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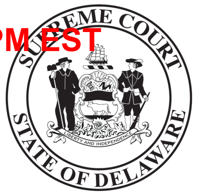

IN THE SUPREME COURT OF THE STATE OF DELAWARE

ALAN R. BELL, MICHAEL T. BOWERS, and OM PARKASH KALRA, Plaintiffs Below/Appellants and Cross-Appellees,	)	No. 343, 2022
v.	)	On appeal from: Court of Chancery of the State of Delaware Consol. C.A. No. 6886-VCL
AT&T MOBILITY WIRELESS OPERATIONS HOLDINGS LLC; NEW CINGULAR WIRELESS PCS, LLC; and AT&T MOBILITY LLC, Defendants Below/Appellees and Cross-Appellants.	)	

APPELLEES' REPLY BRIEF ON CROSS-APPEAL

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Dated: January 13, 2023

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ARGUMENT

AT&T's cross-appeal raises a limited and contingent challenge to the trial court's decision to apply a 0% tax rate to the Partnership's projected cash flows in determining breach of fiduciary duty damages. As even the trial court recognized, that decision has "significant implications," including the "risk[]"of "overstating the value of the Partnership." Nonetheless, because the damages award as a whole falls within the bounds of reasonableness, AT&T has chosen not to appeal it.

In the event this Court finds merit in Plaintiffs' appeal seeking to increase the Partnership's $700 million valuation by $200 million dollars, however, the trial court's DCF analysis would be materially different. In that circumstance, retaining the 0% tax rate would overvalue the Partnership to an unreasonable degree and render the new damages award indefensible. Thus, despite Plaintiffs' insinuations of impropriety or insincerity, AT&T has good reason to seek affirmance of the judgment below yet argue (via this contingent cross-appeal) that reopening the DCF model in the manner Plaintiffs request should prompt review of the tax rate DCF input.

In their opposition brief, Plaintiffs do not dispute the significance of the 0% tax rate decision or the fact that their appeal on breach of fiduciary duty damages, if successful, would disturb the trial court's balancing of DCF inputs. Instead, Plaintiffs claim that a contingent cross-appeal is procedurally improper, which the law refutes, and that AT&T failed to preserve the tax issue, which the record belies.

Consequently, no impediment prevents this Court from resolving the cross-appeal if necessary.

On the merits, Plaintiffs echo the trial court's reasoning, but they cannot surmount the precedent (namely, *Open MRI*) that supports tax affecting projected cash flows for pass-through entities generally. Nor can they overcome the straightforward reasons why a 0% tax rate produces a damages windfall in this case. Presumably, that is why Plaintiffs claim that AT&T's books and records were "entirely made up," making it "impossible" to perform a traditional DCF analysis. But the trial court in fact found AT&T's accounting records to be extensive, careful, and accurate reflections of revenue and expense allocations, and used those records to perform the very DCF analysis Plaintiffs requested. For those reasons, to the extent this Court reaches the cross-appeal, it should require tax affecting the Partnership's projected cash flows at 34.1%—a figure Plaintiffs do not contest.

A. AT&T's contingent cross-appeal is both proper and preserved.

Contrary to Plaintiffs' assertion, there is nothing procedurally improper about AT&T's contingent cross-appeal on the 0% tax rate that the trial court used in its DCF analysis. There is no question that AT&T timely filed a notice of cross-appeal from the final judgment. Nor do Plaintiffs deny that a cross-appeal is necessary to challenge the tax-rate ruling in the Fiduciary Decision. *See, e.g.*, *Haley v. Town of Dewey Beach*, 672 A.2d 55, 58 (Del. 1996) ("A cross-appeal is necessary if the

appellee seeks affirmative relief from a portion of the judgment."). Rather, Plaintiffs take issue only with the contingent nature of AT&T's cross-appeal. But a contingent cross-appeal is the proper way for an appellee to seek affirmance of the trial court's judgment yet retain the ability to challenge a ruling below if an appellate court reopens the judgment. *See Miller v. National Land Partners, LLC*, 2015 WL 849692, at *1 (Del. Feb. 26, 2015) ("Because the appellees' preferred relief is affirmance, we do not reach the issues raised by their cross-appeal, which seeks relief only in the event we disturb the Opinion and Order issued by the Court of Chancery.").

Tellingly, Plaintiffs cite no authority for the proposition that a contingent cross-appeal is appropriate only when "an adverse ruling on a specific issue will create a new material issue that does not exist outside the context of the adverse ruling." Pls.' Opp'n Br. 23. Their example of how that supposed rule would operate in practice, moreover, makes no sense. According to Plaintiffs, AT&T could have preemptively cross-appealed the issue of dissociation damages for the breach of contract claim. But AT&T prevailed on the merits of that claim and therefore could not have cross-appealed a non-existent judgment of dissociation damages, much less a decision that this Court might issue on that subject. *See Hercules Inc. v. AIU Ins. Co.*, 783 A.2d 1275, 1277 (Del. 2000) ("Standing to cross-appeal *** requires the party seeking relief to have been aggrieved by the judgment."); *In re Santa Fe Pac.*

Corp. S'holder Litig., 669 A.2d 59, 67 (Del. 1995) ("Santa Fe could hardly appeal the dismissal of all claims against it.").

In any event, AT&T's contingent cross-appeal would satisfy Plaintiffs' (incorrect) standard because increasing breach of fiduciary duty damages based on the Management Agreement *would* materially "change the facts or law relevant to the tax issue"—far more than "one iota." Pls.' Opp'n Br. 23-24. As AT&T explained in its answering brief, the trial court (at Plaintiffs' behest) conducted a multi-faceted DCF analysis that valued the Partnership and estimated damages, giving Plaintiffs the benefit of the doubt. AT&T Answering Br. 38-44. Increasing the roughly $700 million valuation of the Partnership by $200 million is a material change and necessarily calls into question the reasonableness of the damages award. *Id.* at 44. There is nothing improper about AT&T's contingent request that if (and only if) the damages award is disturbed, this Court should consider an interrelated and significant aspect of the trial court's underlying DCF analysis. *See Miller*, 2015 WL 849692, at *1.

Plaintiffs otherwise argue that AT&T did not preserve for appeal "anything approximating th[e] question" of whether to tax affect projected cash flows. Pls.' Opp'n Br. 24. That argument is perplexing, given that the parties submitted extensive briefing and expert testimony on that exact issue, as the trial court recounted in the Fiduciary Decision. Add.E.95-97, 112-118. AT&T also fully presented the tax issue

in its initial appeal brief. *See* AT&T Answering Br. 44-51. Accordingly, Plaintiffs' request to "summarily dismiss AT&T's cross-appeal" lacks any basis. Pls.' Opp'n Br. 24 n.19.

B. If this Court reopens the breach of fiduciary duty damages award, it should reject Plaintiffs' arguments for applying a 0% tax rate to the Partnership's projected cash flows.

On the merits, Plaintiffs cannot justify the application of a 0% tax rate. In an entire fairness action, damages "ordinarily should be confined to" a plaintiff's share of an entity's fair value as established by a "liberalized appraisal proceeding." *Weinberger v. UOP, Inc.*, 457 A.2d 701, 703-704, 713-714 (Del. 1983). That basic rule applies no less to tax affecting projected flows in a DCF damages model. As *Delaware Open MRI Radiology Associates, P.A. v. Kessler* ("*Open MRI*") makes clear, tax affecting the cash flows of a pass-through entity avoids a situation where minority stakeholders "receive *more* than a fair *** valu[e]." 898 A.2d 290, 328 (Del. Ch. 2006) (emphasis added). That is because "ignor[ing] personal taxes would *overestimate*" a pass-through entity's value and produce a damages "windfall." *Id.* at 328-329 (emphasis added); *see* AT&T Answering Br. 44-46.

Although Plaintiffs framed their damages request in terms of "the value of their interests in the Partnership," Add.E.98, they insist on ignoring the personal taxation of Partnership distributions simply because the trial court was fashioning a damages remedy, Pls.' Opp'n Br. 28. But a valuation "remedy" must reflect "the

amount that estimates the [Partnership's] value to" Plaintiffs, *Open MRI*, 898 A.3d at 328, and "take into consideration *all* factors and elements which reasonably might enter into the fixing of [that] value," *Weinberger*, 457 A.2d at 713 (emphasis added). One of those factors is taxes, because an entity's value is necessarily affected by the amount in taxes that are paid on its earnings, whether at the entity or personal level. "This is a simple premise—no one should be willing to pay for more than the value of what will actually end up in her pocket." *Open MRI*, 898 A.2d at 329; *see In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 495 (Del. Ch. 1991) (recognizing that "under an earnings valuation analysis, what is important to an investor is what the investor can ultimately keep in his pocket").

The general rule for resolving uncertainties against the wrongdoer does not permit Plaintiffs to disregard taxes on Partnership distributions either. No uncertainty exists "regarding application of a tax rate to a damage award." Pls.' Opp'n Br. 26. To the contrary, while Plaintiffs dispute *whether* to tax affect the projected cash flows of pass-through entities—a purely legal question—they do not respond to AT&T's separate argument that a 34.1% tax rate best reflects the operative realities that determine the fair value of the Partnership. *See* AT&T Answering Br. 49-51.

Plaintiffs' double taxation argument is similarly off base. *See* AT&T Answering Br. 46-47. The fair value of the Partnership does not depend on whether

Plaintiffs are taxed once or twice; it depends on the operative reality of the entity being valued. *See Dell, Inc. v. Magnetar Global Event Driven Master Fund LTD*, 177 A.3d 1, 38 (Del. 2017) ("There is precedent favoring adopting tax rates consistent with the operative reality of the company under consideration."). Here, there is no question that partners ultimately paid personal taxes on Partnership earnings even though the Partnership did not. *See* AT&T Answering Br. 45, 51.

Accordingly, tax affecting projected cash flows will *not* result in a lower value for the interests held by the minority partners "relative to the [Partnership's] operative reality." Pls.' Opp'n Br. 27. That reasoning depends on Plaintiffs' misconception that "the investors in the Partnership could expect to receive distributions into perpetuity from an entity that did not pay entity-level tax," *id.*, *without the investors paying any tax themselves*. But that is precisely the valuation "windfall"—based on a hypothetical reality that overlooks personal taxes—which *Open MRI* rejects. 898 A.2d at 328.[1]

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[1] The same misconception underlies Plaintiffs' complaint that tax affecting projected cash flows will permit AT&T to "profit" by "apply[ing] a higher tax rate for purposes of a freeze-out." Pls.' Opp'n Br. 27. Payment of personal taxes is an operative reality, not something tailor-made for the DCF analysis. AT&T, moreover, continues to pay corporate taxes on Partnership distributions. Notably, Plaintiffs no longer argue that it would be unfair to tax affect projected cash flows because AT&T receives a step-up in tax basis. *See* AT&T Answering Br. 48.

Indeed, as AT&T has explained, even assuming (wrongly) that a court should consider the personal taxes paid on a damages award in determining an entity's fair value, Plaintiffs' damages award will be taxed at a far *lower* rate than the future distributions they would have received absent the Partnership's dissolution. Specifically, Plaintiffs' damages awards will be taxed at the capital gains rate of 15%, while their distributions would have been taxed as federal income, likely at 40%. AT&T Answering Br. 47. Plaintiffs do not engage with the reality that refusing to tax affect projected cash flows means they will retain far more in after-tax damages than they would have retained in after-tax distributions.

In the end, Plaintiffs' opposition brief is long on broad-brush arguments about the equities and short on Delaware law laying out the applicable valuation principles. But the fact that a transaction falls short under the entire fairness standard does not negate the need to base damages on fair value. After all, the reasoning in *Open MRI* governs where minority stakeholders were "involuntarily deprived of the benefits of continuing" in that capacity and "forcibly denied the future benefits of [pass-through entity] status." 898 A.2d at 327-328.

In addition, the record refutes the factual bases for Plaintiffs' equitable arguments. Far from finding that AT&T's books and records were "entirely made up," Pls.' Opp'n Br. 24, the trial court credited AT&T's accounting as "extensive," "careful," and "accurate[] reflect[ions] [of] the revenue and expense that AT&T

identified and assigned or allocated to the Partnership," Add.E.14; *see* Add.B.5, 47-51 (finding AT&T's accounting records reliable). Relatedly, at the risk of stating the obvious, the trial court *did* perform a "traditional DCF analysis" (at Plaintiffs' request, no less). Pls.' Opp'n Br. 25; *see* Add.E.98-99 (adopting "plaintiffs' basic approach to damages" and stating that "[t]his decision uses a DCF model to determine the value of what the plaintiffs held"). It was *Plaintiffs'* "fail[ure] to develop the factual record" that precluded the trial court from "estimat[ing] how compliance with the [Management Agreement] methodologies would have affected the value of the Partnership." Add.B.5; *see* AT&T Answering Br. 41-43.

CONCLUSION

This Court should affirm the trial court's judgment, for the reasons set forth in AT&T's answering brief. In the event this Court disturbs the breach of fiduciary duty damages award, it should remand with instructions to tax affect the Partnership's discounted cash flows at 34.1%, for the reasons set forth in AT&T's briefing on its contingent cross-appeal.

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