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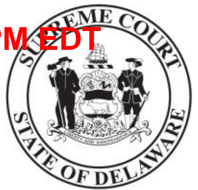

IN THE SUPREME COURT OF THE STATE OF DELAWARE

HUFF FUND INVESTMENT PARTNERSHIP d/b/a MUSASHI II LTD. and BRYAN E. BLOOM,	:	
Petitioners Below/Appellants/ Cross-Appellees,	:	No. 348, 2014
v.	:	(Appeal from Court of Chancery C.A. No. 6844-VCG)
CKx, INC.,	:	Original Filing Date: Oct. 10, 2014
Respondent Below/Appellee/ Cross-Appellant.	:	Public Filing Date: October 14, 2014

APPELLANTS' AMENDED REPLY BRIEF ON APPEAL AND CROSS-APPELLEES' AMENDED ANSWERING BRIEF ON CROSS-APPEAL

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SUMMARY OF ARGUMENT[1]

A. Petitioners' Appeal

The majority of Fortune 500 U.S. firms incorporate in Delaware because Delaware's General Assembly and courts have developed a reputation for expertise, fairness and predictability in corporate affairs. For shareholders in a corporation, it is difficult to imagine a right more important than appraisal, which assures that when shares are involuntarily confiscated from a shareholder in a merger, a judge with expertise in business valuation will determine and award the long-term going concern value of the shares. If the requirement that an independent valuation be conducted is not enforced, then a shareholder in a Delaware corporation faces the unenviable prospect that its investment can be seized at a price set by an opportunistic buyer without any effective remedy.

Here, the Court below failed to conduct an independent business valuation of CKx, and instead improperly deferred to the Merger Price without any financial or valuation evidence suggesting that price reflected the Company's going concern value. In the event this Court concludes, as we believe it must, that the Court below has to select an accepted valuation methodology or methodologies, and use them to actually value CKx as a going concern, the judgment must be reversed and

[1] Appellants' Opening Brief is referred to as "Pet. Br.," and CKx's Corrected Answering Brief on Appeal and Opening Brief in Cross-Appeal is referred to as "CKx Br." Unless otherwise indicated, capitalized terms used herein have the same meaning as in Appellants' Opening Brief.

the case remanded to allow the Court of Chancery to conduct an independent appraisal.

The Court below also erred in concluding that the comparable companies used by Robert Reilly, Petitioners' expert, were not truly "comparable" to CKx because it failed to consider whether the adjustments made by Reilly accounted for the varying degrees of comparability. All companies have individual characteristics, but CKx was at or above the mean on six of Reilly's nine important financial metrics compared to his five GPTC content companies. Given this substantial similarity, Reilly made adjustments to the derived multiples to account for any salient differences. CKx also has not even challenged the comparability of Marvel and Playboy – Reilly's two selected GMAC transactions.

With respect to the Sharp transaction, the Court again failed to conduct a valuation of this corporate opportunity and instead employed something akin to the Efficient Capital Market Hypothesis ("ECMH") to presume that market participants were aware of the potential for acquiring Sharp and factored it into their price for CKx. However, market participants were undoubtedly ***unaware*** of the Sharp transaction because at the time bids were submitted, acquisition discussions had not progressed to the point of being a tangible corporate opportunity. The Court itself found that concrete negotiations to acquire Sharp did not begin until May 2010 – ***after*** the final bid was formulated but ***before*** the

Merger. This confidential, non-public information was not known to market participants or potential bidders. Petitioners would have shared in the value of this opportunity had CKx continued as a going concern, and the Court below therefore had an obligation to value it.

B. Petitioners' Response to CKx's Cross-Appeal

5. DENIED. After an exhaustive analysis of the evidentiary record, the Court concluded that CKx expert Jeffery Cohen's projections were inherently unreliable because they were based on unreliable speculation about the outcome of CKx's negotiations with the FOX network for a renewed contract for *American Idol.* Given the relative strength of CKx and FOX's respective bargaining positions, the Court found it was just as reasonable to predict that CKx would obtain \$20 million in improved economics under the new contract as it was to predict CKx would obtain \$0 or something in between. Since these findings were not clearly erroneous, the Court did not abuse its discretion in rejecting CKx's DCF analysis.

6. DENIED. CKx offered no evidence of synergies either at trial or when offered the opportunity after trial. Instead, it attempted to rely solely on hearsay statements in documents Apollo authored about "savings" it supposedly "expected." No witness testified about these alleged "savings," and they included savings already planned and quantified by CKx management in its December 2010

budget – four months before Apollo's unsolicited bid. The Court below correctly found that CKx had failed to carry its burden of proving synergies.

7. DENIED. The Court below correctly rejected CKx's motion to "pre-pay" a portion of the value of CKx shares (and compel Petitioners to accept it) to stop the accrual of statutory interest. The General Assembly has sought to end protracted and unnecessary litigation over the accrual of interest in appraisal actions by imposing a floating rate designed neither to unjustly reward petitioners nor to punish respondents. CKx's unprecedented proposal to compel acceptance of a pre-payment of a portion of the anticipated judgment, so as to cut off interest at any time of the respondent's choosing, would undermine the delicate balance struck by the Assembly.

ARGUMENT

I. The Court of Chancery's Conclusive Deference to the Merger Price Should Be Reversed

This Court's modern case law construing the appraisal statute has repeatedly confirmed two fundamental principles: (i) the Court of Chancery has an unflagging obligation to conduct an independent determination of the company's going concern value; and (ii) market value and going concern value are not the same. (*See* Pet. Br. at 23-30 (discussing, among other cases, *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357 (Del. 1997), *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790 (Del. 1999), and *Golden Telecom, Inc. v. Global GT LP*, 11 A.3d 214 (Del. 2010).) Rather than deferring to the merger price set by the participants to the very transaction being tested, the Court of Chancery must conduct an independent valuation of the subject company using only those "techniques or methods which are generally considered acceptable in the financial community." *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

Here, the Court below failed to employ a business valuation methodology, and certainly not one generally acceptable in the valuation community. To determine the long-term going concern value of a business enterprise like CKx requires judgments about revenue, income, growth prospects, capital costs and the like. Here the Court simply analyzed whether or not the sales process was procedurally fair. (Ex. A to Pet. Br. at 32-37.) CKx argues that deference to the

merger price is simply a different, more reliable "market-based method" that is actually superior to comparable companies and precedent transactions methodologies. (CKx Br. at 4, 25.) That is not true. When one does a comparable companies valuation methodology, while much of the data is market based, the methodology involves applying a set of well-developed principles to select a number of appropriate companies, make adjustments and derive multiples pursuant to a robust overall method that is recognized in the valuation community. But none of the standard valuation treatises list "deference to the merger price" as an accepted valuation methodology, and no such support was cited by CKx.[2]

Even a merger price produced by a purportedly fair sale process generates only a market value at a given point in time, not a long-term going concern value. That means, as this Court has recognized, merger price cannot be used – and certainly not as a sole valuation determinant – absent independent evidence that it reflects fair value. *M.P.M. Enters.*, 731 A.2d at 796-97; *see also Golden Telecom*, 11 A.3d at 217-18 (the appraisal statute does not "even contemplate[] that the Court of Chancery should consider the transactional market price" because it

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[2] *See* TIM KOLLER ET AL., VALUATION: MEASURING AND MANAGING THE VALUE OF COMPANIES (5th ed. 2010); SHANNON P. PRATT & ALINA V. NICULITA, VALUING A BUSINESS: THE ANALYSIS AND APPRAISAL OF CLOSELY HELD COMPANIES (5th ed. 2008); Z. CHRISTOPHER MERCER & TRAVIS W. HARMS, BUSINESS VALUATION: AN INTEGRATED THEORY (2d ed. 2007); ASWATH DAMODARAN, DAMODARAN ON VALUATION: SECURITY ANALYSIS FOR INVESTMENT AND CORPORATE FINANCE (2d ed. 2006); RICHARD A. BREALEY & STEWART C. MYERS, PRINCIPLES OF CORPORATE FINANCE (6th ed. 2000). (AR1-41.) The Court of Chancery has relied on all of these treatises.

would delegate the Court's task to the very acquiror whose activities the statute was designed to protect against); *Rapid-American Corp. v. Harris*, 603 A.2d 796, 806 (Del. 1992) (rejecting valuation model that placed too much emphasis on market value); *Application of Del. Racing Assoc.*, 213 A.2d 203, 211 (Del. 1965) ("It is, of course, equally axiomatic that market value, either actual or constructed, is not the sole element to be taken into consideration in the appraisal of stock.").[3]

CKx's reliance on *Union Illinois* and *Highfields*, which used the merger price as one "factor" in a going concern valuation, is misplaced. In both cases, the Court rigorously applied accepted valuation methodologies (DCF or "sum of the parts") either to determine that the merger price reflected going concern value or to supplement valuation evidence derived from the merger price. *Union Illinois v. Union Financial Grp. Ltd.*, 847 A.2d 340, 363 (Del. Ch. 2004); *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 62, 64 (Del. Ch. 2007). Neither deferred conclusively to the Merger Price in the ***absence*** of any valuation evidence.

Implicit in CKx's opposition is the idea that ***rejecting*** a valuation

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[3] *See also Bell v. Kirby Lumber Corp.*, 395 A.2d 730, 735-36 (Del. Ch. 1978) (rejecting "arms length merger approach"), *modified on other grounds*, 413 A.2d 137 (Del. 1980). In *Montgomery Cellular Hldg. Co., Inc. v. Dobler*, 880 A.2d 206 (Del. 2005) (cited in CKx Br. at 23), the Court did not rely on the price reached in the squeeze out transaction that gave rise to the appraisal proceeding, but rather on a negotiated post-squeeze out merger between the company and Verizon and only as part of a much more comprehensive valuation utilizing multiple methodologies. *Id.* at 211-13, 214-19. *Gotham Partners, L.P. v. Hallwood Realty Partners, L.P.*, 855 A.2d 1059 (Del. Ch. 2003) (cited in CKx Br. at 24), is not an appraisal case and, again, relied on trading prices for the partnership units only as a minor part of a much more comprehensive valuation analysis.

methodology is the same thing as ***conducting*** a valuation. If the Court below was not satisfied with the methodologies proposed by the parties, it was required to apply an alternative valuation methodology that was generally accepted in the field of business valuation, either by retaining its own expert or advising the parties to propose new methodologies. *Gonsalves*, 701 A.2d at 361 (Court of Chancery must "independently determine the value of the shares that are the subject of the appraisal action"). But it was improper for the Court to conclude that if it was not persuaded by either party's valuation methodology, it could employ none at all and instead accept the transaction price Apollo negotiated. The decision below provides an easy blueprint for respondents to try to convince a judge to find fault with the valuation methodologies proffered by the parties and thereby avoid the difficult task of conducting the business valuation the appraisal statute requires. This would eviscerate the appraisal statute.

Nor does the discretion normally accorded to the Court of Chancery to conduct appraisals justify that Court's decision here. (CKx Br. at 23.) The law gives Chancellors discretion because they need it to make the innumerable judgments necessary to value a complex business enterprise. When valuation "expertise" is used to make these detailed judgments, it should not lightly be second-guessed. *Gonsalves*, 701 A.2d at 360. But here the Court utilized no valuation expertise to determine the relevant valuation criteria and inputs necessary

to value a business enterprise or employ a valuation methodology. Instead, it deferred to the Merger Price as the supposed equivalent of CKx's long-term going concern value without any business valuation evidence to support that conclusion. Neither party offered any evidence or expert testimony showing that the Merger Price was evidence of fair value or demonstrating the relationship, if any, between the Merger Price and the going concern value of the company. Without such evidence, the Vice Chancellor could not simply award the Merger Price as fair value under the appraisal statute. *M.P.M. Enters.*, 731 A.2d at 796-97.

Moreover, the Court's decision cannot be sustained because the undisputed evidence demonstrates that the auction here was deficient. The Board did not decide to market the company, but instead reacted defensively to unsolicited bids from professional investors. (Pet. Br. at 29-30.) Those bidders likely emerged at the same time because they recognized the public stock price was undervalued. In response to the unsolicited offers, the Company authorized an auction in which due diligence had to be completed and offers fully financed ***in just three weeks***. It would be a daunting task to complete due diligence and obtain committed financing to purchase a company as complex as CKx in such a short period.

That Mr. Bloom advocated for such a truncated period (hoping to put yet another unwanted sales process behind the Company quickly) is irrelevant. (CKx Br. at 31.) The Court below found – on the uniformly-held view of management

and the Board – that the continual process of allowing the Company to be "for sale" was distracting management and preventing it from executing on its core strategy of acquiring entertainment content. (Ex. A to Pet. Br. at 9.) That is why the Company announced in October 2010 that it was not for sale. (*Id.* at 9-10.)

In light of the Company's history and its need to implement its growth strategy, Mr. Bloom and the Board were reasonably entitled to believe that a lengthy sales process would do more harm than good. Indeed, they were prescient, since the management team was soon to embark on a significant content acquisition with the Sharp transaction. The point is not that it was a bad business judgment or a breach of duty to conduct a short three-week auction, but that it led to an auction that was not a robust and effective market check.[4] It was not an auction with fifty potential bidders raising their hands to bid, but one to which no new bidders came and in which Apollo, who had conducted more than three months of due diligence in the recent past and already had its financing in place, enjoyed an un-matched advantage. (Pet. Br. at 11-12.) This inequity was

[4] At trial, Mr. Bloom made clear that when he dissented from the Board's decision approving the Merger, he thought Apollo's price was inadequate, but he believed the process was "fair" because shareholders who thought the Merger price was too low had the opportunity to have a Delaware Court appraise their shares. (A1074-76.) Mr. Bloom opposed the Board's recommending to CKx shareholders that they take the Merger consideration. (B737.) Mr. Bloom also would not be expected to view his conduct as a breach of duty. Moreover, Sillerman tendered his shares (rather than roll his equity into the new company) because Apollo misled him about the role he would have in the post-Merger Company. (AR267-68; CKx Br. at 4.) Sillerman in fact thought $5.50 per share "was ***quite under-priced***." (AR269 (emphasis added).)

magnified when the Board declined to give Gores any additional time to obtain a waiver of an investor-imposed restriction that impeded its ability to represent it had a fully-financed, ***higher*** bid. (A1524.) Even if the Court of Chancery is permitted to refuse to conduct a business valuation – and it is not – the three-week time limit prevented the kind of auction from developing that might allow a Court to dispense with such a valuation.

The Court below rejected Dr. Robinson's testimony, mistakenly believing it was based on the view that the Company should have conducted a Vickrey auction instead of a standard English auction. However, her expert opinion was not based on that assertion.[5] (Pet. Br. at 15.) The other aspect of Dr. Robinson's opinion – that CKx's stock price was not efficient and failed to move in response to business fundamentals – was not rejected by the Vice Chancellor at all. To the contrary, the Court found "evidence that the stock price may have undervalued the company due to the company's inability to make acquisitions while it was up for sale" and "failed to reflect material nonpublic information available to bidders who signed confidentiality agreements." (Ex. A to Pet. Br. at 32 n.124.) Both findings were supported by the record. (A700; A682; A731-35; A1915; A804.)

[5] The Chancery Court never made a "credibility finding" about Dr. Robinson. (CKx Br. at 4.) The Court simply misunderstood the basis for her opinion and found it unpersuasive. (*See* Ex. A to Pet. Br. at 36-37.)

The Court's finding that the stock price was depressed was also well supported by the detailed event study conducted by Dr. Robinson. Indeed, although that study indisputably proved that the market for the Company's stock was inefficient, the Court never specifically addressed that evidence. CKx was apparently unable to put on any expert testimony indicating that the market for the stock was efficient and attempted instead to poke holes in Dr. Robinson's opinion. Although they argue she failed to include supposedly material news events related to *Idol* or *X-Factor*, a large number of events indisputably related to *Idol* were captured in her event study. (A996-99; A1369-71 (discussing, among others, announcements that Jennifer Lopez and Steven Tyler might become *Idol* judges.) Indeed, CKx has identified only one news story Dr. Robinson supposedly "failed to capture" affecting its stock price – Simon Cowell's announcement that he would leave *Idol* to join *X-Factor*. (CKx Br. at 29.) But that happened in ***January 2010***, (A1372), five months ***before*** the beginning (in ***May 2010***) of the one-year period analyzed in her event study. (A890.)

CKx makes much of the fact that in the five months following the Company's October 2010 announcement that it was not for sale, "the stock still only traded between $3.00 and $4.00 per share." (CKx Br. at 30.) Although the stock traded as high as $5.30 in the fourth quarter of 2010 and $4.22 in the first quarter of 2011 (A944-46), one would expect the price of the Company's stock to

decline following an announcement that it was not for sale. Merger arbitragers and speculators buy a company's stock hoping to profit from a bidding war or potential takeover. When the company announces that it is "not for sale," as CKx did in October 2010, those takeover speculators sell their shares, thereby depressing the price of the stock. Nor does the fact that the Company was subject to on-again, off-again potential sales transactions constitute an effective market check of the $5.50 Merger Price. All of those offers were at prices substantially higher than $5.50 per share, and the one that was at $5.50 was rejected by the Board as inadequate only six months prior to the Merger. (A318-21.)

These phenomena were consistent with the observations made by Dr. Robinson in her event study, which confirmed that although the Company's stock price did not move in response to news about business fundamentals (including its quarterly financial reports), it did move both positively and negatively in response to news relating to potential acquisitions.[6] (Pet. Br. at 6-7.) Because the stock price was inefficient and depressed, the unsolicited takeover bids induced by that

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[6] The event study reflects numerous material business-related news events (including *Idol*-related events) with ***no*** statistically-significant abnormal stock price return, including such things as (i) the release of CKx's annual statement on Form 10-K for fiscal year 2010, (ii) news regarding the appointment of a new CEO, (iii) the announcement of a partnership for distribution of CKx's television show *If I Can Dream*, (iv) announcements that Nigel Lythgoe, a former *American Idol* executive producer and TV personality, was considering and ultimately decided to return to the show, and (v) CKx's discussion of its expectation of renewal talks with FOX concerning *American Idol*. (A996-99.) If these events are not material to CKx's investors, it is hard to imagine what would be.

price did not reflect CKx's long-term going concern value.

II. The Court of Chancery Should Have Employed Petitioners' Expert's GPTC and GMAC Valuation Methods

CKx's attempt to defend the Court of Chancery's rejection of Reilly's market-based approaches is utterly unpersuasive. *First,* CKx is wrong to assert that "[n]o Delaware court has ever adopted th[e] 'guidelines' approach." (CKx Br. at 5.) At least one Delaware court has done just that. *See Taylor v. American Specialty Retailing Grp., Inc.*, 2003 WL 21753752, at *7-9 (Del. Ch. July 25, 2003) (accepting expert's "guideline companies" analysis because it "summarize[s] how the investing public values one dollar of earnings in a given industry"). The distinction between "comparable" companies and "guideline" companies is semantic and obscures the substance of the analysis, which is to use companies that are similar enough to the subject company to provide useful valuation information. Reilly's conclusion that the companies he chose in both his GPTC and GMAC methods met this test is confirmed by the undisputed fact that Gleacher and Apollo used most of the same companies in their ***own*** comparable companies/transactions analyses of CKx.[7] (*See* Pet. Br. at 19.)

Second, CKx does not even attempt to argue that Playboy and Marvel – the

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[7] Gleacher's witness never said that it "placed little weight on comparables in its fairness analysis for the Board" (CKx Br. at 34), but only that Gleacher "probably relied most heavily on the discounted cash flow." (A1749-50.) Gleacher's comparable companies analysis is featured prominently in its fairness opinion's "football field" valuation summary. (A280.)

two companies Reilly chose for his GMAC analysis – are too dissimilar to CKx. Nor could it, as these two companies are not significantly different from CKx in terms of size and clearly "earn the majority of their revenues from the business of licensing or creating intellectual property." (*See* CKx Br. at 34; A832-34.) Indeed, CKx's ***only*** criticism of Reilly's GMAC analysis is that Disney's acquisition of Marvel involved "huge anticipated synergies." (CKx Br. at 33.) But Reilly accounted for those synergies in his analysis, and CKx never developed any evidence to the contrary. (A1255-56.)

CKx attacks the GPTC guidelines as being more diversified, engaged in different businesses and larger on a revenue basis than CKx. (CKx Br. at 33-34.) Yet, all of these criticisms previously have been rejected as a basis for eschewing a comparable or guideline companies analysis.[8] Contrary to the reasoning of the Court below, perfect comparability is not required. All of the companies selected by Reilly are in the media content business, and are subject to the same economic factors that impact CKx. (A1256-62.) The figures gleaned from analysis of these

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[8] *See Agranoff v. Miller*, 791 A.2d 880, 892-93 (Del. Ch. 2001) (using comparable companies analysis even though the subject company was "far smaller than the comparison companies and [was] not traded on any exchange"); *Bomarko, Inc. v. Int'l Telecharge, Inc.*, 794 A.2d 1161, 1186 (Del. Ch. 1999) (adopting comparables analysis even though "the group of comparables includes companies of substantially different size and scope than ITI" and concluding "that these differences are properly reflected in adjustments made to the multiples"); *Taylor*, 2003 WL 21753752, at *8 ("There may be some differences between comparable companies – they may make significantly more in earnings or have a significantly higher book value."); DAMODARAN ON VALUATION at 252 ("Since the definition of a comparable firm is not one that is in the same business but one that has the same growth, risk, and cash flow characteristics as the firm being analyzed, we need not restrict our choice of comparable firms to those in the same industry.").

companies "summarize how the investing public values one dollar of earnings" in the media content industry, and are thus useful for valuing CKx (as confirmed by Gleacher and Apollo's use of them for precisely that purpose).

Third, CKx completely misunderstands (and never even identifies) the "numerous arbitrary adjustments" Reilly supposedly made. (CKx Br. at 35.) Reilly's adjustments were made to address differences among the companies and are set forth clearly in his report. (A785-93; A815-34.) *See* DAMODARAN ON VALUATION at 248 ("No matter how carefully we construct our list of comparable firms, we will end up with firms that are different from the firm we are valuing. The differences may be small on some variables and large on others and ***we will have to control for these differences in a relative valuation.***" (emphasis added)). CKx has not produced even one example of alleged "manipulation." Nor did Reilly "know that his methodology was suspect" merely because he gave his two market-based approaches 40% weight in the overall analysis in accordance with Delaware courts' preference for DCF analysis. (A1193-94; CKx Br. at 35.)

In this case, the Court of Chancery concluded that DCF was not available and also rejected GPTC and GMAC because they failed a hyper-strict definition of "comparability." But surely the requisite approach in an appraisal case is to utilize an accepted valuation methodology – even if imperfect – rather than none at all. The Court below should be instructed on remand to reconsider Reilly's GPTC and

GMAC methods.

III. Petitioners Are Entitled to a Valuation of the Sharp Acquisition

The Court below clearly erred when it presumed that Apollo factored the value of the concrete Sharp opportunity into its bid and refused to value that opportunity. Contrary to CKx's arguments, the Court did not find that the Sharp opportunity was too speculative to be included in a valuation of CKx. (CKx Br. at 37-38.) The Court instead found that the Sharp deal was "a business opportunity that CKx developed" and that CKx was in "advanced discussions" with Sharp "over price and terms" before the Merger Date.[9] (Ex. A to Pet. Br. at 10.)

The other "evidence" relied on by CKx does not undermine these findings. (*See* CKx Br. at 38.) CKx first quotes merely its own brief to the Court below in support of an opposite finding. (*Id.*; *see also* Ex. B to Pet. Br. at 16 n.37.) CKx next cites the Board minutes instructing management to "continue to pursue these opportunities." (A257.) But that directive is perfectly consistent with Bloom and Benson's unequivocal testimony that the Board authorized management to move forward with a transaction with Sharp. (A709; A1080.) Furthermore, there was much more than a "rough structure of a deal" in place as of the Merger Date (CKx.

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[9] The Court below clearly believed Benson's testimony about the Sharp discussions. Given that the Vice Chancellor (not CKx) is the arbiter of witness credibility, CKx's naked assertion, without any record support whatsoever, that Benson's testimony was "erroneous" does not in the slightest way undermine the Court's finding that CKx was in advanced discussions with Sharp over price and terms as of the Merger Date. (CKx Br. at 38 n.12.)

Br. at 38); the parties were discussing specific terms and had exchanged term sheets. (A1510-11.) Management's memorandum to the Board laid out a pricing structure based on a 6x multiple of EBITDA, equivalent to about $30 million, and consisting of a "15% retained interest in Sharp, 10% CKX stock and 75% cash." (A244.) Moreover, CKx management could not have included Sharp in its April 2011 management projections (*see* CKx Br. at 38-39 n.12), as they ***pre-dated*** the concrete discussions with Sharp. Indeed, that was why Reilly separately valued Sharp. (AR283, AR286.)

CKx also twists CFO Benson's trial testimony about the "probability" of the Sharp acquisition. (CKx Br. at 38 n.12) Benson testified only that it was not so "probable" as to trigger a ***disclosure obligation*** under the securities laws. (A1511.) Typically, those laws do not require companies to disclose potential acquisitions until a final agreement has been reached. That the Sharp acquisition was not yet disclosable under SEC rules says nothing about whether Sharp was part of CKx's "operative reality" for appraisal purposes given that the Company had formed a concrete plan to pursue Sharp as of the Merger Date. (A1510-11; A1523-24.) The reason the Sharp transaction did not close for another approximately twelve months was primarily because of the intervening sale of CKx to Apollo, (A1080; A703), and the desire to have audited financials – an issue Benson admitted occurred frequently when CKx acquired privately-held assets.

(A1639-40.)

There is no evidence to support the Court of Chancery's presumption that Apollo's bid for CKx included value for the Sharp transaction. The Court invoked a presumption akin to the ECMH, pursuant to which the bids for CKx should be presumed to reflect the value of all potential CKx corporate opportunities. (*See* Ex. B to Pet. Br. at 12-13.) Even if sound in theory, the Court's invocation of the ECMH in this case ignored the essential distinction between a ***possible*** corporate opportunity and an ***actual*** one. Many possible acquisitions are known to the marketplace, but when a company discloses that it is in advanced discussions over a specific acquisition, the stock price reacts immediately and substantially. Common sense dictates that an actual, concrete corporate transaction is different from "a hope and a prayer." Apollo identified Sharp along with a long laundry list of companies that were aspirational acquisitions, and deposition testimony indicated that Apollo was aware CKx had "look[ed] at" Sharp back in late 2010. These facts demonstrate only that Apollo (and presumably other market participants) knew that Sharp represented a potential acquisition opportunity that might come into fruition on unknown terms at some future time. (CKx Br. at 37.) Indeed, that is what the Court below found. (Ex. B. to Pet. Br. at 13 (market was aware of "possibility of acquiring Sharp or a similar company").)

But the actual negotiations to acquire Sharp in May 2011 were far more

concrete than the mere "possibility" of acquiring Sharp at some point in the future. Sharp and CKx were in advanced discussions about the price and terms of a specific transaction, and the Board told management to move ahead with a deal. (Ex. A to Pet. Br. at 10; A1510-11; A1523-24; A709; A1080; A257.) These discussions were never disclosed publicly, and Apollo learned about them for the first time in mid-May 2011 – too late to have any impact on Apollo's already-accepted bid. (A1511; A2092.) Indeed, the Court below itself found that "***[i]n May of 2011*** . . . CKx ***began*** exploring a purchase of Sharp Entertainment . . . ." (Ex. A. to Pet. Br. at 10 (emphasis added)).) As that occurred long after Apollo formulated its bid for CKx, it also means the $5.50 per share Merger Price based on Apollo's bid did not incorporate any value for that opportunity.

The Court was required to value the Sharp opportunity because had the Company continued as a going concern, Petitioners would have enjoyed the benefits of that acquisition. *See Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298-300 (Del. 1996); *Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 314-15 (Del. Ch. 2006) (including in appraisal award value for radiology centers that had not yet opened because they were part of concrete expansion plans the company had at the time of the merger). Whether or not the Merger Price is accepted as evidence of fair value – and it should not be – Petitioners are entitled to the incremental value of Sharp as part of the appraisal award.

IV. The Court of Chancery Properly Rejected the Flawed DCF Analysis Proffered by CKx's Expert

A. Question Presented

Whether the Court of Chancery properly rejected the DCF analysis prepared by CKx's expert, finding that his projections based upon his expectations concerning the outcome of the FOX contract negotiation were unreliable.

B. Standard of Review

The Court of Chancery's factual findings must be affirmed unless clearly erroneous, and its rejection of a particular valuation methodology may be reversed for abuse of discretion. *Golden Telecom*, 11 A.3d at 219.

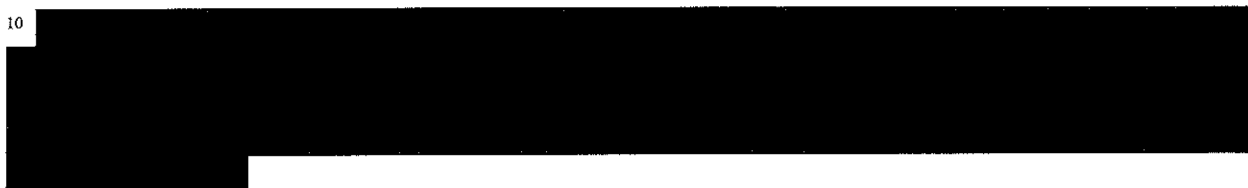
C. Merits of the Argument

The Court below correctly rejected the DCF analysis proffered by Cohen, who downwardly adjusted management's projections in the Five-Year Forecast by eliminating $17.5 million of CKx's *Idol*-related TV fees. (AR275.) It did so because Cohen assumed, contrary to management's view, that CKx would not obtain the fixed fee or other enhanced economics under the renewed *Idol* contract with FOX. Thus, each of Cohen's three cash flow scenarios essentially began with revenue projections that were substantially below what CKx management had projected before the Merger. (A1711-14; B1090-92.)

The Court below concluded that the difficulty of predicting the outcome of the FOX contract negotiations before the Merger rendered Cohen's projections too

unreliable to support his DCF analysis. (Ex. A to Pet. Br. at 24-29.) Cohen assumed that the only reasonable outcome of the FOX contract negotiations was that CKx's cash flows would decrease and its business prospects decline. However, the Court below properly recognized that CKx's entire strategy "arose from the premise that [there are an] ever-increasing number of entertainment distribution channels ... increasing demand for original content." (*Id.* at 4-5.) As a result of this audience fragmentation, "the network television industry has been experiencing ***declining ratings*** but ***increasing advertising revenue*** for many years." (*Id.* at 8 (emphasis added).) Moreover, the 2010 season of *American Idol* that occurred just before the sale to Apollo "was incredibly successful, boasting *increased* ratings . . . ." (*Id.* at 19.) As a result of those findings – supported by the testimony of both parties' industry experts (A1378-86) – the Court held: "I cannot conclude that Cohen's prediction that CKx would receive marginal additional value from a new contract with Fox is any more reliable than management's prediction that the increased benefit would be $20 million per year."[10] (Ex. A to Pet. Br. at 26.)

Thus, Cohen's pessimistic speculation was beyond the tolerable limits

10 

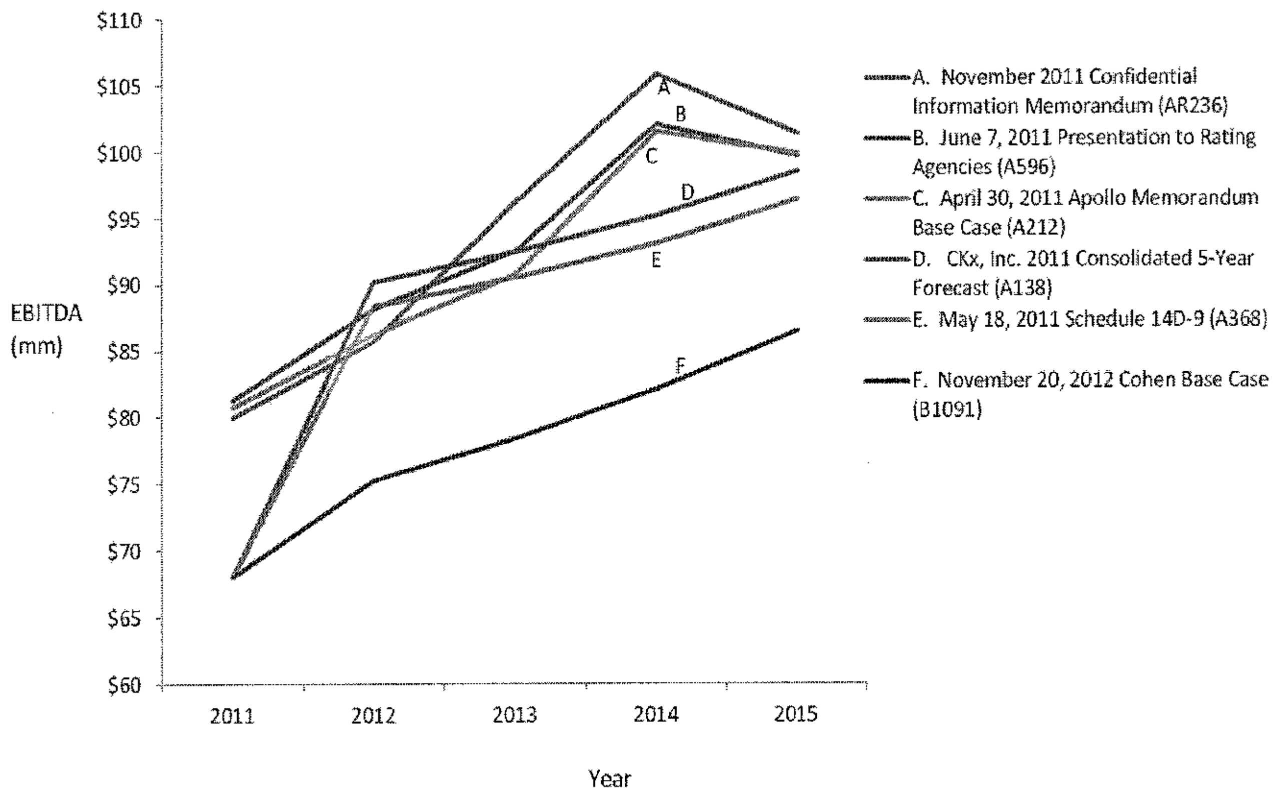
inherent in the DCF methodology itself. *See Doft v. Travelocity.com Inc.*, 2004 WL 1152338, at *5-7 (Del. Ch. May 20, 2004) (rejecting projections as unreliable because they were "thought studies" impacted in unpredictable ways by the September 11 tragedy). Although CKx attempts to distinguish *Doft* because the case at bar does not involve the September 11 events (CKx Br. at 42), that misses the point. The difficulty of predicting how the FOX contract negotiations would turn out made Cohen's downward adjustments to management's projections inherently unreliable, resulting in the sort of litigation-driven, expert-created, hindsight-biased projections that Delaware courts routinely reject. *See, e.g., Prescott Group Small Cap, L.P. v. Coleman Co., Inc.*, 2004 WL 2059515, at *21 (Del. Ch. Sept. 8, 2004). Without a reasonable basis in the record for Cohen's projections, the Court correctly rejected his DCF valuation.

Indeed, because the Court found it equally likely that cash flows could increase (as projected by management) or decrease (as projected by Cohen), the presumption in favor of management's contemporaneously-prepared business projections was far more justifiable.[11] ***Every set*** of contemporaneously prepared

[11] *See, e.g., Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004) ("[T]his Court prefers valuations based on management projections available as of the date of the merger and holds a healthy skepticism for post-merger adjustments to management projections or the creation of new projections entirely."); *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at *8 (Del. Ch. Apr. 25, 2002) (refusing to accept that respondent's expert "with his limited experience with the Company, was better equipped to make future financial projections than [the company's management,]" and rejecting his "litigation-driven" adjustments to management projections as "unreliable").

projections – including those prepared by Apollo itself (for its investment committee) and for public investors – was ***consistent*** with management's projections. The shocking outlier was Cohen's "doomsday projection" – a fact made crystal clear by simply viewing the table comparing the various contemporaneous projections, all of which – except Cohen's – were remarkably consistent in terms of estimated cash flows. (A1881.)

<u>Comparison of CKx EBITDA Projections Created by Management, Apollo and Cohen</u>



The record simply does not support Cohen's projections. The Court below noted that management – who worked for Apollo after the Merger and were

represented by Apollo at their depositions – gave contradictory testimony about their projections containing the $20 million in enhanced economics from FOX. After the Merger, they asserted both that these projections constituted optimistic expectations (for buyers and lenders) as to what might reasonably be achieved from the negotiations with FOX, and that they also represented management's "best estimate" at the time of the outcome of those negotiations. (Ex. A to Pet. Br. at 14-19.) In addition, both FOX and CKx reasonably believed they had strong bargaining positions: FOX was demanding reduced economics for CKx at the same time CKx was demanding increased payments through many different cash flow streams besides the fixed fee. (*Id.* at 18-19.) Given this evidence, the Court of Chancery was not clearly erroneous in finding that Cohen's projections for CKx's cash flows were unreliable due to the difficulty of predicting the outcome of the negotiations with FOX. (*Id.* at 26-28.)

Finally, even were this Court to agree with CKx that the Court of Chancery should have considered Cohen's DCF – and it should not – a remand would be necessary to consider all of the other underlying assumptions necessary to value a complex business enterprise using DCF, including cash flow adjustments, the terminal growth rate and the weighted average cost of capital.

V. CKx Did Not Prove Any Synergies That Should Have Been Deducted From the Appraisal Award

A. Question Presented

Assuming that the Merger Price was the appropriate standard for determining the fair value of Petitioners' shares in CKx, did the Court of Chancery correctly find that CKx had failed to prove any synergies that were required to be deducted from the Merger Price?

B. Standard of Review

The Court of Chancery's interpretation of the appraisal statute is reviewed *de novo* by this Court, *Golden Telecom*, 11 A.3d at 216-17, and its factual findings may be reversed on appeal if "they are clearly wrong and the doing of justice requires their overturn." *Dobler*, 880 A.2d at 219.

C. Merits of the Argument

Under § 262, the fair value of Petitioners' shares must be determined "exclusive of any element of value arising from the accomplishment or expectation of the merger." 8 *Del. C.* § 262(h). This language creates a "very narrow exception to the appraisal process, designed to eliminate use of *pro forma* data and projections of a speculative variety relating to the completion of a merger." *Weinberger*, 457 A.2d at 713; *see also Technicolor*, 684 A.2d at 299 ("'[O]nly the *speculative* elements of value that may arise from the "accomplishment or expectation" of the merger'" should be excluded (quoting *Weinberger*, 457 A.2d at

713) (emphasis added by the Court)). For example, where a buyer intends to combine the company with another in the same industry, a DCF analysis must be based upon the projected cash flows of the stand-alone company. Projected cash flows of the combined companies may contain synergies that need to be removed from an appraisal award. *See In re Appraisal of Metromedia Int'l Grp., Inc.*, 971 A.2d 893, 899 (Del. Ch. 2009) ("Narrowly interpreted 'speculative elements of value,' usually contemplated synergies or speculative *pro forma* projections, are eliminated from consideration."); *cf. Union Illinois*, 847 A.2d at 356 ("The exclusion of synergy value . . . derives from the mandate that the subject company in an appraisal be valued as a going concern."). CKx concedes on appeal that, to be properly deducted from Merger Price, Apollo's projected cost savings must constitute "synergistic value." (CKx Br. at 45.)

The Court below correctly held that CKx bore the burden of proving the existence and value of any synergies it claimed. *See Dobler*, 880 A.2d at 221-22.[12] Yet, CKx put on no testimony at trial about any alleged synergies or cost savings, and declined the Court of Chancery's invitation to submit additional evidence post-

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[12] *See also In re Emerging Comm'cns, Inc. S'holders Litig.*, 2004 WL 1305745, at *14 (Del. Ch. May 3, 2004) (rejecting allegedly synergistic cost savings where "the defendants nowhere documented the existence, or the amount, of such cost savings, and the testimony of their witnesses on that subject is hopelessly inconsistent"); *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *5 (Del. Ch. July 8, 2013) (rejecting respondent's argument to rely on merger price as evidence of value where respondent failed to attempt to adjust the merger price to remove synergies or provide any proof as to those synergies); (Ex. B to Pet. Br. at 4-5.)

trial. (Ex. B to Pet. Br. at 2-3.)

The Court below held that CKx failed to prove that the alleged $4.6 million in cost savings listed in the Apollo Memorandum "were savings that could have been realized only by accomplishment of the merger." (Ex. B to Pet. Br. at 8.) That finding was amply supported by the record because, for example, $2.3 million (of the $4.6 million of claimed savings) were "Management Identified Savings" that were part of CKx's December 2010 operating budget, long before Apollo even made a bid for CKx. (A2187-91; AR90; AR95.) As the Court noted, CKx's counsel conceded at oral argument that these were not "savings that would have been unobtainable by CKx as a going concern." (Ex. B to Pet. Br. at 8.)

As to the "Apollo Identified Savings," the Court correctly found that the Apollo Memorandum "does not on its face contain information sufficient to support a finding that Apollo believed *merger-specific* cost savings would be realized." (*Id.*) This is because for each of the "Apollo Identified Savings" CKx presented no evidence about (i) what the basis for the estimate was, (ii) what redundancies or services could be eliminated, (iii) what impact eliminating them would have on the revenue side of CKx's business, (iv) the costs associated with achieving the savings, (v) whether the costs were one-time or repeating, and (vi) whether achieving these savings was in any way dependent on Apollo's acquiring ownership of CKx through the Merger. There was no way to test any of these

issues because no witness ever testified about them. The alleged cost savings were also dwarfed by Apollo's $2.5 million per year "management fee" [redacted]

[redacted]

[redacted]

[redacted] (B980; B912; B1000.)

Although the Court below did not reach the issue, cost-savings of the kind claimed by Apollo – based simply on trying to make more efficient use of the Company's existing assets as of the merger date – are not "synergies" required to be deducted from an appraisal award. Delaware courts have consistently defined excludable, merger-related synergistic value as "the amount of any value that the selling company's shareholders would receive because a ***buyer intends to operate the subject company, not as a stand-alone going concern, but as a part of a larger enterprise, from which synergistic gains can be extracted***." *Union Illinois*, 847 A.2d at 356 (emphasis added); *Gearreald v. Just Care, Inc.*, 2012 WL 1569818, at *3 (Del. Ch. Apr. 30, 2012) (same). Value that is extracted from the deployment of the company's ***existing*** assets as of the merger date is not synergistic, but accrues to the benefit of all shareholders and must be included in an appraisal award. *See In re Emerging Comm'cns*, 2004 WL 1305745, at *13 (holding that cost savings identified by management that could be achieved

irrespective of the merger are not synergies).[13] None of the alleged cost savings were "synergies" uniquely available to Apollo from operating CKx as part of a larger enterprise.

Recognizing that it failed to put on any admissible evidence of actual synergies, CKx makes the remarkable argument that a buyer need only have an untested, subjective "expectation" of achieving a certain level of cost savings to justify deducting the value of those savings from an appraisal award. (CKx Br. at 45-46.) To hold that a buyer's subjective "expectation" is somehow binding on the Petitioners and the Court of Chancery makes a mockery of statutory appraisal, which requires actual evidence tested for reliability. The Court of Chancery correctly determined that CKx failed to prove synergies that should be deducted from the Merger Price.

[13] The only appraisal cases in which merger-related synergies were quantified and removed involved strategic buyers in the same industry as the acquired company who intended to combine the company with their existing operations to achieve cost savings unique to the acquiror. *Union Illinois*, 847 A.2d at 343-44, 353-54 & n.26 (company was a small, regional bank and the acquirer, as well as other potential bidders, were all "larger banks who expected synergistic gains"); *Highfields*, 939 A.2d at 60-61 (small life insurance company acquired by large life insurance company).

VI. The Court Correctly Rejected CKx's Unprecedented Request to Compel Petitioners to Accept A Partial Pre-Payment of a Potential Award in Order to Stop the Accrual of Statutory Interest

A. Question Presented

Whether the Court of Chancery properly refused to compel Petitioners to accept a partial pre-payment of a potential award in the amount of $3.63 per share, so as to stop the accrual of interest on that portion of the judgment.

B. Standard of Review

The Court of Chancery's interpretation of the appraisal statute is reviewed *de novo*. *Golden Telecom*, 11 A.3d at 216-17.

C. Merits of the Argument

The Court correctly found that CKx's unprecedented demand that Petitioners be compelled to accept a partial pre-payment of a potential award to relieve CKx from having to pay interest runs afoul of both the language and purpose of Section 262(h). To simplify interest awards in appraisal proceedings, the General Assembly amended the appraisal statute in 2007 to provide that "[u]nless the Court in its discretion determines otherwise for good cause shown, ***interest from the effective date of the merger through the date of payment of the judgment*** shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time ***during the period between the effective date of the merger and the date of payment of the***

judgment." 8 *Del. C.* § 262(h) (emphasis added); *see also Metromedia Int'l Group*, 971 A.2d at 907. The statute's plain language definitively establishes both the interest rate (5% over the Federal Reserve discount rate, whether in "low" or "high" interest rate environments) and the period during which interest is to accrue (from the effective date of the merger through the date of payment of the judgment after a definitive appraisal award). As the Vice Chancellor observed, "[w]ith respect to the appropriate interest rate and accrual period in connection with statutory appraisal, the General Assembly has made its call." (Ex. B to CKx Br. at 6.) Nowhere within the General Assembly's framework is there a procedure to stop interest and compel appraisal petitioners to accept pre-payment of some portion of an expected judgment.

Moreover, the interest rate and accrual period chosen by the General Assembly reflect a balance between "the competing interests of appraisal petitioners, who have been cashed out of their preferred investment and denied the ability to invest the merger consideration in the market pending the outcome of the case, and respondents, against whom too large an interest award may operate as a penalty." (*Id.*) Here, Petitioners lost the opportunity to invest their merger consideration in equity markets that enjoyed dividend-adjusted returns over the applicable period nearly ***triple*** the appraisal statute's default interest rate: (i) NASDAQ: 56.35% ***annualized 19.80%***; (ii) S&P 500: 46.90%, ***annualized***

16.82%; and (iii) Russell 2000: 43.83%, ***annualized 15.82%.*** (AR328.) *See, e.g., Gilbert v. MPM Enters., Inc.*, 709 A.2d 663, 674 (Del. Ch. 1997). Instead, Petitioners have been unsecured creditors of a company sold through a leveraged buyout and whose unsecured, second-lien debt bore a 13.5% interest rate. (*See* AR332.)

The variable interest rate imposed by the statute is not a "windfall," but strikes a balance between appraisal petitioners who have lost the use of their money and respondents who have been free to deploy it. Giving respondents the right to cut off statutory interest by making a "pre-payment" whenever they wish and in whatever amount they choose disrupts this carefully-constructed balance. As the Court below correctly reasoned, the General Assembly "determined that the appropriate way to compensate appraisal petitioners . . . is not to compel petitioners to accept prepayment, even if such prepayment is unconditional, but to award them interest . . . through the payment of a final judgment." (Ex. C to CKx Br. at 7.) Until there is a final, non-appealable appraisal award, interest continues to accrue. The unprecedented right to compel partial, interim payment demanded by CKx simply cannot be reconciled with the language or purpose of the statute, and CKx cannot cite to a single case as authority for its novel proposition.[14]

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[14] Chancellor Chandler's decision in *ONTI, Inc. v. Integra Bank*, 1999 WL 160131 (Del. Ch. March 2, 1999), provides no support for CKx's position. (*See* CKx Br. at 49.) There, the Court protected the judgment creditors by enabling them to take discovery in aid of execution in the

Moreover, [redacted]

(AR321-25.)

Although CKx contested Petitioners' interpretation of the Tax Code (an easy ploy since CKx did not have to pay the tax or subject itself to IRS scrutiny), it ultimately refused to put its money where its mouth was. In response to a question from the Vice Chancellor, CKx agreed to indemnify Petitioners against adverse tax consequences from the pre-payment only on the condition that Huff agree to surrender to Apollo control over its partnership tax filings. CKx well knew that the Huff Fund, as a fiduciary obligated to make tax filings on behalf of investors, could not delegate that duty to a litigation adversary with opposing financial interests. (AR366-78.)[15]

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face of well-founded allegations that the judgment debtors were secreting assets. *ONTI, Inc.*, 1999 WL 160131, at *3. The Court never even considered, let alone endorsed, the supposed "right" demanded by CKx here of an appraisal respondent in ***any*** appraisal case to cut off the accrual of interest by compelling the petitioners to accept partial pre-payment of an award.

[15] With respect to payment of the Judgment entered below (*see* CKx Br. at 50), although the issue plainly is not before this Court, Petitioners informed CKx about case law from this Court (and others) indicating that the "acceptance of benefits" doctrine would result in waiver of Petitioners' right to appeal if they accepted payment of the judgment. *See Smith v. Smith*, 893 A.2d 934, 937 (Del. 2006). Petitioners offered to make a ***joint application*** to this Court to resolve the issue of whether accepting the tender would result in waiver of Petitioners' right to appeal, but CKx refused. In addition, CKx's tender was not unconditional, as it demanded the right to claw the

Failure to grant appraisal respondents an unprecedented right of partial pre-payment will not encourage appraisal petitions from investors seeking to "create arbitrage opportunities." (CKx Br. at 50.) Empirical evidence presented in recent scholarship shows that the "idea that sophisticated investors are pouring hundreds of millions of dollars into risky appraisal proceedings to chase above-market interest rates simply is not credible." (AR405 (Charles R. Korsmo & Minor Myers, *Appraisal Arbitrage and the Future of Public Company M&A*, 92 Wash. U. L. Rev. (forthcoming 2015)).) The reason is simple: 5% over the Federal Funds rate actually "undercompensates" appraisal petitioners for the loss of stock market returns, the risks of their position as unsecured creditors, and the litigation costs and risks inherent in the appraisal proceeding itself. *Id.* In any event, if the statute needs to be changed – and it does not – it should be changed by the General Assembly.

CONCLUSION

For the foregoing reasons, the Order and Final Judgment should be reversed and the case remanded for further proceedings. CKx's arguments on cross-appeal should be rejected in their entirety.

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money back if post-appellate proceedings resulted in an appraisal award below $5.50 per share. (AR439-46.)

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