IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

HAROLD FINKELSTEIN and	)	
MARILYN FINKELSTEIN,	)	
	)	
Petitioners,	)	C.A. No. 19598
	)	
v.	)	
	)	
LIBERTY DIGITAL, INC.	)	
	)	
Respondent.	)	

MEMORANDUM OPINION

Date Submitted: January 26, 2005
Date Decided: April 25, 2005

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STRINE, Vice Chancellor

I. Introduction

This appraisal case is unusual in one respect that is refreshing. The broad issue in this case is the typical one involving the fair value of shares of a company — Liberty Digital, Inc. — that was merged with an acquisition subsidiary of Liberty Media Corporation and survived the merger as a wholly owned subsidiary of Liberty Media. But what is less typical is that the parties were able to stipulate to the value of all but one of Liberty Digital's assets. In the merger, which occurred on March 14, 2002, Liberty Digital's public stockholders received a quarter share of Liberty Media Class A stock in exchange for each share of Liberty Digital that they owned — an implied value of $3.31 per share of Liberty Digital stock.

In their stipulation, the petitioners — who collectively owned 1,329,600 shares of Liberty Digital stock — and the respondent, Liberty Digital, stipulated that the fair value of Liberty Digital's assets other than an "Access Agreement" with AT&T was $497,627,000 or $2.15 per Liberty Digital share. Over the years since its creation, Liberty Digital has owned, in addition to the Access Agreement, a number of other assets including interests (of both a controlling and non-controlling variety) in several private and public companies such as the Game Show Network, DMX/AEI Music, Open TV, Inc., move.com, BET.com, Replay TV, Inc. and TiVo Inc. Although this opinion does not focus on these other assets, the reader should not lose sight of the fact that Liberty Digital possessed them or that the petitioners agree that their fair value was nearly a half billion dollars.

In contrast to a more typical appraisal proceeding valuing an entire company, the stipulation left for resolution at trial the more narrow question of "whether and to what extent the fair value of shares of [Liberty Digital] common stock should be increased as a result of any value arising out of or attributable to the AT&T Access Agreement."[1] Therefore, this post-trial opinion focuses on that issue.

In this opinion, I conclude as follows. The Access Agreement, while a valuable asset, is essentially a contract right and a vague one at that. By its terms, the Access Agreement is a binding "agreement to agree" on terms whereby Liberty Digital would have preferential access to channel space on AT&T's digital cable network if and when AT&T, of its own volition, decided to deploy "advanced set-top boxes" that would facilitate the delivery of so-called "interactive television programming" — programming whereby the viewer could interact with the television much like a user of the internet does by placing instant orders, freezing programming, and calling up other programming, all by using the remote control.

Liberty Digital secured the Access Agreement when AT&T bought TCI from John Malone. Malone, who retained a continuing equity interest and control

[1] Pretrial Stipulation and Order at 9.

of Liberty Digital's parent, Liberty Media, in the merger, sought the Access Agreement because he believed that interactive programming had great potential. Throughout the period 1999 until 2001, Liberty Digital worked hard to put together programming that would be broadcast by AT&T under the Access Agreement. But despite diligent efforts, Liberty Digital could not put together even one network of programming because other necessary partners (e.g., partners with products and actual programming) would not commit to any agreements with Liberty Digital until Liberty Digital had converted its agreement to agree (i.e., the Access Agreement) into a definitive affiliation agreement with AT&T guaranteeing carriage of programming on specific and advantageous terms.

By the year 2001, Liberty Digital, despite strenuous efforts, had failed to secure any definitive agreement with AT&T. As important, by that year, earlier hopes that AT&T would deploy advanced set-top boxes in the near future had dimmed. By early autumn 2001, AT&T was in the process of selling its cable business, a process that culminated in a final agreement signed with Comcast in December 2001, and its negotiating posture with Liberty Digital was anything but urgent. In that timeframe, AT&T informed Liberty Digital that it had no imminent plans to deploy advanced set-top boxes and denied any responsibility to provide Liberty Digital with preferred access, or even negotiate the terms of that eventual access, until that deployment occurred.

This development convinced Liberty Digital's top management that their plans to develop interactive programming networks had no feasibility in the immediate years. For its part, Liberty Media decided to take Liberty Digital private and did so through the merger described above.

Herein, I find that the Access Agreement, while valuable, is, at best, an ambiguous contract right that might, with patience and hard bargaining, yield some advantage to Liberty Digital in the future. Because the Access Agreement provides no concrete terms for access and there is no time frame in which AT&T must deploy advanced set-top boxes, the petitioners' contention that the Access Agreement is worth $2.2 billion must be rejected. That contention is based on wildly speculative and outrageously optimistic assumptions that have no reasonable basis in the record. By contrast, the respondent's approach to valuing the Access Agreement, which focuses on the potential savings in carriage costs and launch fees that the Access Agreement would provide to a programmer seeking to broadcast on AT&T cable systems, is more rational and realistic, and is accepted, with some adjustments, as the basis for my ruling.

In the end, I conclude that the Access Agreement is worth only $135 million and that the fair value of Liberty Digital's stock was $632 million on the Merger Date, or $133 million less than the consideration paid in the merger. I also add to that amount an award of pre-judgment interest at a 5.56% rate of interest, compounded monthly.

II. Factual Background

Because of the stipulation, the facts as I describe them focus almost exclusively on Liberty Digital's efforts to exploit the value of the Access Agreement.

A. The AT&T/TCI Merger And The Origins Of The Access Agreement

At the beginning of 1998, Liberty Digital was a majority owned, public subsidiary of Telecommunications, Inc. or "TCI," a major cable television company controlled by John Malone. At that time, Liberty Digital went under the moniker of TCI Music, Inc. AT&T, meanwhile, was looking to acquire cable systems to facilitate a business strategy focused on providing a variety of telecommunications services to end-users through cable's entry into the home. By June of 1998, Malone forged a deal whereby TCI would be acquired by AT&T. In the deal, Malone obtained agreements with AT&T that would permit him to retain control of some of TCI's assets, including TCI Music.

As far as I can tell, AT&T contemplated that these assets would be spun off after the merger, with Malone continuing to have a predominant say in their affairs. The assets that Malone was to continue to control were placed under a subsidiary of AT&T called Liberty Media, which was spun off from AT&T in 2001. In keeping with this contemplated event, the AT& T–TCI merger agreement called for AT&T to enter into contracts setting forth "Intercompany Agreement Principles" contained in Schedule 7.14 to the merger agreement.

These principles, among other things, called for Liberty Media to be granted "preferred vendor status with respect to access, timing and placement of new programming services . . ." over AT&T and its affiliates' (e.g., TCI's) cable systems.[2] Likewise, AT&T was to negotiate "principles for Liberty Media (or its designee) to provide Interactive Video Services over the digital cable television systems of AT&T and its controlled affiliates. . . "[3] To translate this into an understandable business reality, it appears that Malone secured from AT&T control of certain TCI assets that were on the programming side of the cable television business (i.e., what became Liberty Media) and, through Schedule 7.14, of additional contractual rights that could be valuable to a company that wished to create new or expand existing programming that would be shown on cable systems.

To implement Schedule 7.14, AT&T and Liberty Media executed a letter agreement on the date the AT&T–TCI merger closed. That agreement provided in Paragraph 3 as follows:

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[2] JX 1 (AT&T/TCI Merger Agreement at LDG05369-70).
[3] *Id.*

> Definitive Agreement. Upon the written request of either party, AT&T and LMC [Liberty Media Corp.] shall (a) negotiate in good faith the terms and conditions of a definitive agreement (the "Definitive Agreement") which (i) would contain provisions incorporating and expanding upon the agreements set forth herein, together with other provisions customary in the case of transactions of the type described herein, and (ii) would supersede this Letter Agreement, and (b) use reasonable efforts to execute and deliver, subject to clause (a) of this Section 3, such Definitive Agreement; provided, however, that the foregoing shall not constitute an agreement to agree and (subject to the obligation to negotiate in good faith and use reasonable efforts to enter into such Definitive Agreement) neither party shall be obligated to enter into any Definitive Agreement. Notwithstanding anything to the contrary set forth herein, until such Definitive Agreement is executed by both parties, this Letter Agreement shall continue to be a valid, binding and enforceable obligation of the parties.[4]

Through this odd provision, AT& T and Liberty Media bound themselves, by a contract, to agree to a full later contract. Of most importance here, they bound themselves to execute a definitive agreement incorporating the provisions of that portion of Schedule 7.14 — Paragraph 4 — dealing with Interactive Video Services.

Within two months of the AT&T/TCI merger, on April 23, 1999, Liberty Media assigned the rights that Liberty Media possessed under Paragraph 4 of Schedule 7.14 to the public company that was formerly known as TCI Music and that became Liberty Digital in exchange for Liberty Digital stock.[5] Paragraph 4 of

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[4] JX 1 at 3.
[5] JX 33, Contribution Agreement.

Schedule 7.14 constitutes the "Access Agreement," the value of which is the primary question addressed in this decision.[6]

As an overview, the Access Agreement established a framework for the negotiation of a definitive contract that would grant Liberty Digital access to 6 MHz of bandwidth through which to deliver interactive digital video programming on AT&T's digital cable TV systems. From the record, it appears that 6 MHz translates into somewhere between 12 and as many as 18 channels of programming.[7]

Interactive programming is best described as the internet meets TV. As envisioned, a love-handled American male (for example) could sit in his leather chair watching a bass fishing show on crank baits. As the programming showed the best new baits, the male could, using his remote control, do such things as: 1) freeze the program and cause it to play a special video on one of the products; 2) place an order for the product; or 3) book a bass fishing vacation, having possibly been lured to that decision by an ad during the crank bait program. What was supposed to make all this possible was the roll-out of the Motorola DCT-5000 advanced set-top box, which would allow the viewer two-way, real-time

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[6] Schedule 7.14 also contains a preferred vendor status provision in Paragraph 1. As is later discussed, this Paragraph 1 right was not transferred to Liberty Digital in the Contribution Agreement, but Liberty Media and Liberty entered a letter agreement involving that Paragraph. JX 1; *see* JX 33. The parties' dispute about the value of Paragraph 1 to Liberty Digital is also later addressed.

[7] *See, e.g.*, JX 8 at LDG 062784 (suggesting that 6 MHz would support 12-18 interactive channels).

communication and interaction through a television set. By this means, the remote and advanced set-top box would function together like a computer, permitting interaction between the viewer and the outside world of product vendors and program providers. Just like on the web, credit card transactions could be processed. Programs could be paused, stored, and retrieved through the remote, much as TiVo now allows. You get the idea; something so addictive and attention-span reducing as to make the X-box seem like an educational device by comparison, while simultaneously innovatively encouraging Americans to part with their hard earned money — a huge new opportunity for product purveyors, television producers, and advertising agencies alike.

Malone understandably saw great potential in this concept and wanted to be among the first on the programming side to exploit it commercially. As an experienced cable player, Malone knew that one of the key issues for any programmer was access. Without affordable access to well-placed channels on good cable systems, a programmer would have difficulty attracting capital and developing a product. With those things, however, a programmer could move forward. With the Access Agreement, Malone hoped to have in hand an asset — preferred and guaranteed access to a major cable system — that would help Liberty Digital to be among the first to successfully develop interactive programming, thus capturing the upside in an evolving new market with dynamic potential. The timing, therefore, was critical. In 1999, when the Access Agreement was negotiated, the expectation was that major cable companies would be rolling out advanced set-top boxes with interactive programming capabilities in the next few years.

Of course, the Access Agreement was not a definitive agreement, but only an outline. But it did, through incorporation of the text of Paragraph 4 of Schedule 7.14, have some meat on the bones. The Access Agreement provided for two different ways in which Liberty Digital and AT&T could forge a relationship involving interactive programming:

> 4. Interactive Video Services
>
> AT&T will enter into arrangements with LMC for Interactive Video Services under one of the two arrangements described below.
>
> (a) Pursuant to a 5-year arrangement, renewable for an additional 4-year period on then-current MFN terms, AT&T will make available to LMC capacity equal to one 6 megahertz channel (in digital form and including interactive enablement, first screen access and hot links to relevant web sites[8] — all to the extent implemented by AT&T cable systems) to be used for interactive, category specific video channels that will provide entertainment, information and merchandising programming. Nothing herein shall compel AT&T to disrupt other programming or other channel arrangements. The suite of services will be accessible through advanced set-top boxes deployed by AT&T except that, unless specifically addressed in a mutually acceptable manner, AT&T shall have no obligation to deploy set-top boxes of a type, design or cost materially different from that it would otherwise

[8] At this point, the Agreement contains a footnote which reads, "[n]othing herein shall compel AT&T to provide interactive applications or video services or access thereto, direct or indirect, to competitors of AT&T in its principal business."

> have deployed. The content categories may include, among others, music, travel, health, sports, books, personal finance, automotive, home video sales and games.
>
> (b) Alternatively, at AT&T's election, AT&T may enter into one or more mutually agreeable ventures with LMC for the interactive video services described in the first sentence of (a) above. Such ventures would be structured as 50/50 ventures for a reasonable commercial term and provide that AT&T and LMC will not provide interactive services in the category(s) of interactive video services provided through the ventures for the duration of such term other than the joint venture services in the applicable categories. When the distribution of such interactive video services occurs through a venture arrangement, AT&T will share in the revenue and expense of the provision of such interactive services pro rata to its ownership interest in lieu of the commercial arrangements described in paragraph (a) above. At the third anniversary of any such venture, AT&T may call the ownership interest of LMC in such venture at fair market value; the parties will endeavor to make such transaction, if any, tax efficient to LMC.

B. Liberty Digital Attempts To Capitalize On The Access Agreement

From early 1999 until autumn 2001, Liberty Digital worked hard to exploit the opportunity presented by the Access Agreement. To add to its credibility and effectiveness, Liberty Digital hired Jarl Mohn to lead its interactive programming efforts. Mohn was respected in the programming industry, having been general manager of MTV and VH1 in the late 1980s and, even more important, having become CEO of the E! Entertainment Television channel, transforming a moribund channel called Movietime into a success.[9] To aid Mohn, Liberty Digital also brought on board Craig Enenstein, who was experienced in M & A and finance, and Eddie Monnier, a strategy specialist, to help put together Liberty Digital's plans for entering, and helping to create, the interactive programming market.

Each of these top executives was attracted to Liberty Digital because he was excited by the potential to get in on the ground floor of interactive programming. Each perceived Liberty Digital as having a leg up because of the Access Agreement. The reason for that is that one of the key assets any successful programmer needs is access to broadcast rights on cable systems. Through the Access Agreement, Liberty Digital seemed well positioned to obtain not only guaranteed broadcast rights on a large cable system but also to secure those rights on preferential (if to-be-defined) terms. Market analysts also perceived this to be an advantage and touted Liberty Digital's prospects on this basis. Obviously, undergirding all these high hopes was the expectation that interactive television was soon to be a reality and that cable companies, in particular AT&T, would facilitate that new dawn by rolling out advanced set-top boxes in the near future.

The challenges Liberty Digital faced were several, however. For starters, Liberty Digital did not have any programming of its own or any products of its

[9] Mohn used the name Lee Masters for much of his entertainment career but has now decided to use his legal name on a full time basis. This opinion respects that personal choice by referring to him solely as Jarl Mohn hereafter.

own. Therefore, what it had to do was come up with concepts for interactive channels and convince content and product owners to become its partners. To this end, Liberty Digital came up with several concepts for interactive channels, including a Travel Channel Shop, an automobile channel, a "Generation X and Y" channel, and a home channel.

Of these possibilities, the concept that it pursued the farthest was the Travel Channel Shop. To put that together, Liberty Digital approached Discovery Communications (for travel programming) and Travelocity, Expedia and Mark Travel (for travel products to sell through the programming). Again, the idea is that the viewer would watch a program provided by Discovery, for example, on the Caribbean, come across a resort in the program that she liked, click a button and watch a more detailed segment on that particular resort, and then decide to buy a travel package to that resort (through the product provider), all in real time using her television remote and the advanced set-top box provided by the cable provider.

The difficulty for Liberty Digital was moving from this concept — the appeal of which is rather obvious — to a deliverable product. Although Mohn had a great deal of credibility and the Access Agreement gave Liberty Digital a conversation starter, the other providers all wanted to know the exact terms on which Liberty Digital would have access to AT&T's digital cable network before they would consider signing a definitive partnership. As important, Liberty

Digital's hope that it would have the predominant interest in any channels that resulted from its brainstorming was dampened when it became obvious that the necessary content and product providers believed that their contributions warranted a larger stake in the resulting networks than Liberty Digital had anticipated. These issues were related because the potential partners and Liberty Digital would have difficulty pricing their relationship until the terms on which the channel they were developing would have access to AT&T's cable network were known.[10] In short, until Liberty could make its access relationship with AT&T definitive and concrete, it could not convince the partners necessary to create a travel channel to commit to a deal. This same problem prevented Liberty Digital from advancing any of its other ideas for interactive channels beyond a conceptual, introductory phase. The partners Liberty Digital needed all wanted to know what it brought to the table, and all it had really had was the Access Agreement, a document of highly uncertain value.

For these reasons, I now turn to a summary of Liberty Digital's efforts to negotiate a definitive agreement with AT&T.

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[10] According to the testimony at trial, the industry in general was both intrigued by and suspect of the Access Agreement's value. The Access Agreement was solid enough, combined with the credibility and clout of Liberty Digital's executives, to bring prospective partners to the table from all walks of the media spectrum, but it was, in each case, not enough to secure any commitment from prospective partners. *See* Tr. 497-98 (indicating that Liberty Digital "had conversations with the major player in any commerce sector that we pursued a discussion . . . Our stopping point in every discussion was 'This is great, but where is the access agreement? If you finalize the access agreement, we would like to continue to talk to you.'").

C. AT&T And Liberty Digital Never Come Close To A Definitive Agreement

Although the Access Agreement is by its terms a binding agreement, it nonetheless remained at core an agreement to agree. Like any agreement to agree, the Access Agreement was by nature ambiguous and general, because it specifically contemplated the need for further negotiations and definition. And, as with any agreement to agree, the bargaining process was likely to be influenced by which of the two parties most wanted or needed to move beyond an agreement to agree to a final contract.

In the case of the Access Agreement, both of these factors came into play. For its part, Liberty Digital had a powerful incentive to move quickly to a definitive agreement because that was necessary for it to convince other potential partners, content and fulfillment providers, to sign the other deals required to create new interactive channels. Meanwhile, AT&T was a huge organization with diverse interests; doing a deal with Liberty Digital was only one minor component of its consideration of whether to roll out advanced set-top boxes (which was in itself one of a myriad of issues AT&T was pondering in its approach to the cable and telecommunications markets).

In the negotiation process, Liberty Digital therefore took the role of pursuer. In autumn 2000, Liberty Digital initiated informal discussions with AT&T about reaching a global distribution agreement for the use of all 6 MHz of bandwidth available to Liberty Digital over AT&T's digital cable systems. When Liberty Digital sought to commence formal negotiations over that topic, however, AT&T stopped responding. And at that level of detail, the discussion process was not smooth. Liberty Digital and AT&T did not share the same understanding of many of the general terms in the Access Agreement, including such issues as 1) what it meant for Liberty Digital to be entitled to "then-current MFN terms" and to "first screen access," 2) whether Liberty Digital had to pay launch support payments to A T & T in connection with the initial broadcasting of new channels, 3) what commissions, if any, would be guaranteed to AT&T in connection with Liberty Digital programming, and 4) the terms governing Liberty Digital's relationship with AT&T if it exercised its option to renew the original definitive agreement. This is not to mention whether AT&T would exercise its option, under paragraph 4(b) of the Access Agreement, to enter these endeavors as a 50% partner with Liberty Digital with the potential to buy Liberty Digital out after three years. The ultimate resolution of these details would allocate millions of dollars of value between the parties.

By the summer of 2001, Liberty Digital narrowed its negotiation strategy in an attempt to get AT&T off the dime. Instead of attempting to forge a global distribution agreement for all 6 MHz of bandwidth, Liberty Digital sought to secure a more limited distribution agreement specifically for its Travel Channel

Shop concept, thinking that it could begin with that channel and also use that agreement as a template for later channels. But even that less ambitious objective met with resistance.

For one thing, AT&T was hardly vigilant in pursuing negotiations. Although it initially expressed interest in the Travel Channel Shop, AT&T was slow in responding to Liberty Digital's specific contractual suggestions. Even more important, when AT&T did propose an affiliation agreement for broadcast of the Travel Channel Shop, the agreement was more or less a standard affiliation agreement it would offer to any programmer looking to broadcast over its cable system, without any of the preferential terms contemplated for interactive programming under the Access Agreement.

In this regard, Liberty Digital itself had a problem. In none of its conceptual planning had it worked out the important technological issues needed to actually roll out a fully interactive television channel. This required, of course, that the remote at home interact with an advanced set-top box that in turn interacts with AT&T which in turn interacts with various fulfillment providers (of both content and product) in a real-time manner. Few, if any, of the major issues that had to be solved to make that sort of interactivity a reality had even begun to be addressed. For that and another important reason, the Travel Channel Shop concept that

Liberty Digital was proposing to AT&T did not involve, at its inception, interactivity of the kind just described.

The other important reason was signaled by AT&T most strongly in an important letter sent by AT&T's Associate General Counsel, Karla Tartz, to Liberty Digital on September 7, 2001.[11] That letter came in response to a Liberty Digital letter of August 28, 2001 indicating that it wanted to "move the process forward aggressively" and complaining that "notwithstanding [Liberty Digital's] efforts, it had received no substantive response from anyone at AT&T."[12] AT&T's response was not what Liberty Digital was hoping to receive, to wit, it stated in pertinent part:

> The Interactive Video Services Principles addresses the potential for negotiations regarding a business arrangement for interactive programming when technology that could enable such interactivity is deployed. (I refer you to the language of the Principles for their specific terms.) As you know, that technology has not yet been deployed. Moreover the Travel Channel does not use or rely upon interactive television technology. Even Dob Bennett acknowledged in an article in the Rocky Mountain News that "[i]t's hard to negotiate an agreement for businesses that don't yet exist. Both sides are looking at it, and so far we have not come up with a combination of opportunity and product to be able to hammer out terms." In short, AT&T Broadband is under no obligation, under the Interactive Video Services Principals or otherwise, to negotiate or conclude an agreement regarding the Travel Channel.
>
> Having said that, we were, and still are, prepared to discuss the Travel Channel on its own merits as a distinct business proposition.

[11] JX 6.
[12] JX 83, LDG05250.

> That is why we provided a draft Form Affiliation Agreement to you earlier this year. As you may know, there have been certain intervening issues surrounding the broader Liberty-Broadband relationship, which we are trying to sort out. Nevertheless, we are willing to continue our discussions regarding the Travel Channel. I understand that [an AT&T representative] will be contacting executives at Liberty Digital to set up a convenient time to meet and discuss the draft Form Affiliation Agreement.[13]

The AT&T letter depressed Mohn and his management team for several good reasons. Among them was the reference to "certain intervening issues surrounding the Liberty-Broadband relationship . . . ." This referred to the disagreements between Malone and AT&T that had arisen and that were an active irritant, despite the then-recent completion on August 10, 2001 of AT&T's long-planned spin off of Liberty Media. To the extent Liberty Digital had hoped that some shared vision between Malone and AT&T regarding the future of interactive television would aid, however intangibly, in the negotiation process, that hope was clearly dashed. Likewise, by this point, AT&T itself had made a major corporate decision that affected Liberty Digital. By the latter half of 2001, it had abandoned its strategy to use the cable industry as a platform for overall telecommunications growth and was looking to sell its cable business.[14]

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[13] JX 6.

[14] In July 2001, Comcast made an unsolicited bid for AT&T Broadband. Following an auction process involving Comcast, Time Warner and Cox, and a negotiation period, a final agreement with Comcast was signed in December 2001. *See* Tr. 474, 549, 623.

These factors contributed to an overriding reality: AT&T had no near-term plans to deploy advanced set-top boxes. Without that roll-out, AT&T had no duty under the Access Agreement to complete an agreement giving Liberty Digital the preferred access (or any access) to the 6 MHz of bandwidth contemplated for interactive programming. And AT&T made clear that it felt no ethical obligation and had no business interest in treating Liberty Digital as a preferred partner until such time as it, in its own business discretion and with no set timetable, chose to deploy advanced set-top boxes.

In view of these realities, Mohn concluded that Liberty Digital had no hope in the near future of concluding an agreement with AT&T. Without an agreement with AT&T, Liberty Digital could not put together a deal with the other partners required to create the Travel Channel Shop, or any of the other new channel concepts it had conceived. Liberty Digital thought about trying to negotiate further with AT&T or even suing AT&T, but those did not seem like realistic options to generate near term value. And Liberty Digital also faced an important financial issue in January 2002, when $100 million of its debt came due.[15] Liberty Digital did not have the funds to meet that payment,[16] a fact that also militated against pursuing costly and likely lengthy litigation.

[15] Tr. at 414.
[16] *Id*.

I credit the testimony of Mohn and his management team that they began considering other career plans after receiving the September 7 letter and concluding that they had no feasible strategy for moving AT&T's position. Without a definitive agreement with AT&T (or at least, the prospects that a favorable definitive agreement would be reached in the near future), Liberty Digital had nothing valuable to bring to the table in putting together new networks. New networks require hundreds of millions of dollars in capital, capital Liberty Digital did not possess. Dependent on other partners to bring that capital to the table (in the form of cash, programming, and other factors of production) and lacking any asset of its own to convince partners to do that, Liberty Digital was without any real near-term options, or so Mohn and his team thought.

As a result, Mohn concentrated on finding jobs for his team and on figuring out his next career move. Another development likely confirmed that direction.

D. Liberty Media Announces And Completes A Short-Form Merger With Liberty Digital

After receipt of the September 7, 2001 letter and a consideration of its consequences, Liberty Media began to discuss with Mohn the possibility of taking Liberty Digital private. Because Liberty Media owned more than 90% of the shares of Liberty Digital, it was eligible to use a short-form merger under 8 *Del. C.* § 253 as the method of acquisition.

On October 12, 2001, Liberty Media publicly announced its intention to effect a short-form merger whereby it would exchange 0.25 shares of Liberty Media stock for each outstanding share of Liberty Digital stock. One of the reasons for the merger was that Liberty Digital's prospects for moving forward with interactive programming in the near future were stymied by AT&T's bargaining posture and its lack of plans to deploy advanced set-top boxes.

In the registration statement filed in conjunction with the merger, Liberty Media disclosed that interactive television required technological advancements both for the set-top box and at the cable television system operations site, neither of which had occurred, delaying the process.[17] The S-4 went on to say:

> Access Agreement with AT&T. Successful implementation of LDIG's [Liberty Digital's] distribution strategy depends in part on the resolution of discussions with AT&T . . . . LDIG has sought to negotiate a definitive distribution agreement with AT&T under both arrangements. However, AT&T has been reluctant to enter in substantive negotiations concerning a definitive distribution agreement under either arrangement until such time as the technologies necessary to support the interactive channels contemplated by the Access Agreement are more fully deployed. It is possible that LDIG and AT&T may not be able to agree on terms for a definitive carriage agreement under the Access Agreement.[18]

There were other reasons Liberty Media had to pursue a merger, which it also disclosed. These included Liberty Digital's more limited access to and higher cost of capital, its responsibility to pay back the $100 million note due in January,

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[17] *See* JX 102 at 18-19.
[18] JX 102 at 19.

and the costs of operating Liberty Digital as a public company, which were estimated to be over $9 million annually.

Nonetheless, there is no basis to conclude that Liberty Media was not genuinely motivated by the Liberty Digital's inability to move forward in interactive television because of the absence of any progress with AT&T. In particular, there is no record basis to conclude that the merger was a pretext whereby Liberty Media sought to capture for itself, at the expense of the Liberty Digital stockholders, a lucrative opportunity to make profits through the rights provided by the Access Agreement. The petitioners admit that they have no evidence of this kind and press no valuation claim based on this theory.

At most, the petitioners are left with the unconvincing argument that Mohn and the other Liberty Digital managers overreacted to the September 7, 2001 letter from AT&T. The petitioners contend, in various forms, that these managers are either making up their supposed consternation now or were simply wrong in throwing in the towel after receiving that letter.

The problems for their argument are several. For starters, I found the testimony of Mohn and his key subordinate Enenstein entirely convincing on this score, not only in the sense that I believe that they testified truthfully at trial, but as importantly, because their testimony comports with the most likely business reality, as evidenced by the relevant business factors existing as of September 2001.

Next, the petitioners have absolutely NO EVIDENCE — i.e., not any evidence, not one bit — that AT&T had any plans in existence as of September 2001 to roll out advanced set-top boxes on any specific timetable. This is critical because the rights Liberty Digital was trying to exploit were all triggered by AT&T's deployment of advanced set-top boxes. In the absence of any likelihood that AT&T was going to deploy advanced set-top boxes, Liberty Digital could derive no market advantage from the Access Agreement, as it had nothing to capitalize upon.

Relatedly, there is no evidence in the record that suggests that other cable companies were planning to roll out advanced set-top boxes within a commercially reasonable time frame from September 2001. As to this factor, it is also worth noting that the roll out of advanced set-top boxes by other cable systems would not necessarily have advantaged Liberty Digital, except insofar as it forced AT&T to follow suit to keep up with the industry. Because Liberty Digital's supposed advantage was the Access Agreement relating to AT&T's cable system only, the roll out by other cable companies would give a leg up to other providers of interactive programming who would bring to that new industry the kind of things more traditionally associated with a new network, such as programming or products to sell. If other cable systems went first, then other interactive channels would likely be created by those other providers, filling the niche that Liberty Digital hoped to fill first by using the Access Agreement to give it a head start.

For these and other reasons, I credit the notion that, as of autumn 2001, there was no reasonable basis to believe that Liberty Digital could create new interactive televisions networks within any specific time horizon, much less within the coming year or so.

On March 12, 2002, Liberty Media consummated the merger.

E. Liberty Digital's Stock Price During The Period From 1999 Until The Merger

Before turning to my valuation analysis, I must discuss a topic that I suspect in part motivates this suit. In the years before the merger, the equity markets were excited about Liberty Digital's prospects. Malone was a proven cable player with credibility, AT&T at points seemed interested in rolling out advanced set-top boxes, the concept of interactive television was commercially exciting, Mohn had shown his ability to build successful cable television networks, and the Access Agreement seemed to give Liberty Digital a "first mover" advantage.

Characteristic of the times, equity analysts put out amazing (in the sense of being astonishingly speculative and ungrounded in any hard facts) research reports that, at times, contained "discounted cash flow" analyses of Liberty Digital's supposed worth. These so-called DCFs were not based on any real projected revenues but on entirely hypothetical estimates of how many networks it could put up, the potential savings that would flow to those networks from the Access Agreement, and the commercial success those networks would enjoy.

As we shall see, this sort of Fantasy Island approach has been fully embraced by the petitioners' expert in this action. Some of the analyst community's fantasies had them, like the petitioners' expert, valuing Liberty Digital as a whole, and the businesses it hoped to create as a result of the Access Agreement in particular, in the billions.[19]

As a result of the "irrationally exuberant"[20] expectations for Liberty Digital, its stock price was quite lofty for much of its existence. Although Liberty Media, its parent, had a much stronger balance sheet and profitability, in 2000 and in early 2001, Liberty Digital's stock often traded at a much higher multiple of earnings than did Liberty Media's. The interactive television "growth story" apparently contributed to that gap. In early 2001, Mohn was able to reap large rewards from Liberty Digital's stock price. At that time he received $133 million in exchange for his vested Liberty Digital options.[21]

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[19] *See* JX 2, Feinstein Report at ¶¶ 98–103 (collecting analyst estimates from 2000 and 2001).

[20] For a learned consideration of factually implausible overconfidence by investors, *see* Robert J. Schiller, *Irrational Exuberance*, (Princeton University Press 2000).

[21] In February 2001, for diversification purposes, Mohn wished to sell Liberty Digital vested options that he had acquired in connection with his initial agreement with Liberty Media. That agreement committed Liberty Media to pay Mohn, in cash, for increasing the value of Liberty Digital. When Liberty Digital went public, the arrangement was converted to a more typical stock option deal, but Mohn negotiated to get cash, the original right. As a compromise, and to

By late summer 2001, however, the market's valuation of the companies began to sharply adjust, with Liberty Digital's market multiple falling and bringing the ratio of Liberty Media and Liberty Digital's respective per share trading prices into an alignment more favorable to Liberty Media.[22] This readjustment reflected, I conclude, a rational reassessment of the companies' relative values. Liberty Media held much more valuable and proven cash-generating assets. By contrast, Liberty Digital held a modest portfolio of hard assets, faced a looming debt crunch, and was dead in the water on its growth vehicle because there was no sign that AT&T or other companies were going to deploy advanced set-top boxes within the near future. And once Liberty Digital received the Tartz letter internally, Liberty Digital management knew there was no likelihood that the company could ink a favorable affiliation agreement with AT&T in the near future. In view of these hard economic realities, Mohn and his management team accepted the merger

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avoid having the CEO of Liberty Digital send potentially negative signals to the market by exercising and selling substantial options in the market, Liberty Media agreed to pay Mohn $133 million in a combination of cash and Liberty Media stock, in exchange for the options. Mohn exchanged 20% of his options — all of the options that had vested by February 2001, in exchange for the $133 million. The remaining 80% of his options eventually expired worthless. Tr. 482-87.

[22] *See* JX 4 at exhibit 2 (listing the stock ratios of Liberty Digital to Liberty Mutual from 1/3/00 through 2/5/02); *see also* JX 4 at ¶¶ 28-29 (noting average of 0.60 and 0.38 ratios for Liberty Digital's versus Liberty Media's stock price for period of 12 and 6 months, respectively ending 3 months before the merger). As the merger announcement date approached, the ratio between companies ranged from 0.38 to 0.22. JX 4 at exhibit 2. At several times over the preceding year, the ratio between the companies was at or below the 0.25 ratio at which the merger was ultimately consummated, specifically during long stretches of May and August 2001, and in the days before the announcement. *Id*.

price and accepted that a huge slug of Liberty Digital options they held would be forfeited as worthless.

III. Legal Analysis

The court's task in this case is the familiar one of determining the fair value of the petitioners' shares on the date of the merger, exclusive of any value arising from the merger itself.[23] The concept of fair value under Delaware law is not equivalent to the economic concept of fair market value. Rather, the concept of fair value for purposes of Delaware's appraisal statute is a largely judge-made creation, freighted with policy considerations.[24] As a result, the court's task is not to find the actual real world economic value of the petitioners' shares, but instead to determine the value of the petitioners' shares on the assumption that they are entitled to a pro rata interest in the value of the firm when considered as a going concern, specifically recognizing its market position and future prospects.[25] There are any number of accepted valuation techniques that this court may employ in a given case to determine its best estimate of this appraisal value. The judges of this court are unremittingly mindful of the fact that a judicially selected determination

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[23] 8 *Del. C.* § 262(h).

[24] The idea that stockholders should share pro rata to their ownership in the firm's going concern value is designed, or so it seems, to protect against exploitation by insiders with the power to time mergers. In the real world, if a firm is worth $100, has 100 shares, and one stockholder owns 51 shares, and 49 other people each own one share, the 51 shares, as a bloc, could be worth $70 and the remaining shares worth $30. But, in the world of appraisal, the 49 shares are worth $49.

[25] *In re Shell Oil*, 607 A.2d 1213, 1218 (Del. 1992); *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950).

of fair value is just that, a law-trained judge's estimate that bears little resemblance to a scientific measurement of a physical reality. Cloaking such estimates in grand terms like "intrinsic value" does not obscure this hard truth from any informed commentator.

This does not mean that appraisal does not have a useful purpose or that judicial estimates of value cannot be responsibly formulated. But it is to say that the process of valuing an asset after the fact in court is one that presents multiple opportunities for error. Often, the kind of companies that are valued are the hardest to price because they lack reliable earnings histories, are under the control of majority stockholders, or do not trade their shares in liquid markets. In these cases, the court must make its determination of value without an ideal data set to rely upon, a problem exacerbated by the incentives of the litigation process. Men and women who purport to be applying sound, academically-validated valuation techniques come to this court and, through the neutral application of their expertise to the facts, come to widely disparate results, even when applying the same methodology. These starkly contrasting presentations have, given the duties required of this court,[26] imposed upon trial judges the responsibility to forge a responsible valuation from what is often ridiculously biased "expert" input.

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[26] *See Gonsalves v. Straight Arrow Publishers*, 701 A.2d 357, 362 (Del. 1997) (noting the trial court's "statutory obligation to engage in an independent valuation exercise" and requiring the

Here, of course, the twist is that the court is only being asked to determine any value added to Liberty Digital by the Access Agreement. But the case remains typical of the temptations provided by the appraisal process, whereby the incentives of litigating parties lead to the presentation of some testimony that is more incredible than it is credibly grounded in a sound approach to valuation.

To be specific, the parties in this case have taken markedly different approaches to valuing Liberty Digital. For its part, the respondent's approach to valuation actually has grounding in the record and economic sensibility. But the petitioners' presentation, while putatively involving the use of accepted techniques of valuation such as the discounted cash flow method, is entirely untethered to reality.

In the pages that follow, I state why that is so, starting with a description of the petitioners' approach to valuation and an explanation of why I reject it as a wholly unreliable basis on which to value the Access Agreement. I then turn to the respondent's valuation technique, which while imperfect, is a rational method by which to make a necessarily difficult estimate of value. Because the petitioners largely ignored the multiple opportunities given to them to critique the respondent's approach, the court is forced to adjust the respondent's valuation

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court to eschew a baseball arbitration approach to solve the problem of addressing widely disparate "expert" opinions about value).

using its own assessment of the record, having had virtually no help from the petitioners themselves in that endeavor.

A. The Petitioners' Approach: If Wishes Were Horses . . .

The petitioners submitted an expert report by Steven P. Feinstein, an associate professor of finance at Babson College. Feinstein is an experienced academic but has no real experience in the telecommunications or cable industries. What he did bring to his assignment was an incredible enthusiasm for the concept of interactive television.

Feinstein clearly thinks that this idea is going to be a winner and he grounded his view that the Access Agreement was worth $2.2 billion to Liberty Digital as of the merger date in both his optimism and his opinion that the Access Agreement gave Liberty Digital a "first mover" advantage in what would likely be a very profitable new aspect of the television and cable business. Now, this optimism about interactive television is, in itself, not at all problematic. The concept, as I understand it, is one that is likely, someday, to be very successful. It is a logical next step in the use of available cable, television, and internet technologies and builds on Americans' love of TVs and computers. What's not to like about it as a pure business concept?

1. <u>Feinstein's DCF analysis</u>

What is a problem is Feinstein's failure to consider the actual circumstances facing Liberty Digital as of the merger date. To be as fair as possible, I am going to focus on the value of the Access Agreement before the announcement of the merger, but after Liberty Digital received the September 7, 2001 letter from AT&T. After describing the foundation of Feinstein's valuation, I will compare that to the actual facts facing Liberty Digital at that time. What will be seen is that Feinstein's assumptions bear no relationship to reality.

To understand why that is so, it is useful to describe the premises for Feinstein's DCF valuation. He started from the assumption that Liberty Digital would ultimately provide 12 interactive channels on AT&T's digital networks. He assumes that Liberty Digital would have launched its first two channels in January 2004, with 2 channels to be added each year until all 12 were up in running. Feinstein further assumed that each channel would earn revenues equal to $0.75 per AT&T digital subscriber to be adjusted upwards 2% annually for inflation. Feinstein derived the $0.75 figure by giving equal weight to his initial estimate of revenues received by the Home Shopping Network ("HSN") and QVC per subscriber, on the assumption that the Liberty Digital channels would be as profitable on a per subscriber basis. To come up with the number of AT&T subscribers, Feinstein projected that AT&T's digital subscribers would grow 20%

annually until they reached 80% of AT&T's overall customer base, and would then grow in tandem with his estimate for the overall customer base, or 3%.

In order to be conservative, or so he says, Feinstein only calculated the value of 9 years of cash flow, running from January 2004 until January 2013. Thus, he says, he low-balled his outcome because he included no terminal value. The 9 year period was tied to the Access Agreement, which gave Liberty Digital access for five years with an option to renew for four years. After discounting these estimated cash flows using a weighted average cost of capital that seems too low,[27] Feinstein came to a DCF value of Liberty Digital of $2.272 billion.

There is a well-known phrase, "if wishes were horses, then beggars would ride." If Feinstein's wishes were horses, the petitioners would have ridden and owned Secretariat, Seattle Slew, and (the trial judge's favorite) Affirmed, Triple Crown winners all. The problems with his DCF analysis are so pervasive and numerous that it is impossible to describe all of them. But I will hit a few of the key ones.

First, Feinstein totally ignores that the time frame in which good ideas can be commercialized has a profound effect on their value. He admits that he has no evidence that AT&T had any plans to roll out advanced set-top boxes within any

[27] Feinstein did not, in my view, derive a cost of capital that adequately took into account the nature of the businesses his analysis assumed Liberty Digital would undertake, which were television programming networks. Had he done so, his cost of capital would have been higher.

foreseeable time period. If Chuck Berry had envisioned the iPod in 1955, he would have had a good idea but no way to make money off it absent technological innovations decades away; thus, he was far better off giving us the gift of *Maybellene*.[28] Put simply, that interactive television might be commercially valuable in the future does not logically translate into a large present value for the Access Agreement as of the merger date.

Second, Feinstein disregards the inability of Liberty Digital to forge an advantageous, definitive affiliation agreement with AT&T in the years leading up to the merger. He ignores the fact that AT&T essentially told Liberty Digital that it would get no preference until AT&T, on its own undetermined time frame, rolled out advanced set-top boxes. He ignores the fact that AT&T's own decision to exit the cable business would necessarily affect Liberty Digital's ability to reap value from the Access Agreement.[29]

Third, Feinstein ignores that Liberty Digital's plans for interactive channels were essentially conceptual and turned on its ability to sign up programming and product partners, none of whom would sign with Liberty Digital until it had an advantageous and specific final access agreement with AT&T.

[28] C. Berry, R. Fratto & A. Freed, *Maybellene*, (Isalee Music Co. 1955).
[29] The exit meant that Liberty Digital would have to negotiate with the buyer of AT&T's cable assets, i.e., with a stranger to the original negotiations over the Access Agreement.

Fourth, Feinstein ignores the fact that these potential partners made clear to Liberty Digital that they expected to have a material ownership interest in any interactive channels that resulted. He assumes that Liberty Digital would get the total cut, or that in outsourcing, it would retain, after splitting with its partners, the same profit margin as QVC since QVC also incurred additional costs by owning the means of production. That assumption is both unrealistic and unsupported by the record.

Fifth, Feinstein ignores AT&T's right, under Paragraph 4(b) of the Access Agreement, to take a fifty percent interest in any resulting interactive television channels, and buy Liberty Digital out at a fair market value on the third anniversary of any joint venture, thus potentially freezing Liberty Digital out of any long term upside play.

Sixth, Feinstein pretends that it costs nothing to bring a channel to market. He claims to have taken this factor into account by eliminating any terminal value for his analysis. But the absence of any terminal value, is not, as Feinstein seems to believe, a panacea rendering his speculative and aggressive estimation conservative. His analysis assumes, without discounting, that each of the 12 channels that Liberty Digital would launch would be as successful as HSN and QVC, channels that are broadcast on analog cable and that have established their profitability over a long period of time, during which good times followed the struggles of securing a foothold. The record reflects that it takes hundreds of millions of dollars to create new television networks, that it takes time to roll them out, and that no company, in the history of television, has ever rolled out 12 new networks in 6 years. Moreover, the initial years after launching a channel often involve the incursion of substantial operating losses. And, of course, some channels fail. Feinstein optimistically assumes these factors away as a wash with his lack of terminal value. It is no fair balance to assume away the risks of failure and to assume "conservatively" a DCF value premised entirely on multiple years of solid profits based on two proven networks.

Seventh, Feinstein erroneously inflated the per subscriber revenue received by HSN and QVC. Professor Feinstein originally took what he thought to be the appropriate HSN per subscriber revenue of $0.53 and averaged it with the QVC revenue per subscriber of $0.92, somehow arriving at an approximate average of $0.75, rather than the more precisely correct $0.725. But the $0.53 figure that Professor Feinstein used also included the revenues of the other network sharing common ownership with HSN, USA Network. In fact, as respondent's expert Katz brought to Feinstein's attention before trial, the appropriate revenue figure for HSN was $0.22 per subscriber. Rather than recalculate his valuation in light of this critical change to input, which implies an average per subscriber revenue of $0.57, instead of the substantially larger $0.75 initially used to generate his $2.2

billion valuation, Professor Feinstein reiterated his $2.2 billion valuation at trial. Feinstein's easy disposal of his original methodology when confronted with a clear input error that changed his mathematical outcome in a manner adverse to his client does not inspire confidence in Feinstein's objectivity. Rather, it smacks of a stubborn desire to stick to a pre-conceived value number regardless of the facts.

Eighth, Feinstein assumes that the narrower offerings contemplated by Liberty Digital (e.g., Travel Channel Shop) would be as profitable as established channels like QVC and Home Shopping Network that offer a wide variety of products for sale. He also assumes, as I alluded to above, that Liberty Digital, with no programming or products of its own, could capture the same proportion of profits from each of its channels as QVC or HSN, which presumably control and own more of the factors of production. Why that would be so is not apparent to me, especially given the actual record showing that Liberty Digital's prospective partners were, even in the initial conceptual discussions, expressing their intent to demand a substantial material stake in exchange for their contributions.

Ninth, Feinstein's brimming confidence that Liberty Digital would beat other cable players to the interactive television punch might be genuine, but it is not, in my view, rational. Liberty Digital had a contractual advantage, to be sure, but it lacked attributes that other possible entrants would have that seem to be much more obviously advantageous. Why, for example, would Liberty Digital be able to out-duel QVC in this space? Does Feinstein really believe that QVC, and other established networks, were not watching developments in interactive television with interest and making plans to capitalize on those developments for themselves? Wouldn't these channels be well-positioned to develop new, improved versions of their existing, proven programming that would take advantage of the coming interactivity? This is not to say that Liberty Digital would not be a player, but that its comparative advantage, as demonstrated in its negotiations with providers of other relevant ingredients for success, was modest and narrow.

Finally, taken as a whole, Feinstein's DCF analysis is simply incredible. He eschews any reliance on the real-world beliefs of Mohn and his management team about Liberty Digital's prospects and, in the absence of any management projections of cash flows, invents his own. That is, rather than addressing the operative reality of Liberty Digital, as required by law,[30] Feinstein imagines an ideal world for Liberty Digital and values the Access Agreement on that basis. In that ideal world, a poorly capitalized firm can start multiple cable television channels all at once, succeed in all of them, and extract all the same value as a QVC, even though it only brings to the table an ambiguous contract right. But

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[30] *See Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298-99 (Del. 1996).

there is no rational basis to conclude that this was the world Liberty Digital lived in before the merger (or lives in now, for that matter).

For these and other reasons too numerous to set forth,[31] I find Feinstein's DCF valuation to be unreliable and to provide no rational insight into Liberty Digital's value.

2. The Petitioners' Other Valuation Techniques Are Equally Flawed

On the petitioners' behalf, Feinstein performed a variety of other aggressive valuations, none of which is reliable. For example, Feinstein conducted an analysis whereby he analogized Liberty Digital's access to AT&T's cable system to owning a certain number of channels. He then looked at change of control transactions involving cable companies and drew an inference that Liberty Digital's right to 6 MHz of bandwidth was equivalent to owning those channels, and that with ownership of those channels came a pro rata (to the total number of channels) claim to the value of an entire cable company. But there is no business basis to make the inference that a programmer with a preferential right of access to

[31] There are so many problems with Feinstein's analysis that it is impossible to address them all. For example, Feinstein assumes that all of the 12 channels he imagines would be commerce channels like QVC. If that were not to be the case, as would more likely be the case, the per subscriber profits would likely drop. And, as mentioned, the idea that new, narrowly focused commerce channels would be as profitable as QVC is impossible to accept. I am also dubious about Feinstein's estimate of growth rates for AT&T's subscriber base, given the maturity in the cable industry and growing competition from satellite television companies. Although the digital portion of cable systems was likely to grow, digital's overall growth over an extended time will tend to converge with that of cable as a whole.

a certain amount of bandwidth possesses something as valuable as a per channel pro rata share of the cable system's value. The type of rigorous economic analysis that would be required to make this logical leap is not undertaken by Feinstein and I have no confidence that his cable company comparables are, in any meaningful manner, comparable to Liberty Digital.

Likewise, Feinstein gives weight to Liberty Digital's market price at the height of market expectations about the imminent deployment of advanced set-top boxes and of technology companies more broadly. But those expectations did not reflect the reality of Liberty Digital's worth as of the merger announcement date. By that time, there were no imminent plans by AT&T (or any other cable provider) to deploy advanced set-top boxes, AT&T had no programming contracts with AT&T or content partners, and Liberty Digital was facing a debt crunch. Outdated market price quotes simply provide no reliable insight into Liberty Digital's value as of the merger announcement.[32]

[32] The petitioners argue that the Tartz letter did not materially change the expectations of Mohn and his management team regarding the prospects of a deal with AT&T. In support of this, they cite portions of Liberty Digital's SEC filings that deal with AT&T and that do not change after the Tartz letter. The problem for the petitioners is that the Liberty Digital filings throughout all relevant periods had material caveats emphasizing that the road between the Access Agreement and a completed affiliation agreement was a winding one, with paving of uncertain and risky quality. In this appraisal suit, I need not ponder whether Liberty Digital's disclosures were less than ideal. What is clear is that the absence of an emergency 8-K filing upon receipt of the Tartz letter does not mean that the letter did not have a material influence on Liberty Digital's short-term prospects. In any event, the merger prospectus clearly noted the absence of any definitive agreement with AT&T and the ongoing risk of not obtaining one as a reason for the merger.

Of similar ilk is Feinstein's reliance on analyst "valuations" of Liberty Digital. These valuations are in the billions of dollars. They are comprised of the same building materials as Feinstein's own DCF. And they are no more reliable, as they do not confront the actual economic circumstances facing Liberty Digital and the limited nature of the contractual leverage it owned under the Access Agreement. Anyone who would place weight on these valuations would be well-advised to ask themselves this question first: If my family had to derive its nutrition during the next six months exclusively from food delivered to our home by Webvan during the next six months, would we live to tell about it? Put summarily, the petitioners have done nothing to demonstrate the reliability of these analyst "valuations" and there is nothing about the recent history of analyst projections of issuer worth that would inspire judicial confidence in using them as an important determinant of appraisal value.

Without burdening the reader with more, let me just conclude this segment of the analysis by indicating that none of Feinstein's other attempts to justify a value for the Access Agreement of more than $2 billion is persuasive.

3. <u>Paragraph One Rights From Schedule 7.14</u>

Paragraph 1 of Schedule 7.14 also contains a Preferred Vendor Status provision that states, in its entirety:

1. Preferred Vendor Status

> Liberty Media Corporation ("LMC") will be granted preferred vendor status with respect to access timing and placement of new programming services. This means that AT&T will use its reasonable efforts to provide digital basic distribution of new services created by LMC and its affiliates, on mutual MFN terms and conditions and otherwise consistent with industry practices, subject to the programming meeting standards which are consistent with the type, quality and character of AT&T's cable services as they may evolve over time.[33]

In his report, Professor Feinstein values this portion of the Schedule 7.14 separately, arriving at an independent additional value of $292 million,[34] and treats it as if it is part of the Access Agreement. To do so, he first notes Liberty Digital's "rights" under Paragraph 1, then proposes a "conservative and reasonable" estimate that Liberty Digital would create 6 non-interactive channels, two in each of 2004, 2005 and 2006, to take advantage of the rights granted under this Paragraph with each channel realizing cash flows of $0.10 per digital subscriber, which Feinstein discounts to present value using a separate DCF analysis.[35] The question of whether Liberty Digital could develop these additional channels while in the process of rolling out 12 interactive channels to take advantage of their Paragraph 4 rights, faster than any development of programming channels in television history, seems not to have bothered Feinstein in the least. Apart from

[33] JX 1.
[34] *See* JX 2, Feinstein Report at ¶¶ 94-97.
[35] *Id*. at ¶ 95.

the implausible factual assumptions that drive this analysis, it also misstates the contractual rights of the parties.

In the Contribution Agreement that transferred certain contractual rights in Schedule 7.14 from Liberty Media to Liberty Digital (then TCI Music), only the rights under Paragraph 4 were assigned.[36] Paragraph 1 rights were not transferred to Liberty Digital, and remained with Liberty Media. It is true that, by its terms, Paragraph 1 applies both to Liberty Media "and its affiliates," including, definitionally as of that time, Liberty Digital.[37] The reason for that reference, however, is not to vest rights in the affiliates of Liberty Media against AT&T as separate entities, but to permit Liberty Media to avail itself of the Paragraph 1 rights when doing so through an affiliate benefited Liberty Media as a parent company. That this is the only sensible reading is reinforced by the actual dealings between Liberty Media and Liberty Digital as to this issue. In the Contribution Agreement, Liberty Mutual and Liberty Digital specifically addressed these implicit rights, stating in relevant part that:

> LMC [Liberty Media Corp.] agrees that, so long as it beneficially owns a majority of the voting power of the outstanding capital stock of TCI Music [Liberty Digital], *LMC will use its commercially reasonable best efforts to make available to TCI Music such rights and benefits as LMC and its Controlled Affiliates are entitled pursuant to Paragraph 1 of Schedule 7.14 with respect to TCI Music's offering of the interactive Video Services referred to in The Assigned*

[36] JX 33 at ¶ 2.1.
[37] JX 1.

> *Paragraph 4 Rights* and TCI Music hereby agrees that, to the extent such rights and benefits are made available to it, it shall fulfill all obligations of LMC thereunder. *The foregoing covenant shall not require LMC to exercise any rights under Paragraph 1 of Schedule 7.14 or to enter any additional agreement or arrangement with AT&T regarding the making of such rights or benefits available to TCI Music*.[38]

In sum, Liberty Media agreed to pursue Paragraph 1 rights only if it was in its own best interest to do so, and Liberty Digital could not, independently invoke or compel any such rights.

As a part of his valuation, Feinstein admits that Liberty Digital's management was not focused on exploiting the rights under Paragraph 1 outside of Liberty Digital only, but suggests that there was independent value to be had there nonetheless. Based on the contractual provisions, however, it appears more accurate to say that Liberty Digital's management did not focus on Paragraph 1 rights because they had no enforceable Paragraph 1 rights as to channels that did not fall within Paragraph 4. Any rights under Paragraph 1 as against AT&T directly belonged to Liberty Media, not to Liberty Digital. And Liberty Media had only contractually promised that it would use "its commercially reasonable best efforts" to enable Liberty Digital to take advantage of Paragraph 1 in forging a relationship with AT&T under Paragraph 4 — i.e., the Access Agreement. Even then, Liberty Digital could in no way compel Liberty Media to exercise these

[38] JX 33 at ¶ 4.5 (emphasis added).

rights against AT&T on Liberty Digital's behalf. This is a very weak contract right, as it consists in the notion that Liberty Digital is simply owed a non-enforceable promise by its parent to use its commercially reasonable best efforts to cause a third party to honor the spirit of an agreement to agree by providing preferred access to Liberty Digital's interactive television programming on unspecified MFN terms that were subject to specific negotiations and multiple conditions in the already difficult context of negotiating a Paragraph 4 final affiliation agreement.

In other words, the financial consequence of Paragraph 1, if any, remained to be determined in later negotiations, but in this case in later negotiations not only with AT&T, but also with Liberty Media itself. To assume that Liberty Digital would have created six channels with "preferred Paragraph 1 status," worth a present value of $292 million completely outside the Paragraph 4 process is patently unreasonable, and I therefore reject the petitioners' position on this issue.

After all, Liberty Media owed no duty to Liberty Digital at all as to channels that did not qualify as interactive programming subject to the Access Agreement.

Rather, if the stars aligned properly, Liberty Digital might have derived value from Liberty Media's promise as to Paragraph 1 only insofar as the promise (and Liberty Media's own Paragraph 1 rights) influenced the pricing of an affiliation agreement reached as to interactive programming under the Access

Agreement. The petitioners have failed to present any responsible, non-speculative estimate of that modest value. In any event, the pro-petitioner adjustments I make in valuing the Paragraph 4 Access Agreement rights are in part designed to fairly capture the value that Paragraph 1 would have provided to Liberty Digital in the negotiation of affiliation agreement with AT&T under the Access Agreement.

B. Katz's Methodology: The Relative Realism Of The Respondent's Approach

In contrast with the flights of fancy that petitioners, expert indulged in as described above, respondent's expert, Marc H. Katz,[39] recognized the Access

[39] Katz is a managing Director in Lehman Brothers' Mergers and Acquisition group, dealing primarily in the telecommunications industry, and served as respondent's expert witness at trial. He was the primary author of the respondent's expert report, though it was also reviewed by Lehman Brothers' Fairness Opinion Committee and, as a consequence, bears that firm's imprimatur. Lehman Brothers and Katz have been engaged by Liberty Media on several occasions as investment bankers, receiving the customary fees for such work, a fact that both readily disclosed. Lehman Brothers also candidly admits that it deals in the securities of Liberty Media, both in its own accounts and those of its clients. This potential conflict of interest, or at a minimum the appearance of inappropriate pressures, caused petitioners to repeatedly urge the disqualification of Katz as an expert in this matter.

The petitioners' attempt to disqualify Katz as an expert is based on strained and inadequately documented assertions that Katz and his firm, Lehman Brothers, are violating new or existing ethical standards of the Association for Investment Management and Research, the NYSE, the NASD and the SEC, which seek to insulate stock analysts from investment bankers when their joint employers represent both issuers and buyers of stock. The petitioners assert that, as an investment banker offering an equity analyst-like opinion as to the value of a company that he also serves in an investment banker capacity, Katz, and Lehman Brothers by offering their endorsement, run afoul of these ethical rules (or at least create an appearance of impropriety). The petitioners, despite having been invited to do so, have not provided any history showing that these new standards were designed to preclude an investment banker whose firm represents a client on other matters from testifying in court about the value of a subsidiary controlled by that client. Indeed, Feinstein's Supplemental Report on this issue concedes as much. More obviously, the standard is designed to prevent analysts from touting stock to the investing public when the analyst's employing firm has its bread buttered in various (conceivable) ways by the issuer. That said, I am acutely aware that Katz's firm, and Katz himself, have done a good deal

Agreement for what it was: a unique contract right of uncertain value, with language that the parties disputed and that therefore was of dubious specific enforceability, but that potentially offered a material advantage to Liberty Digital if it could be parlayed into an actual, finalized affiliation agreement with definite terms. In short, as Katz views it, the Agreement promised an undefined potential upside but several clearly identifiable impediments had to be overcome to achieve that potential. Accordingly, Katz valued the Access Agreement as a contract right and tried to price the economic value it gave to Liberty Digital. It was this incremental value, in Katz's view, that gave Liberty Digital whatever advantage it would have in the future in competing to create interactive television channels. Katz reasoned thusly and rationally, I conclude, because there is no evidence that Liberty Digital possessed any other programming advantage (e.g., the rights to all

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of work for Liberty Media and that Katz admitted that he did not, as a regular matter, act as an expert witness and would not have worked for the petitioners had they come to him first and asked him to testify for them against Liberty Media. Put bluntly, Katz is not ideally positioned to be an "independent expert witness," if that oxymoronic concept has meaning. But disqualification is not the answer, judicial acknowledgement and consideration of his possible bias are. I take the bias-producing factors into account in assessing Katz's work, adding it to the grains of salt necessary to flavor consideration of any expert testimony.

Nor do I apply this culinary metaphor only to Katz. Notably, Feinstein works for a consulting firm that advertises that it has done work for the petitioners' prominent nationally known law firm of Milberg Weiss Bershad & Schulman, LLP, and I have little doubt that the hourly rate he has received for his work in this case, and the hourly rate that he might receive from working for the Milberg Weiss firm in the future, materially exceeds what he receives from Babson College. I factor that into my rulings as well. In the end, I do not find either Katz or Feinstein to be disqualified as experts but, of course, recognize that each has a powerful incentive to give testimony favoring his respective client.

Seinfeld reruns forever) in this space; its only asset of value was whatever better than market access to AT&T's cable system the Access Agreement provided.

Katz proceeded by first describing how the Access Agreement came to exist and the specific terms it embodies, to the extent that they are specified. He went on to first identify potential additional benefits that may have been implied, or at least suggested, by the terms of the Agreement and that Liberty Digital hoped to exploit. Against these, Katz counterbalanced the ambiguities and limitations of the Agreement, such as 1) the lack of specific price terms and 2) the fact that advanced set-top boxes had not yet been deployed — a necessary prerequisite to trigger Liberty Digital's rights under the agreement and one that was completely at AT&T's discretion. Despite the ambiguities and uncertainties, Katz produced a valuation of the Access Agreement of $83.4 million.[40]

To get to that result, Katz eschewed a DCF analysis of the interactive television business that might have been ultimately developed through the Access Agreement, because the lack of concrete data about such a theoretical business, in his opinion, made such an analysis untenable. In this regard, as I described above, I agree that such a methodology is inappropriate under these facts, and that Professor Feinstein made this exact error in attempting to make a conceptual leap across too great a divide, creating theoretical constructs too divorced from reality

[40] JX 5, Katz Report at 26.

to be given credence. Katz instead chose an alternative assumption: that the Access Agreement would ultimately have secured Liberty Digital some preferential treatment from AT&T, an advantage best approximated by assuming that Liberty Digital would not have been required to pay the launch support or carriage fees typically associated with starting new channels on a digital cable system.

Once one accepts the premise, the rest of Katz's valuation flows from it: first, he used a precedent transactions analysis to quantitatively establish the range of carriage costs on a digital network; second, he purportedly confirmed this range qualitatively though conversations with industry insiders; finally, he applied the positive and negative particulars of the Access Agreement to select a cost per subscriber carriage fee from within the qualitatively established range that, in his estimation, best approximates the costs that Liberty Digital 1) would be required to pay absent the Access Agreement, and 2) would thus save as a result of the Agreement. The rest is simple math — multiplying the assumed cost per subscriber saved through the Access Agreement by the number of digital subscribers on AT&T's network at the time of the merger[41] and by the number of

[41] Katz's report acknowledges that AT&T's digital subscriber base was likely to expand over time (both as AT&T's total subscribers increased and as the percentage of those subscribers that were digital, as opposed to analog, continued to increase). But using the most common methodology evidenced by both experts, the trading off of assumed offsetting values, Katz assumes that this growth is offset by the fact that none of the digital subscribers had functioning advanced set-top boxes at the time of the merger. Rather then correct for either of these

channels that the bandwidth provided in the Access Agreement, could theoretically support, assumed to be 12.

Although there are quibbles that can be made with Katz's precedent transaction analysis, some of which I discuss below, the most pressing theoretical question is whether his choice of carriage and launch fees makes sense as a empirical proxy for the rights embodied within the Access Agreement. For reasons I next explain, I conclude that it does. I therefore accept Katz's general framework for the reasons discussed below, and modify it based on my impression of the factors that he considered.

1. Katz's Initial Assumption

As an initial matter, it should be kept in mind that the Access Agreement consists of less than two pages, and that its operative provisions comprise two paragraphs that have been quoted earlier in this opinion. My point is that the rights discussed, in contrast to a typically-extensive final affiliation agreement, are not expansively described. But there nonetheless is an explicit discussion of access to 6 megahertz of bandwidth for interactive video channels. It is therefore reasonable

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modifications, the lack of deployed technology versus the continued growth of the subscriber base, Katz simply assumes that they cancel out. *See* JX 5, Katz Report at 26 n.3. In this opinion, I similarly adopt this assumption as it strikes me as reasonable. The expected growth in digital subscribers was substantial, but capped by the mature nature of the cable industry itself and satellite competition. Such growth as would be experienced was not enough to offset the absence of any reliable evidence that AT&T, as of the merger date, planned to roll-out advanced set-top boxes in the ensuing years. By giving present value to the launch fees on the assumptions that he did, Katz fairly balanced the competing considerations.

to assume that the costs of obtaining access of that kind, and any reduction or elimination of these costs provide real world data that can be looked to in valuing this asset. Moreover, Liberty Digital itself, in negotiations with AT&T for access, specifically deleted a proposed charge for access, presumably in reliance on the terms of the Access Agreement, suggesting that Liberty Digital executives also considered this type of saving to be covered or implied by the Access Agreement.[42] Katz's choice of assumption therefore finds some support both in the type of assistance that is contemplated by the Agreement and in the form that such assistance might take, i.e., reduced rates or costs.

It is true that the Access Agreement does not specify the exact form of assistance that AT&T is committing to provide. But assuming that some tangible support was provided, a reduction in launch or carriage fees is a relevant and therefore likely component of such assistance. Moreover, the objection that the Agreement does not provide expressly for such financial support ignores the simple fact that the agreement does not provide, expressly, for much of anything concrete. In other words, by focusing on launch fees, Katz rationally gave a present value to other factors — such as a leg up in securing Liberty's (shaky) contractual access to bandwidth — that are difficult to price without speculation.

[42] *See* JX 5, Katz Report at 14 (discussing a letter from Robert Hoegle, Liberty Digital's General Counsel, on June 18, 2001, revising a draft affiliation agreement to remove the reference to $1.00 per subscriber launch fee).

Katz just summed up these intangibles in one possible metric by which Liberty Digital might have secured and summed up the economic advantages of the Access Agreement.[43] If I were to limit my estimation of the Access Agreement's value to what it provides expressly, I would be left, as both the respondent and Katz suggest, looking for an estimate of what a third-party would have paid to purchase the Access Agreement — a value that, given the considerable indefiniteness of the Agreement, is arguably much lower, or even zero, reflecting the fact that no logical prospective buyer of the Access Agreement would likely pay hundreds of millions of dollars (much less billions) in consideration for a unspecified right to be clarified at a later time in negotiation with a third party, AT&T, that was selling its cable assets.

Finally, I find that Katz's reliance on launch and carriage fees recognizes a reasonable alternative source of real world data to base a valuation upon. Without anything more then a hypothetical business to value using traditional DCF or comparable companies analysis, both experts were left with the task of valuing a nebulous contract right. By tying the value of that right to the relevant and related costs of launch and carriage, Katz grounds his valuation in factual data. Under the

[43] Katz's report expressly notes that AT&T and Liberty Digital could have opted to spread the financial benefits implied by the Access Agreement over different facets of their final negotiated affiliation arrangement. His report therefore relies on the precedent transactions analysis to estimate the extent of these benefits, not the precise form that they might ultimately take after the negotiations of the parties.

circumstances, Katz's alternative both bears logical connection to the contract right being valued and provides sufficient objective support for his analysis.

2. Katz's Precedent Transactions Analysis

In his precedent transactions analysis, Katz identified a total of 16 precedent transactions that occurred within the six years before the merger: 4 on direct broadcast satellite systems and 12 on analog networks, 3 of these occurring on the digital tier.[44] The cost, in cash, equity or other compensation, is laid out in chart form representing analog channels on cable networks, satellite digital channels and digital channels on cable networks.[45] Katz notes several distinctions between the types of channels that explain the low costs associated with digital cable as opposed to the other two channel types.

Access to digital tier channels on cable networks typically costs less than access on their analog counterparts because digital channels reach only that (albeit growing) fraction of the subscriber base that has digital capability, usually in the neighborhood of 25% of the total cable network, with some variation among networks.[46] Contrastingly, analog channels, which reach the full subscriber base, are more expensive both because of the greater number of customers reached and because of the limited amount of analog bandwidth available, which creates supply

[44] JX 5, Katz Report at 21-22.
[45] *Id*. at 22.
[46] *Id*. at 23.

and demand pressure.[47] Additionally, analog channels typically receive favorable channel placement near the channels of broadcast networks.[48]

Similarly, satellite channels bear a higher cost than digital tier cable channels because all satellite channels, though digital, reach the totality of the digital subscriber base, assuming they are included on the basic tier. Moreover, satellite penetration can be optimized by negotiation with the two leading satellite providers that together are estimated to reach more consumers than all digital cable networks combined, providing a valuable ease of market penetration.

After explaining the distinctions between the types of channels, Katz's analysis presents the ranges and calculates the means for the costs associated with each type of channel.[49] Because the Access Agreement contemplated digital cable channels, Katz adopts the 3 digital tier channels as the most appropriate comparables with a range of $1.00 – $3.00 as the cost of carriage per subscriber and a mean of $2.58.[50] This step of Katz's analysis is well reasoned, and given the reality that any channels ultimately secured by Liberty Digital under the Access Agreement would be digital channels on a cable network, I accept that the costs typically associated with launching digital cable channels, as opposed to analog

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[47] *Id*. at 24 (noting that the limited number of analog channels on cable networks are "fully utilized").
[48] *Id*.
[49] *Id*. at 22.
[50] *Id*. at 22, 25. Katz also indicates that industry insiders confirmed the $1.00 - $3.00 range for digital channels on cable networks.

cable or satellite channels, provide the most relevant data for analysis in attempting to value the rights under the Access Agreement.

3. Specific Aspects Of The Access Agreement That Bear On The Valuation Analysis

In describing the Access Agreement, Katz includes a description of the limited, but possible additional upsides hinted at in the Agreement, as well as its limitations, factors that he then incorporates and applies in selecting a specific valuation from the range produced in his quantitative analysis. On the potential positive side, there are several considerations. First, the Access Agreement mentions "first screen access," which trial testimony suggested would include either a Liberty Digital page as an interactive television homepage equivalent, or, as Katz notes, a link to Liberty Digital's homepage from an AT&T default first screen.[51] Either way, the feature had the potential to increase Liberty Digital's visibility on the AT&T network, and correspondingly to increase its value. Second, the Agreement contemplates "Hot Links," which essentially would permit Liberty Digital to bestow ease of access to a third party via a link. Finally, the initial 5-year Agreement is renewable for an additional 4 years at then-current MFN terms. Thus, if terms improve over the years, Liberty Digital would get a window to capture those improved terms.

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[51] *See* Tr. 171-72; JX 5, Katz Report at 8.

But by far the more compelling issue facing Liberty Digital, in Katz's view, was the Agreement's indefiniteness. The Agreement was, in essence, an enforceable agreement to agree, lacking many of the necessary details of a comprehensive affiliation agreement. This lack of specificity created the dual risk that either no final agreement would be reached, or that, if reached, the terms would not be favorable for Liberty Digital. Perhaps the most significant of the terms missing from the Access Agreement are the price terms, including the fees customarily paid by a network, like those contemplated by Liberty Digital, to cable network operators, like AT&T — launch and carriage fees and the affiliate license fees.[52] These uncertainties required further negotiation with AT&T to resolve, and AT&T had indicated no interest in finalizing these terms.

Similarly, the number of channels that the 6 MHz specified in the Agreement could support was not certain. The record contains estimates of 12 to as many as 18 channels, but the content of those channels had the potential to affect bandwidth use. Because the technology for interactive television had yet to be developed, the eventual impact of the content itself was unknown. On the other hand, the technology used in compressing information continues to evolve, so potentially 6 MHz could go from carrying 12 to 18 channels, or more, as was

[52] Katz notes that AT&T and Liberty Digital at least explored the possibility that such fees could be covered by a revenue sharing arrangement. Although no terms were agreed to, commissions between ten and twenty percent were discussed. *See* JX 5, Katz Report at 15.

suggested by Feinstein at trial.[53] The number of channels that the 6 MHz represented obviously affects the value of the Agreement and could not be conclusively established before implementation of the nascent technology.

Lastly, Liberty Digital had no way to control the time table of when any of its rights might come to fruition. Apart from being unable to force negotiations with AT&T, Liberty Digital was contractually unable to compel the deployment of any set-top box, let alone an advance set-top box capable of supporting the envisioned Liberty Digital model of interaction. Thus, AT&T was within its rights, under the Access Agreement, to never develop or deploy interactive set-top boxes, a risk that Liberty Digital acknowledged.[54]

With AT&T stonewalling until the technology was deployed, an additional level of uncertainty arose in negotiations with third party content providers. No potential partners were prepared to negotiate beyond the initial phases without a better understanding of what Liberty Digital brought to the table and when it would bring it, and Liberty Digital could not, without negotiating with AT&T, either clarify what it brought to the table or better explain the timing that it proposed. As a consequence, at the time of the merger, the cost of obtaining programming, either

[53] Tr. at 63, 113.

[54] *See* JX1, Access Agreement ¶4(a) ("…AT&T shall have no obligation to deploy set-top boxes of a type, design or cost materially different from that it would have otherwise employed."). *See also* JX 5, Katz report at 9 (listing among the risks that Liberty Digital publicly disclosed in its August 3, 1999 proxy statement that "the set-top boxes required for interactive television may not be deployed.")

as an absolute dollar figure or as a percentage of any cooperative venture, remained uncertain. As of the time of the merger, Liberty Digital had no programming or any contracts to obtain any.

Additionally, I would add, though Katz does not, that AT&T's development of advanced set-top boxes was not the only technological implementation problem facing Liberty Digital. The software that would govern and secure the electronic pathways used to send information from advertiser to consumer, consumer to provider, provider to credit card company, et cetera, the so-called "middle ware," had yet to be developed and tested. Similarly, no remote control capable of supporting this interaction had yet been developed. It is conceivable that this would flow from the development of the boxes themselves, but this assignment of developmental responsibility is nowhere made clear. It is one thing to conceive of ordering products at the touch of a button; it is quite another to actually provide the button itself.

The application of these specific factors impelled Katz, with little explanation, to choose $2.00 as "the appropriate metric for valuation of the Access Agreement,"[55] as opposed to the $2.58 mean for cable digital channels provided by his precedent transaction analysis, or any other figure in the $1.00 – $3.00 range generated by that analysis. This brief aspect of Katz's analysis presumably

[55] JX 5, Katz Report at 26.

incorporates his "gut" weighing of the various specific factors discussed, en masse, to provide some justifiable narrowing of the quantitatively produced range.[56]

Despite Katz's extensive experience in the field of telecommunications, I nonetheless find this step in his analysis less convincing than his overall precedent transactions analysis. Although I agree with his identification of the relevant factors to consider, as I discuss below, I do not accept his near-mystical assessment of their inherent total effect on the value of the Agreement and his resulting adjustment to the mean of his precedent transactions. Rather, I am more comfortable in using Katz's analysis, shorn of this downward adjustment, by using the mean of his hand-selected precedent transactions. As I soon explain more fully, I use the mean to make sure I have accorded the petitioners the benefit of reasonable doubts at the margin.

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[56] In his valuation process, Katz specifically does not assign a particular weight to any of the factors considered, suggesting that his analysis must be considered as a whole, with individual assessment of factors potentially leading to a mistaken view of the big picture. JX 5, Katz Report at 18. In making such a broad caveat, however, Katz undermines a substantial part of the valuation process, which seeks to specify the relevance and weight of particular factors and subject those choices to the adversarial process of the litigation format to distill the truth in the crucible of informed debate. *See Universal City Studios, Inc. v. Francis I. du Pont & Co.*, 334 A.2d 216, 218 (Del. 1975) (noting the requirement that factors be identified and discussing weights assigned to the factors) (citing *Tri-Continental Corp. v. Battye*, 74 A.2d 71 (Del 1950)); *see also Jacques Coe & Co. v. Minneapolis Moline Co.*, 75 A.2d 244, 247-48 (Del. Ch. 1950) (noting challenges to specific factors in the valuation). Although the petitioners have rejected my repeated invitations to join this debate by challenging Katz's valuation on its own terms, preferring instead to press their untenable valuation model, I must review this weighting independently, both to ensure that Katz has met his burden of persuasion, and more explicitly, because, pursuant to 8 *Del. C.* § 262(h), it is the court that performs the ultimate valuation and must be satisfied as to its particulars.

Finally, to achieve his valuation of $83.4 million, Katz multiples his cost of carriage estimate by the number of subscribers on AT&T's network and by the number of estimated channels that the 6 MHz discussed in the Agreement could theoretically support, a number he took to be 12. But this number is debatable. The petitioners have suggested a range of 12-15 channels as the minimum that 6 MHz could support,[57] and evidence of 16 or 18 possible channels is supported by the record. Accordingly, in revising Katz's calculations, I have used 15, the mid-point of the petitioners' minimum estimate of 12 channels and the maximum estimate of 18 potential channels supportable on 6 MHz. Again, I do so to be perhaps more than justifiably fair to the petitioners, who have themselves done little to aid me in reasonably valuing the Access Agreement.

In particular, I have used both the mean of Katz's comparables and a generous assumption of 15 channels to capture any value from Liberty Digital's agreement with Liberty Media regarding Paragraph 1 of Schedule 7.14 and its effect in helping Liberty Digital forge favorable affiliation agreements under Paragraph 4. More generally, these upward adjustments give value to the overall, intangible commercial value of the Access Agreement to Liberty Digital in dealing with potential partners with whom it might start broadcasting channels. This intangible value is difficult to price, but I give it some credit by these adjustments.

[57] Pet. Op. Pre-Tr. Br. at 23.

By doing so, I do not assume that Liberty Digital would have ultimately operated 15 channels. I am simply trying, as Katz did, to put a number on an asset that has value of uncertain amount. If I had to choose between valuing the Access Agreement at $2.2 billion or zero, I would choose zero.[58]

C. Modifications To Katz Calculations And Final Valuation

With these two modifications I have discussed, I recalculate the value of the Access Agreement under Katz's methodology, which I accept in general, as follows.[59] First, I multiply the revised assumed cost of carriage, $2.58, by the number of AT&T digital subscribers at the time of the merger, 3.475 million, yielding a revised cost of carriage per Liberty Digital network of $8.97 million. I then multiply by my assumed number of potential Liberty Digital networks, 15, for a result of $134.55 million. I then add that to the stipulated value of Liberty

[58] In making these modifications, I am cognizant that Liberty Digital's own balance sheet valued the Access Agreement at $250 million. This figure was generated by Morgan Stanley when the rights were assigned to Liberty Digital in 1998, and had not been written down on the balance sheet because, according to respondent and without persuasive rebuttal from the petitioners, the Access Agreement was still expected to reap this nominal amount over the course of its life and therefore there was no GAAP requirement to restate the reported value.

The relevance of an accounting valuation to a going concern valuation, though briefly touched on by both parties in their papers and at oral argument, was never joined in earnest. Accordingly, the record is devoid of any evidence of the weight to be given to this figure. In an effort to be thorough, however, and under my mandate to consider all relevant factors, I engage in the following brief thought experiment. If one were to reasonably assume that the Access Agreement would in fact produce $250 million in revenue over its life, but not until the years 2008 to 2015 when interactive television might actually be up and running, at $25 million a year, the calculation would yield a range of present values between $95 and $151 million, assuming a discount rate range of between 5% and 10%. While I in no way rely on this figure, it does confirm the logical plausibility of the award that I reach below and show why the reported figure does not aid the petitioners.

[59] See JX 5, Katz Report at 27 for a summary chart that corresponds to the form of this calculation using Katz's original values.

Digital's other assets, $497 million, to obtain a total value, rounded off, of $632 million. The astute reader will note that this result is still below the value paid in the merger transaction. The transaction itself yielded consideration per share of $3.31[60] and Katz's report yields a value per share of $2.51.[61] But my calculation yields a value per share of $2.74,[62] which represents the base compensation that petitioners are entitled to receive as a result of this appraisal action.

IV. Application Of Interest

My last task is a familiar, but inefficient one: the calculation of pre-judgment interest. The continued devotion of expert, attorney, and judicial time to this endeavor is of dubious social value. A simple statutory change setting the rate in equity to the legal rate[63] compounded monthly would seem a preferable approach to the current case-by-case joust over small margins of difference.

But in lieu of such change, I embark on the pursuit of an ideal, case specific pre-judgment interest rate with gusto. Of course, interest consists of two components: a rate of interest and a form of interest — simple or compound.[64] The appraisal statute grants me discretion to apply either simple or compound interest,[65]

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[60] $765 million divided by the 230,951,072 outstanding shares at the time of the merger.
[61] $580 million divided by 230,951,072 equals $2.51.
[62] $497 million plus $135 million equals $ 632 million, divided by 230,951,072.
[63] *See* 6 *Del. C.* § 2301(a).
[64] *Gonsalves v. Straight Arrow Publishers, Inc.*, 2002 WL 31057465, at *9 (Del. Ch. Sept. 10, 2002).
[65] *See* 8 *Del. C.* § 262 (i) ("Interest may be simple or compound, as the Court may direct."); *see also In re Shell Oil*, 607 A.2d 1213, 1222 (Del. 1992).

and to consider all relevant factors in setting the interest rate, including the rate at which the surviving corporation borrows money.[66] The purpose of the pre-judgment interest award is twofold: first, it compensates the petitioner for the loss of the use of his or her money during the appraisal process, and second, it forces the respondent to disgorge any benefit that it has received from employing the petitioners' money in the interim.

As to form, the case law regarding this statute has logically evolved in favor of awarding compound interest in appraisal actions because it better comports with "fundamental economic reality."[67] "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."[68] Neither are today's companies, nor the companies that lend them money, generally unsophisticated enough to invest or lend at a simple rate of interest.[69] Thus, with respect to both intended purposes of the interest award, reimbursing lost opportunity cost or disgorgement of assets and their benefits, compound interest is generally more appropriate to accomplishing those purposes.

It remains for me to determine the rate of interest and the frequency of the compounding. Where, as here, the parties have advocated a specific rate to apply,

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[66] 8 *Del. C.* § 262 (h).
[67] *Onti, Inc. v. Integra Bank*, 751 A.2d 904, 921 (Del. Ch. 1999); *see also Taylor v. American Specialty Retailing Group, Inc.*, 2003 WL 21753752, at *12 (Del. Ch. July 25, 2003).
[68] *Onti* 751 A.2d at 926; *see also Gonsalves*, 2002 WL 31057465, at *10.
[69] *Onti* at 926-7.

the validity of that figure becomes a burden of proof issue, with each party bearing the burden of advancing its recommended rate.[70] To reflect both purposes of the award, such rates commonly include two components: the cost of borrowing for the surviving respondent company,[71] and the prudent investor standard representing the lost opportunity cost for the petitioners as an objective measure.[72]

The respondent advocates a total rate of 5.56% compounded monthly,[73] arrived at by first averaging 1) the actual cost of borrowing for Liberty Digital as evidenced by its existing debt instruments at the time of the merger, 7.4%, averaged with 2) a comparable companies cost of debt analysis that yields 8.6%; the average of these figures being 8.0%. This 8.0% figure was noted to be 3.25% over the prime rate. The respondent next calculated an annualized rate, using 3.25% over prime compounded monthly, and arrived at 7.07% a figure they suggest represents Liberty Digital's cost of capital on an annualized basis. This figure in turn was averaged with the respondent's reasonable calculation of a prudent investor portfolio, which, relying on this court's holding in *Gonsalves*, included 20% diversified stocks, 40% bonds and 40% money market, a combination that over the period of March 14, 2002 (the date of the transaction)

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[70] *Grimes v. Vitalink Communications Corp.*, 1997 WL 538676, at *9 (Del. Ch. Aug. 28, 1997).
[71] *Prescott Group Small Cap, L.P. v. Coleman Co.*, 2004 WL 2059515, at *34 (Del. Ch. Sept. 8, 2004).
[72] *Gonsalves*, 2002 WL 31057465, at *11-13.
[73] JX 201, Katz Supplemental Report at 5.

through August 21, 2004 (prepared for trial) yielded an annualized return of 4.04%. Averaging 7.07% and 4.04% respondent offers a final rate of 5.56%.

The petitioners do not in any substantial way contest the prudent investor calculation. Rather, the petitioners halfheartedly suggest that if respondent's cost of borrowing is part of the equation, that Professor Feinstein's calculation of a 9.4% cost of borrowing for Liberty Digital, annualized as an element in producing his DFC analysis from public data covering the period of December 31, 2000 through September 30, 2001, and derived from the ratio between the interest payment and the debt balance for that period, should be substituted for the 7.4% that Katz employed based on the outstanding notes at the time of the merger. The petitioners suggest no reason why their figure is more reliable and seem to imply that the publicly disclosed nature of the figure is somehow significant — it is not. This prong of the analysis is designed to capture Liberty Digital's cost of borrowing, and the petitioners have not shown why their figure better captures that value than Katz's use of the actual debt instruments.

Alternatively, the petitioners urge that the legal rate of 6.25% should be applied as a default. Such a result is appropriate when a party advocating a specific rate fails in its burden of proof.[74]

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[74] *See Dobler v. Montgomery Cellular Holding Co.*, 2004 WL 2271592, at *18 (Del Ch. Sept. 30 2004) (applying the legal rate where petitioners failed to meet their burden of proof as to the

The petitioners' contention is a technical, form over substance argument, that is unappealing to a court of equity making a discretionary compensatory decision. At first, they asserted that I needed to look to Liberty Media's cost of borrowing because it was in reality the surviving company. At other times, the petitioners have claimed that Liberty Digital, as a survivor, had no creditworthiness post-merger, and thus its cost of debt must be very high. As a practical matter, the petitioners' original argument that Liberty Media's cost of debt is the relevant question makes the most policy sense. It is the parent which caused the merger giving rise to appraisal rights and which, as a matter of policy, our law does not want to obtain an unfair windfall. Here, however, the debate is academic because even after the merger, Liberty Digital had assets of half a billion dollars aside from the Access Agreement and I am therefore persuaded that its cost of debt is in the range advanced by Katz and that Liberty Media's cost of debt is even lower. No unfairness results therefore from using Katz's approach and his use of Liberty Digital's pre-merger cost of borrowing was a reasonable, conservative assumption that sufficiently buttresses his calculation of pre-judgment interest.

Therefore, I reject petitioners' request that I default to the legal rate of interest. The 5.56% Katz calculated should be compounded monthly and the

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specific rate they advocated); *see also Gonsalves*, 2002 WL 31057465, at *10; *Grimes*, 1997 WL 538676, at *9.

interest award should be brought current from the date of the transaction to the date of this decision.[75]

V. Conclusion

For the reasons discussed above, I conclude that the value of Liberty Digital shares at the time of the merger was $2.74 per share, and that petitioners are therefore awarded this amount, together with pre-judgment interest at 5.56%, compounded monthly from the time of the merger through the date of this opinion. Counsel for the parties shall prepare a final judgment consistent with this opinion and submit it within ten days.

[75] *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *15 (Del. Ch. Feb. 10, 2004) (citing *Grimes*, 1997 WL 538676, at *13); *Gray v. Cytokine Pharmasciences*, 2002 WL 853549, at *12 (Del. Ch. Apr. 25, 2002) (same).