have used 4% to 5% as his default rate for increases due "to inflation and increase in census."[137] The Court rejects several growth assumptions of Cimasi for specific categories of expenses. Some of his assumptions based on economies of scale cannot survive the Court's conclusion that CTCA would not expand beyond AIH and MMC. The Court also notes that AIH was at or near capacity and its ability to add additional cancer patients was limited. Although a new AIH facility might have been able to accommodate more cancer patients, the embryonic status of that expansion effort, as of the Merger Date, makes unreasonable any projection of capacity based on that project.

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[134] The preferred approach, of course, is to employ objective management forecasts. *See*, *e.g.*, *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *12–*15 (Del. Ch. May 3, 2004). Unfortunately, CTCA's management's forecasts are suspect because there is no long-term perspective against which to measure them and, more importantly, the limited experience demonstrates that they were not reliable and tended to be unduly optimistic.

[135] The Court adopts 5% as the terminal growth rate.

[136] RX 87 at 26, 28.

[137] PX 41 at sch. 18.

Baehr also predicted that two elements of costs, interest and depreciation and amortization, would decline based in part on the view that the opening of new facilities was unlikely, a projection that the Court has accepted. The Court, thus, turns to consider, first, the appropriate projection of interest expenses and, second, the appropriate projection of depreciation and amortization.

2. Interest[138]

Baehr assumed the same interest expenses in all four of his scenarios. These were deducted from net income as an expense before determining taxes and then added back as an adjustment before applying any discount factor. He noted that they were "based on the outstanding indebtedness of CTCA as of December 30, 1990."[139] The Court adopts the following interest expenses:[140]

	1991	1992	1993	1994	1995
AIH	175	128	80	39	4
MMC	60	43	27	13	1
Total	235	171	107	52	5

[138] Interest and depreciation and amortization are allocated to MMC and AIH in the same proportion as the total costs for each facility as calculated for 1990. Thus, 74.67% is allocated to AIH and 25.33% is allocated to MMC.
[139] RX 87 at 27.
[140] Because interest expenses net out for purposes of the cash flow analysis if they are subtracted from revenues to determine net income and added to achieve a "debt free" model, Cimasi did not bother with interest projections. Unless otherwise noted, all tabulated numbers, except for the experts' projections, throughout the balance of this Memorandum Opinion represent thousands of dollars.

3. Depreciation and Amortization

With respect to Depreciation and Amortization, the parties, at first glance, appear wildly divergent. The two experts projected the following depreciation and amortization schedules:

	1991	1992	1993	1994	1995
Baehr[141]	$487,300	$492,300	$450,800	$389,100	$367,600
Cimasi	$515,680	$601,563	$709,238	$770,097	$817,339

However, the substantial difference between the two experts can be largely ascribed to Cimasi's assumptions regarding the opening of the three operated centers. When the operated centers are removed, Cimasi's projections of depreciation and amortization attributable to the managed centers become:

1991	1992	1993	1994	1995
$515,680	$392,543	$282,198	$324,607	$143,456

Thus, with the exception of 1991, the projected annual depreciation and amortization attributable to the managed centers is larger in Baehr's model than that of Cimasi.

I reject Cimasi's, albeit modified, model because the increase in 1994 is inconsistent with maintaining and depreciating the established level of fixed assets. Thus, I find that Cimasi's schedule of depreciation and amortization is a

[141] Baehr claimed the same depreciation and amortization in all of his four scenarios.

less accurate reflection of the relevant circumstances existing at the time of the Merger.

In contrast, I find that the depreciation and amortization presented by Baehr reasonably reflects the relevant facts at the time of the Merger. The amounts projected by Baehr are based upon those assets, as noted on the audited financial statements, existing at the end of 1990, and not upon any projected expansion and new centers. Therefore, I will rely upon the depreciation and amortization schedule as set forth in Baehr's report. After allocating to MMC and AIH, depreciation and amortization are as follows:

Projected Year	1991	1992	1993	1994	1995
AIH	364	367	337	290	275
MMC	123	125	114	99	93
Total	487	492	451	389	368

4. <u>Costs and Revenues</u>

Under the MSA, the more proper approach for projecting revenues is to ascertain the increase in costs and then determine the contractually mandated 20% return for the first three years and the projected markup of 15% for the last two years of the analysis. As set forth above, CTCA's costs, except for interest and depreciation and amortization are projected to grow at 5% annually. Accordingly, it is necessary to project CTCA's other costs.

In 1990, AIH paid $7,934,900 in management fees to CTCA under the MSA. After deducting the 20% markup under the MSA then in place, it can be determined that the costs incurred by CTCA in servicing AIH were $6,612,000, which includes both interest and depreciation and amortization. Costs other than interest and depreciation and amortization can reasonably be projected to grow out 5% annually but, as set forth above, the more reliable projection for these two components is that they would decline. To escalate all costs at 5% would distort the likely future cost structure of CTCA. In order to avoid the inappropriate cost escalation for the two components that will decline with time, interest and depreciation and amortization are subtracted from the 1990 costs.[142] Thus, the base 1990 amount for AIH is costs other than interest and depreciation and amortization would be $6,174,000. When that number is increased at 5% each

[142] Interest and depreciation and amortization have been allocated to AIH and MMC in the same proportion as their projected revenues. Those expenses have been subtracted from the base year numbers (1990) in order to determine the expenses other than interest and amortization. Those other expenses are then projected to grow annually at 5%; the expenses thus allocated to AIH – interest and depreciation and amortization in accordance with Baehr's projection and all other expenses in accordance with a 5% annual growth projection are then the basis for the markup.

year and the projections for interest and depreciation and amortization are included, the total projected costs for AIH are as follows:

	1991	1992	1993	1994	1995
Depreciation & Amortization	364	367	337	290	275
Interest	175	128	80	39	4
Other Costs	6,483	6,807	7,147	7,505	7,880
Total Costs	7,022	7,302	7,564	7,834	8,159

I have previously determined that the MSA would pay out 20% return over costs for the first three years, followed by a 15% return over costs. Thus, for the five-year period, the markup derived from the MSA is:

1991	1992	1993	1994	1995
1,404	1,460	1,513	1,175	1,224

Accordingly, the projected revenues from AIH are as follows:[143]

1991	1992	1993	1994	1995
8,426	8,763	9,077	9,009	9,382

The total costs (other than the Oral Roberts Lease) from MMC for 1990 were $2,243,000. Of that, $122,000 may be allocated to depreciation and amortization

[143] The MSA entitles CTCA to recover from AIH "direct and indirect costs" plus a 20% markup. RX 23 at R1444. Interest and depreciation and amortization are indirect costs of performance of the work done by CTCA. The contractual relationship between AIH and CTCA allows recovery of CTCA's costs only through the mechanism of the MSA. Thus, I have treated interest and depreciation and amortization as expenses which are properly subjected to the markup. Baehr's projections of depreciation and amortization and interest, are consistent with the Court's model and, significantly, decrease with time.

and $27,000 to interest. Costs, other than depreciation and amortization and interest are the difference: $2,094,000. With interest and depreciation and amortization as projected by Baehr and the other costs increased by 5% annually, the costs of serving MMC and the revenues based on those services, which are equal based on the MMC Oral Contract, are as follows:

	1991	1992	1993	1994	1995
Depreciation & Amortization	123	125	114	99	93
Interest	60	43	27	13	1
Other Costs	2,199	2,309	2,424	2,546	2,673
Total Costs	2,382	2,477	2,566	2,657	2,767

5. Taxes

The two experts did not vary significantly on their assumed tax rates.[144] Cimasi assumed a rate of 40%, Baehr assumed one of 38%. I will use Baehr's assumption as it appears more reasonable under the circumstances.

6. Capital Expenditures

As an adjustment to net income in order to determine cash flow, Baehr subtracted $100,000 for each projected year on the assumption "that CTCA will spend $100,000 per year on capital expenditures for the corporate office functions."[145] These expenditures were assumed to have a useful life of ten years.

[144] Neither expert contended that CTCA's election under subchapter S required any special treatment.
[145] RX 87 at 28.

Cimasi, while not specifically naming such expenditures "capital expenditures," adjusts net income by the "increase in Gross Fixed Assets." These amounts, for projected years one through five, are ($226,720), ($1,861,180), ($2,076,725), ($689,425) and ($1,860,983), respectively.[146] Cimasi's estimates are largely the product of his assumption of CTCA's expansion and the opening of the operated centers. As this factual assumption has been previously rejected, I conclude that Cimasi's projected adjustments for the increase in gross fixed assets do not reasonably reflect the business reality of CTCA at the time of the Merger.

I will adopt Baehr's assumption here as well. His expenditures appear reasonable for a company that is not significantly expanding and, thus, unlike Cimasi's numbers, do not rely on any assumptions that have been rejected.

7. Change in Working Capital

The final adjustment to net income necessary to derive cash flow is to account for changes in working capital. Baehr, in scenario 2a, projected an adjustment for cash applied to working capital as follows:

1991	1992	1993	1994	1995
$20,221	$32,517	$24,979	$28,624	$30,106

Meanwhile, for scenario 2b, Baehr projected adjustments to net income for cash applied to working capital of:

[146] PX 41 at sch. 22.

1991	1992	1993	1994	1995
$20,221	$26,574	$25,139	$28,791	$29,957

Working from the audited financial statements of December 31, 1990, Baehr assumed that accounts receivable are equal to three days of management fee revenue, prepaid expenses are equal to ten days of the total supply of supply expense, professional fees and advertising expenses annually, accounts payable equal to 44 days of operating expenses (net of salary-related expenses and depreciation and amortization expenses), and accrued expenses are equal to 15% of salaries, wages and benefits.

Cimasi adjusted net income for decreases in working capital. For the five projected years, Cimasi deducted the following sums:[147]

1991	1992	1993	1994	1995
($97,750)	($385,327)	($1,692,791)	($1,257,024)	($1,142,698)

However, it must be noted that, with the exception of projected year 1991, these values are again influenced by the planned expansion of CTCA. After confining the analysis to existing centers and noting that for projected year 1991 the increase in inventories and supplies was zero and the adjustment for the increase in prepaid expense was ($35,488), Cimasi's projections can be restated as follows:[148]

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[147] *Id.*

[148] These restated numbers include all amounts attributable to "increases in inventories & supplies" even though, presumably, these amounts are larger than

1991	1992	1993	1994	1995
($97,750)	($32,383)	($221,307)	($226,771)	($125,667)

Even with these adjustments, the projected numbers still seem to be disproportionate to the numbers one would expect. Neither of the experts' projections for changes in working capital fits the model adopted by the Court, one of regular (except when the MSA markup is reduced) but limited growth in revenue. Cimasi's approach is dependent upon his unreasonably optimistic projections for expansion. However, a steady increase in revenue should result in a negative change in working capital, which makes Baehr's projections of increases in working capital somewhat unrealistic. Thus, the change in working capital is determined by calculating the increase in revenue from year to year and assuming a 30-day payment period, an assumption that may be optimistic for MMC in light of its fiscal problems. Other causes for changes in working capital, such as inventory adjustments, appear to be of relatively minimal consequence. The projected changes in working capital are:

1991	1992	1993	1994	1995
(53)	(36)	(34)	(2)	(40)

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they would be if no new additional sites were opened. There is no feasible way of separating the amounts attributable to Cimasi's assumption of three new operated centers being opened from this value.

8. Projection of Income

Thus, under the Court's model, CTCA's simplified, projected income statement is as follows:

	Income Statement				
	1991	1992	1993	1994	1995
Revenue					
Management Fees					
AIH	8,426	8,763	9,077	9,009	9,382
MMC	2,382	2,477	2,566	2,657	2,767
Total Revenue	10,808	11,239	11,643	11,667	12,150
Costs					
Depreciation & Amort	487	492	451	389	368
Interest	235	171	107	52	5
Other Expenses	8,682	9,116	9,572	10,050	10,553
Total Costs	9,404	9,779	10,130	10,491	10,926
Earnings Before Taxes	1,404	1,460	1,513	1,175	1,224
Taxes	(534)	(555)	(575)	(447)	(465)
Net Income	871	905	938	729	759

9. Determination of Cash Flows

Based on the assumed tax rate and adjustments for interest expenses, depreciation and amortization, capital expenditures, and decrease in working capital stated above, the cash flows of CTCA are projected as follows:

	Cash Flow				
	1991	1992	1993	1994	1995
Net Income After Tax	871	905	938	729	759
Additions					
Depreciation & Amort.	487	492	451	389	368
Interest[149]	235	171	107	52	5
Subtractions					
Capital Expenditures	(100)	(100)	(100)	(100)	(100)
Δ Working Capital	(53)	(36)	(34)	(2)	(40)
Cash Flow	1,440	1,433	1,362	1,068	991

10. Discount Rate

For their discount rate to determine the present value of future cash flow, both experts employed the WACC which is the expected rate of return on the investment as calculated with reference to a blend of a company's various capital components including the cost of debt and cost of equity.[150] The formula used to derive the WACC is:

WACC = (Cost of Equity * Weight of Equity) + (Cost of debt * (1 – Tax Rate) * Weight of Debt).

The experts differed little in their determined values for WACC; Cimasi calculated 27.43%; Baehr calculated 27.9%.[151]

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[149] Treating interest as an addition to determining cash flow is a matter of adhering to Baehr's analytical approach to achieve a "debt free" cash flow.

[150] PX 41 §6.10.

[151] The sensitivity of the DCF analysis to the discount rate is such that Cimasi's discount rate would increase the fair value of Lane's holdings by almost 7% over the fair value determined by using Baehr's rate.

Cimasi calculated his WACC using the "build up technique" or Adjusted Capital Asset Pricing model ("ACAPM"). The ACAPM is "based on several risk and return conditions, that when totaled, result in an estimate of the rate of return that an investor would most likely require to invest in" the Company.[152] Cimasi's cost of equity, 34.37%, was the sum of five components: an equity risk premium of 7.10%; a health care industry risk premium of 2.01%; a risk free rate of 8.36%; a size premium of 5%; and a company-specific risk premium of 12%. His value for cost of debt, 10.53%, was an average of CTCA's cost of debt of 11.9%, the debt of the guideline public companies of 10.30%, and the Corporate Baa bond rate of 10.09%. Finally, Cimasi determined that the proper corporate structure for the Company was 25% debt and 75% equity, which led to his value for WACC of 27.43%.

Baehr calculated his value for the WACC using the Capital Asset Pricing Model ("CAPM"). Under CAPM, cost of equity is calculated as follows:

Cost of Equity = $R_f + B * (E(R_m) - R_f) + S_{sp} + A$,

Where R_f is the risk-free rate of return, B is the beta of the company and measures the risk and volatility of the company's securities relative to the overall market portfolio, $E(R_m)$ is the expected rate of return on an investment in the market portfolio, S_{sp} is Small Stock Premium, which recognizes the difference between the returns of small companies and the market in general, and A is the specific risk

[152] *Id.* § 6.9.

premium, which is applied to account for additional risk not captured by the equity of small stock premiums.[153] Baehr calculated a cost of equity of 35.1% using an R_f equal to the rate of return on a twenty-year Treasury bond on March 20, 1991 of 8.36%, a market premium over the risk-free rate equal to 7.1%, a small stock premium of 6.34%, a Beta of 1.47, and a Specific Risk Factor of 10.0%. For cost of debt, Baehr used Moody's Baa Corporate Bond Yield as of March 20, 1991 of 10.18%. Using the same capital structure as Cimasi, 25% debt and 75% equity, Baehr calculated the WACC to be 27.9%.

Thus, there is a modest difference between the two calculations of WACC. The Court accepts as reasonable the capital structure used by both experts. Baehr's methodology and inputs for determining the cost of equity, with their better developed factual support, are accepted by the Court.[154] As such, the Court will utilize Baehr's calculated WACC of 27.9%.

With the discount rate now established, the discounted cash flows for CTCA can be calculated:

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[153] RX 87 at 31.

[154] Baehr used a slightly higher cost of debt than did Cimasi.

1991[155]	1992	1993	1994	1995
$1,025	$1,044	$776	$476	$345

The sum of these present values is $3,667,000.

11. Terminal Growth Rate and Terminal Value

To calculate the terminal value for CTCA after projected year 5, a terminal growth rate must be determined. I find Baehr's assumption that no growth would occur beyond the projected five-year period unreasonable; it must be assumed that CTCA would continue to grow at least at the rate of inflation. Thus, I will assume a 5% growth rate for perpetuity. The projected year 5 net cash flow forms the basis for calculating the payments made in perpetuity. Thus, with a year 5 net cash flow of $991,000 divided by (the discount rate of 27.9% minus the terminal growth rate of 5%), the present value of the terminal value projected in perpetuity from 1995 is calculated as $4,330,000.[156] When this is discounted to the Merger Date at a discount rate of 27.9%, the present value of the terminal value of CTCA is $1,334,000.

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[155] Because the cash flow projection for 1991 was for a full year, a partial year adjustment (i.e., recognizing that the period from March 20, 1991, the date for determining CTCA's fair value, to December 31, 1991 is 0.78 years) has been made to the projected 1991 cash flow of $1,440,000. See *supra* Part III.C.9. Thus, the present value of cash flow is for a period of 4.78 years, and not a full 5 years. The cash flow for each year (except 1991) is discounted from July 1, *i.e.*, it is assumed to have been obtained as the middle of each year. For 1991, it is discounted from August 11; the mid-point between March 20 and the end of the year.

[156] *See*, *e.g.*, *In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 491 (Del. Ch. 1991).

12. Debt

CTCA's debt in the amount of $3,993,000 must be subtracted to arrive at fair value.[157]

13. Fair Value Under the DCF Method

Accordingly, the fair value of the common stock of CTCA under the DCF model at the time of the Merger was $1,008,000, which is determined as follows:

Present Value of Cash Flow	3,667
Discounted Terminal Value	1,334
Gross Enterprise Value	5,001
Debt	(3,993)
Fair Value	1,008

14. Adjustment for Minority Discount

Finally, I reject Cimasi's addition of a 20% control premium to correct for an alleged minority discount arising from the inclusion of market date in his model.[158]

> Some analysts believe that the income approach always produces a publicly traded minority basis of value because the Capital Assets Pricing Model (CAPM) and the buildup model develop discount and capitalization rates from minority transaction data in the public markets. This is a very common and highly flawed conclusion. *There is little or no difference in the rate of*

[157] The debt consists of $2,209,700 of long term debt owed by CTCA to others and $1,783,300 which was owed to AIH. These numbers, the ones accepted by Baehr, are drawn from CTCA's 1990 audited financial statements. Cimasi's calculations used a slightly higher figure for debt: $4,052,300. The difference may be attributed to Cimasi's efforts to account more accurately for the current portion of the long term debt. Baehr's debt number is, however, reasonable.

[158] For an example of adjusting a market-based valuation for an inherent minority discount, *see Doft & Co. v. Travelocity.com, Inc.*, 2004 WL 1152338, at *11 (Del. Ch. May 20, 2004).

> *return that most investors require for investing in a public, freely tradable minority interest versus a controlling interest.*[159]

The streams of income here do not require any adjustment for an impermissible minority discount.[160] Thus, no premium will be added in order to correct for any inherent minority discount.

D. Comparable Companies and Transactions Approaches

1. The Experts' Views

To varying degrees, both Cimasi and Baehr relied upon the comparable companies approach[161] either to help determine the value of CTCA or to act as a check upon the value derived from the DCF analysis. Cimasi also pursued a comparable transactions analysis to aid in determining the fair value of CTCA. Both methodologies suffer from one underlying and fundamental shortcoming: no company can comfortably be considered comparable to CTCA.

The many distinguishing features of CTCA impair comparison to publicly traded companies and thereby frustrate any attempt to measure value by using the comparable companies analyses. First, CTCA is a player in an extremely narrow

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[159] SHANNON PRATT, BUSINESS VALUATION DISCOUNTS AND PREMIUMS 30 (John Wiley & Sons, Inc. 2001).

[160] *See In re Radiology Assocs. Litig.*, 611 A.2d at 494. Furthermore, while there may be an intellectually interesting argument in support of the proposition that the DCF analysis necessarily introduces something of a minority discount, Cimasi failed to make that argument persuasively.

[161] "The comparable company approach entails the review of publicly traded competitors in the same industry, then the generation of relevant multiples from public pricing data of the comparable companies and finally the application of those multiples to the subject company to arrive at a value." *Travelocity.com, Inc.*, 2004 WL 1152338, at *8.

and specialized niche market, that of privately insured, terminal care cancer patients seeking alternative therapies, a market whose size has never been determined. While some of the companies utilized by the experts operate in niche markets, including one (Salick Health Care, Inc.) that operates comprehensive outpatient diagnostic and treatment cancer centers, none targets this exact, though defining, patient-type. Moreover, none has been demonstrated to utilize the holistic and total care approach that was the hallmark of the CTCA treatment experience. Additionally, of those cancer companies listed, none emphasizes treating patients on an inpatient basis. Second, almost by definition, these public companies do not reflect the customer base of CTCA. CTCA and its customers are essentially alter egos of one another, given that Stephenson is the majority shareholder in all three entities. As has been found, a significant subsidy was paid in accordance with the business model for creating a national network of cancer treatment centers. None of the public companies has been shown to be structured even as remotely similar to CTCA. Furthermore, those public companies claimed to be comparable are not beset by the turmoil CTCA found itself in with effectively no management at the time of the Merger. Thus, for many reasons, the differences between CTCA and those companies utilized by both experts minimize the benefits of conducting a comparable companies analysis.

With that admonition, and given the Court's discomfort in relying solely upon a methodology (DCF) that, in this case, has a number of limitations on its

ability to capture the fair value of CTCA, a review the experts' comparable publicly traded companies analyses is appropriate.

Cimasi conducted a comparable publicly traded companies analysis, and arrived at a fair value for the common stock of CTCA of $18,259,000. Cimasi first identified 15 guideline public companies he characterized as comparable to CTCA. He then selected several multiples on the basis of which he would compare and compute the value of CTCA from the historical data of CTCA; the multiples selected were the price to revenue multiple, price to EBITDA multiple, the total invested capital to revenue multiple, and the total invested capital to EBITDA multiple.[162] Cimasi ultimately relied solely on the TIC-to-revenue (1.74) and TIC-to-EBITDA (12.55) ratios and applied these chosen ratios to the historical data of CTCA. Next, Cimasi took the average of the two values and added a 20% control premium to correct for a perceived minority discount inherent in the use of market-based price data. Finally, he subtracted $4,052,300 in "interest bearing debt" to obtain a fair value for CTCA of $18,259,000.

While Cimasi's methodological approach may not be unreasonable in its format and structure, its main flaws, which lead to an exaggerated value for CTCA, can be traced to the comparable companies he selected and how he determined which financial ratios to rely upon in extrapolating from CTCA's data.

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[162] Cimasi judged these multiples to be the most meaningful methods of comparison based upon the comparison of CTCA to the guideline companies on the basis of liquidity, leverage, profitablilty and size. Cimasi also reviewed the mean, median, and upper quintile measures for each ratio.

First, the companies he selected as comparable were far less risky and far more successful than CTCA and, thus, investors naturally would pay higher multiples for a share of ownership in those companies. In 1990, CTCA received revenues of $10.6 million. Ten of Cimasi's fifteen "comparable" public companies earned revenues greater than $70 million for the last twelve month period before March 20, 1991. Moreover, in 1990 CTCA had $1,994,100 in EBITDA. However, eight of the fifteen "comparable" public companies had EBITDA values in excess of $14 million, seven of which exceeded $30 million. Thus, this misrepresentative set of "comparable" companies imparts incomparably high multiples, which create an artificially high fair value for CTCA, one which fails to reflect all relevant facts and circumstances concerning CTCA at the time of the Merger.

Second, Cimasi noted that "[t]o select the multiple that best exemplifies the characteristics of [CTCA], [CTCA] was compared to the guideline companies utilizing several pertinent factors, e.g. in terms of liquidity, leverage, profitability, and size."[163] Two of these measures, liquidity and profitability pose a particularly high degree of uncertainty and error in the case of CTCA. CTCA's liquidity is an artificial trait, given the unique role of AIH as a means to subsidize CTCA and any subsequent national expansion. Similarly, the profitability of CTCA, which is largely driven by the percentage markup under the MSA, a return previously

[163] PX 41 §6.13, at 18.

found to serve as a means of subsidizing CTCA, requires a degree of skepticism in its comparison to profits derived from actual operations in a competitive environment. Thus, here too, Cimasi selected a set of comparable companies that fails to accurately reflect the relevant facts and circumstances affecting CTCA at the time of the Merger.

Baehr conducted essentially two comparable public company analyses to serve as a check upon his determined fair value for CTCA under his DCF model. Baehr chose five comparable companies based, in part, upon SIC codes and, in part, upon the following characteristics: product offerings, capital structure, depth of management, personnel experience, nature of competition, earnings, book value, credit status, and revenues. Using a TIC-to-EBITDA multiple derived from the set of five comparable companies, Baehr calculated two different fair values for CTCA under the comparable public companies approach. First, Baehr, using a median multiple of 5.5 and the unadjusted financial statements of CTCA, and subtracting $3,993,000 in total CTCA debt, arrived at a fair value for CTCA's common stock of $6,929,230. In the second scenario, Baehr adjusted CTCA's financial statements to exclude MMC management fees and interest due CTCA; this then produced a negative fair value for CTCA's common stock. Such adjustments were proper, argues Baehr, because otherwise it would implicitly be assumed that MMC would continue its operations beyond the Merger Date. However, as I have found, MMC would continue operating. Thus, I reject Baehr's second version of his comparable public companies analysis, utilizing adjusted

financial statements, as not accurately reflecting the business reality of CTCA (and MMC) at the time of the Merger.

Looking at Baehr's first, unadjusted, comparable companies model, I also conclude that, like those of Cimasi, Baehr's selected set of comparable companies would enjoy higher multiples than those which would more accurately apply to CTCA. Three of his five companies enjoyed revenues in excess of $70 million, two of which ($265 million and $627 million) greatly exceeded the annual revenues of CTCA. Thus, Baehr's calculated fair value of $6,929,230 under this approach also overstates the fair value of CTCA.

2. Comparable Company Methodology and Its Limited Value

Any comparable company analysis to determine CTCA's fair value is frustrated by CTCA's unique status.

> The utility of the comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison. At some point, the differences become so large that the use of the comparable company method becomes meaningless for valuation purposes.[164]

If CTCA had more extensive historical financial data or if its management forecasts were more reliable, both of which would significantly enhance confidence in the DCF analysis, the difficulties in finding "comparables" or making adjustments to correlate "somewhat comparable" companies would support a decision to rely exclusively upon the DCF. Because of the shortcomings

[164] *In re Radiology Assocs., Inc. Litig.*, 611 A.2d at 490.

impairing the DCF approach, some input from a different methodology may yield a more accurate fair value.

In the context of CTCA, the preferable approach is to perform a comparable company analysis and account for its shortcomings by giving it relatively minimal weight in relation to the result of the DCF process.[165] Baehr identified two companies, Salick Health Care, Inc. ("Salick") and CBL Medical, Inc. ("CBL") that shared significant characteristics with CTCA. CBL managed medical centers with a special focus on physical injuries and work-related diseases and provided administrative services. Its revenues for the year ended 1990 were $6.1 million; its EBITDA was $1.6 million; its TIC-to-EBITDA ratio was 3.3. Accordingly, CBL had in common with CTCA both a narrow focus in the health care field and comparable income. Salick, although a significantly larger venture, provided disease-specific diagnostic and treatment services, primarily on an outpatient basis. Its annual revenues, as updated to November 1990, were $69.7 million; it had EBITDA of $13.2 million and a TIC-to-EBITDA ratio of 5.5.[166] The most useful ratio in a comparative company's analysis frequently is the total capital to

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[165] For the reasons which make the comparable company analysis problematic, the Court concludes that Cimasi's comparable transaction analysis is not helpful in guiding the Court in its attempt to determine CTCA's fair value. The key benefit of the comparable companies approach may be found in the "going concern" nature of the companies compared.

[166] Baehr compiled a list of five companies which he considered somewhat comparable. The other three were larger than Salick. Salick's TIC-to-EBITDA ratio was the median of the group. The size of the other companies makes comparison less valid.

EBITDA. An average of that ratio for Salick and CBL is 4.4; the Court will use that average.[167]

For 1990, CTCA had EBITDA of $1,994,100. That number, however, included a substantial interest entry ($470,100) that, under the Court's model of CTCA's cash flow, would not reoccur. Thus, it is both reasonable and appropriate to adjust CTCA's EBITDA by deducting the interest. With an adjusted EBITDA of $1,524,000 and a total interest capital to EBITDA ratio of 4.4, the enterprise value of CTCA, under the comparable companies analysis, is $6,705,600. Determination of the equity value also requires the addition of cash and the subtraction of debt.[168] CTCA's balance sheet (as of December 31, 1990) shows no cash. The debt was $3,993,000. Subtraction of the debt leads to a value of $2,713,000.

Comparable company analysis, however, suffers from an inherent minority discount.[169] To determine "the intrinsic worth of a corporation on a going concern basis," a premium must be added to adjust for the minority discount.[170] Although this Court has tended to apply a control premium on the order of 30%,[171] Cimasi

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[167] It can be argued that Salick's ratio of 5.5, the median on Baehr's list, should be used (or that the arithmetic average of the ratios of the firms on that list of 6.4 should be used.) A downward adjustment, however, might otherwise be called for in light of the uncertainties surrounding CTCA. Such an adjustment, if the higher median or average number had been used, would have resulted in a ratio similar to the average of Salick's and CBL's ratios.
[168] *Travelocity.com, Inc.*, 2004 WL 1152338, at *10.
[169] *Id.*
[170] *Id.*
[171] *Id.* at *11.

advocated, on behalf of Lane, a 20% premium.[172] The Court does not consider the premium proposed by Cimasi unreasonable and, thus, will adopt it. Accordingly, the fair value of CTCA as of the Merger Date, based on the Court's comparable companies analysis, becomes $3,256,000.[173]

E. Valuation

Because CTCA sought a special niche in the healthcare market, because CTCA had encountered substantial difficulties in implementing its business model at MMC, and because of the general state of CTCA's financial history, the use of any valuation approach other than DCF is problematic. Indeed, the limited duration of CTCA's operations and the lack of reliable management forecasts raise concerns about the DCF approach. Input from other methodologies can be valuable and, where possible, should be incorporated in the valuation analysis. Because the DCF analysis is, as set forth above, more reliable than the comparable companies analysis in the context of finding fair value for CTCA, the Court will use a weighting of 85% for the DCF analysis and 15% for the comparable

[172] PX 41 at §6.13.1.

[173] This raises the question of when to make the adjustment for the minority discount. Here, the TIC-to-EBITDA ratio is the operative number imposing the minority discount. One can argue – as Cimasi did – that the result of that operation – the enterprise value – should be adjusted (*i.e.*, adjusted before adding cash and subtracting debt). After all, this would correct the inherent bias at the earliest possible stage of the process. On the other hand, the result of the comparable company analysis is the number reached after adding cash and subtracting debt. That number, presumably, is the equivalent of the market based number that reflects the lack of control bias. This Court, in *Agranoff v.* Miller, 791 A.2d 880, 900 (Del. Ch. 2001) and *Travelocity.com, Inc.*, 2004 WL 1152338,

companies analysis. Accordingly, the fair value of CTCA, as of the Merger Date was $1,345,000.[174]

F. Interest on the Award

Next the Court turns to the rate of interest which should accompany payment of the fair value of Lane's shares. Unsurprisingly, the parties also differ over what interest rate should attach. CTCA argues that no interest should be paid, because of Lane's failure to prosecute timely his claim, or, in the alternative, 7.52% as simple interest. Lane claims, based largely on the testimony and report of Cimasi, that the proper rate is 12.97%, compounded monthly. I find that the proper interest rate is 9.14%, compounded monthly.

By 8 *Del. C.* § 262(h), "the Court shall appraise the shares . . . together with *a fair rate of interest* . . . to be paid upon the amount determined to be the fair value."[175] The interest award "may be simple or compound,"[176] but the Court

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at *10-*12, has made (or considered making) the correction for minority discount after the cash and debt adjustments. That precedent will be followed here.

[174] This conclusion necessarily reflects the Court's assessments of the two experts. Due to CTCA's short history, the experts (and the Court, for that matter) were required to make projections for which there was minimal financial information to marshal in support of those efforts. With respect to Baehr's projections, I find, on the whole, that his numbers, while perhaps not unreasonable, were unduly pessimistic. As to Cimasi, I find his projections, in some significant aspects, such as growth and profitability, to be unreasonably optimistic (and, at times inconsistent with the factual findings of the Oklahoma Court), at least based on what was known as of the Merger Date.

[175] 8 *Del. C.* § 262(h) (emphasis added).

[176] *Id.* § 262(i).

must give an explanation for its choice.[177] The award of interest serves two important purposes. First, "[i]t compensates the plaintiff for the loss of the use of his money during this period," and thus "endeavors to place the dissenting stockholder in the position she would have been in had the corporation promptly paid the value of her shares."[178] Second, "it forces the surviving corporation to disgorge the benefit it received from having use of the plaintiff's funds."[179]

1. The Effects of Any Delay are Equally Chargeable to Both Parties and Provide no Basis for Denying or Reducing an Award of Interest

In a slight variation of an argument which it had lost twice before trial,[180] CTCA argues that Lane's lack of reasonable diligence in prosecuting his claim must function to deny him any interest on his reward, or, at least to reduce any amount of interest. While, the progress of this case has not exactly been a model of expediency, any delay in its prosecution to trial is fairly chargeable to both parties, and therefore no justification exists for reducing the period over which interest is calculated.

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[177] *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23104613, at *44 (Del. Ch. Dec. 31, 2003); *Gonsalves v. Straight Arrow Publishers, Inc.*, 1999 WL 87280, at *4 (Del. Feb. 25, 1999).

[178] *Chang's Holdings, S.A. v. Universal Chems. & Coatings*, 1994 WL 681091, at *1 (Del. Ch. Nov. 22, 1994).

[179] *Id.*

[180] *See Lane I*, 2000 WL 364208, at *4 (rescinding, on motion for reargument, a decision to dismiss the case for lack of prosecution); *Lane II*, 2001 WL 432445, at *2 (denying a second motion to dismiss for lack of prosecution).

This Court may "deny a plaintiff interest if he delayed in the prosecution of a claim."[181] However, "[a]cquiesence by a defendant in delay or defendant's failure to seek relief from delay has been considered relevant in determining whether to penalize a plaintiff for litigation delay."[182]

This case was filed in 1991 and Lane did not take his first deposition until October 2, 2001. The docket sheet, however, reveals more than ninety-two filings during this period, with only four occasions in which there is a gap of more than six months between filings. The longest period during which there was no filing was the one-and-a-half years – November 6, 1996 to May 14, 1998 – between CTCA's response to Lane's second request for production of documents and CTCA's supplemental response to Lane's first set of interrogatories. Indeed, CTCA's response to discovery has been previously termed "tortoise like" by this Court.[183]

Therefore, because the record establishes a fairly regular, even if somewhat lethargic, pattern of entries reflecting substantive action by the parties, I must reject CTCA's argument that the cause for delay in this case is solely the responsibility of Lane. Any delay was acquiesced in by CTCA as reflected by its

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[181] *Wacht v. Cont'l Hosts, Ltd.*, 1994 WL 728836, at *1 (Del. Ch. Dec. 23, 1994). *See also Summa Corp. v. Trans World Airlines, Inc.*, 540 A.2d 403, 409 (Del. 1988); *Dorsey v. Mulrine*, 301 A.2d 516, 518–19 (Del. 1972); *Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 705 (Del. Ch. 1996).
[182] *Wacht*, 1994 WL 728836, at *3.
[183] *Lane II*, 2000 WL 364208, at *3.

lackadaisical discovery responses.[184] Awarding interest in this matter does not grant an "undeserved windfall" to Lane but, instead, avoids giving one to CTCA which would otherwise have had free use of money rightfully belonging to Lane for more than a decade.

2. The Rate of Interest

"In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding."[185] In addition to looking to the company's cost of borrowing, or "borrowing rate," the Court "has historically examined the return that a prudent investor would have received if he had invested the judgment proceeds at the time of the merger."[186]

Both experts generally agreed on the appropriate borrowing rate. Baehr testified that it would be "a little over ten percent"[187] and Cimasi suggested

[184] I reject CTCA's argument that it did not acquiesce in this delay because it filed two motions to dismiss for failure to prosecute. Both of these motions were rejected by this Court, and indeed the first was rejected because this Court noted CTCA's own responsibility in causing the delay. Furthermore, the first motion was not even filed until 1999 — eight years after the complaint was filed.

[185] 8 *Del. C.* § 262(h).

[186] *Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084, at *33 (Del. Ch. Oct. 19, 1990). This Court also, on occasion, uses the legal rate, *see Travelocity.com*, 2004 WL 1152338, at *11–*12. Here, the parties provided a sufficient record to support a prudent investor rate and a borrowing rate. *See Gonsalves*, 2002 WL 31057465, at *10; *Kleinwort Benson Ltd. v. Silgan Corp.*, 1995 WL 376911, at *11 (Del. Ch. June 15, 1995).

[187] Tr. at 1194.

10.53%. As there is no significant difference between the two values, I will use Cimasi's as it is more definite.

The experts, however, differ substantially with regard to the prudent investor rate. Cimasi assumed that the prudent investor would invest in the general stock market, or equity investments alone without diversification, and would expect a return of approximately 15.4 percent. He calculated this rate by adding the "risk free rate" of return of 8.36% to the "equity risk premium" of 7.10%.[188]

By contrast, Baehr testified that a prudent investor would expect a return of 6.15%. Baehr reached this conclusion by assuming that the prudent investor would have a diversified portfolio of 40% stocks, 40% one-year treasury bills, 10% cash, and 10% gold. For the equity portion, Baehr used a Standard & Poor's index fund to predict a return of approximately 10% before subtracting 1% for transaction costs. For the bond component, Baehr used one-year Treasury bills with an average rate of return of 5.6%. For the cash component, he used a 4.5% rate of return on money market accounts. Finally, he found that the investment of gold would provide a negative rate of return of 1.4%. His calculation of the prudent investor rate, was a weighted average of these four components.

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[188] Cimasi defines the risk free rate as "[t]he rate of return of a U.S government Long-Term Bond, with a maturity of 20 years (2011), as of March 1991." PX 41 at sch. 23. He also describes the "equity risk premium" as an adjustment that "reflects the extra return, or premium, that is expected by the typical equity investor in large company stocks in excess of the return on a riskless asset." *Id.*

I reject the calculations of both experts. Cimasi's assumption that a prudent investor would invest solely in equity ignores this Court's precedent that "[t]he prudent investor takes both a long term and short term investment strategy . . . . [and] employ[s] a mix of . . . conservative investments . . . and . . . riskier investments."[189] On the other hand, Baehr's calculation is far too conservative. Indeed, his 6.15% rate is just barely above the Federal Reserve Discount rate of 6% at the time of the merger. In particular, I differ from Baehr's assumptions that a prudent investor would invest 10% in gold and that the investor would utilize only short-term bonds.

I find the prudent investor rate in this case to be 7.74%, by assuming a diversified portfolio of 50% stocks, 20% short-term bonds, 20% long-term bonds, and 10% cash. For the securities, I used Baehr's suggested interest rate of 10%, reduced by 1% for transaction costs. I similarly used Baehr's suggested rates for the cash and short-term bond components. For the long-term bond component, I used the "risk free rate" suggested by Cimasi, which is the rate of return on a United States bond with a 20-year maturity rate.

The interest rate awarded Lane is thus found to be 9.14%, which is the arithmetic average of the "borrowing rate" and the "prudent investor rate."[190]

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[189] *Chang's Holding's, S.A.*, 1994 WL 681091, at *4.

[190] *In re Emerging Communications, Inc.*, 2004 WL 1305745, at *27; *accord Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *14 (Del. Ch. Feb. 10, 2004). I reject CTCA's argument that the proper ratio in this case is two-thirds of the prudent investor rate and one-third of the borrowing rate. While I do note that this court has applied this suggested ratio in the past, *see, e.g.*, *Kleinwort Benson*

3. The Interest Should be Compound

Under 8 *Del C.* § 262(i), an interest award may be either "simple or compound." This Court has recently noted that "where an interest award is warranted in an appraisal action, compound interest would generally be necessary to satisfy the purposes of that award."[191]

> [T]he fair rate of interest should be compound. It is simply not credible in today's financial markets; that a person sophisticated enough to perfect his or her appraisal rights would be unsophisticated enough to make an investment at simple interest — in fact, even passbook savings accounts now compound their interest daily. . . . As for the defendant company in an appraisal action, it is even harder to imagine a corporation today that would seek simple interest on the funds it holds. One cannot imagine that a sophisticated businessman . . . would invest his companies' funds in instruments yielding simple rates of interest.[192]

Interest compounded monthly is also appropriate in this case. The record shows that Lane is a sophisticated businessman who, with full use of his money, probably would not have invested in anything which returned only simple interest. CTCA's only argument that simple interest should be awarded is its view that Lane should not prosper through his delay in pursuing this action. However, this argument has already been rejected. Furthermore, not awarding compound

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Ltd., 1995 WL 376911, at *12, I accept the prevailing approach followed in *JRC Acquisition Corp.*

[191] *Gonsalves*, 2002 WL 31057465, at *10; *In re Emerging Communications, Inc.*, 2004 WL 1305745, at *27. *But see Technicolor IV*, 684 A.2d at 302 (noting that "[a]n award of compound post-judgment interest is the exception rather than the rule); *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 527 (Del. 1999) (noting that compound interest should not be awarded routinely).

[192] *Onti, Inc. v. Integra Bank*, 751 A.2d 904, 926–27 (Del. Ch. 1999) (citations omitted).

interest would unfairly enrich CTCA which has had the use of Lane's money and which made little effort to determine the fair value of CTCA stock in 1991.

G. Concluding Thoughts

I pause to reflect upon certain problems that undermine the confidence one should have in the accuracy of this effort to find the fair value of CTCA as a going concern in March 1991.

First, I note that CTCA operated under what very well may have been a valid business model. The deficiencies in the MMC expansion could be described as locale (and hospital) specific, and not indicative of any greater flaws in the business model. That said, the implementation of this business model by CTCA management left much to be desired. So, in the end, CTCA could be described as a company with possibly a good plan, but poor execution.

Second, another aspect of this case which is worthy of comment is the uncertain capacity of the typically employed financial models to capture the value of an emerging, niche market company. The financial information of CTCA was collected for only a little over one year, clearly not enough to appreciate the trends, cycles and nuances of its revenues, cost structure and evolution. DCF analyses are better suited for well-established companies with a lengthy and reasonably consistent history of earnings. The problems associated with CTCA's short history also impede the effort to gauge the potential success in expanding into new markets. The only evidence of CTCA expansion, the process which was the driving mechanism of its business model, is roughly one year of data from

MMC. The need to rely upon an even newer entity to project the future success of an emerging entity can only inject greater uncertainty into the determination of fair value.[193]

Finally, CTCA, as of the Merger Date, was a two contract company, and those contracts were with affiliated entities. Moreover, CTCA did not (and would not unless and until it opened operated centers) provide medical care directly. Its function was to facilitate that effort by others. Thus, its prospects for survival, based on the conditions at the time of the Merger, are difficult to assess. In short, CTCA was a unique concept in a unique market. Its uniqueness, in the end, may have significantly restricted the usefulness of the tools commonly used to determine fair value.

IV. CONCLUSION

For the foregoing reasons, the fair value of CTCA, as of the Merger Date, was $1,345,000 or $1,345 per share. The fair value of Lane's holdings is $134,500, on which he is entitled to annual interest of 9.14%, compounded monthly, from the Merger Date.

Counsel are requested to submit a form of order, within ten days, to implement this Memorandum Opinion.

[193] Further compounding the difficulty of determining the value of CTCA is the skepticism with which management's projections should be considered.