IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

NBC UNIVERSAL, INC.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	C.A. No. 650-N
	)	
PAXSON COMMUNICATIONS CORPORATION,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

Submitted: February 14, 2005
Decided: April 29, 2005

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LAMB, Vice Chancellor.

I.

Plaintiff NBC Universal, Inc. brought this action against defendant Paxson Communications Corporation for declaratory judgment and to enforce its rights under Paxson's certificate of incorporation. Both NBC and Paxson are Delaware corporations.

In September of 1999, NBC made a $415 million investment in Paxson by purchasing 41,500 shares of 8% Series B Convertible Exchangeable Preferred Stock (the "Stock") at $10,000 per share. The dividend rate was set at 8% for the first five years. Thereafter, the dividend rate was to be adjusted based on a formula set out in the Certificate of Designation ("COD") governing the Stock. Specifically, the COD provides that on September 15, 2004, the dividend rate was to be reset to a "Cost of Capital Dividend Rate," defined in the COD as the dividend rate at which the Stock would trade at its liquidation preference on September 15, 2004 (the "Reset Rate"). The COD further provides that the Reset Rate was to be determined by a "nationally recognized independent investment banking firm" chosen by Paxson, in its sole discretion.

The dividends on the Stock accrue but remain unpaid. The holder of the Stock is entitled to realize the accrued dividends under several circumstances. These include a redemption of the shares by Paxson, certain change of control transactions, a liquidation of Paxson, or a declaration of dividends by Paxson's

board. Also, upon a liquidation of Paxson, the holder of the Stock is entitled to a "liquidation preference," the amount of which is at issue in this litigation. NBC argues that the term "liquidation preference," as used in the COD, is equal to the original issue price of $10,000, plus all accumulated dividends. As of September 15, 2004, $166 million (or $4,000 per share) of dividends had accumulated. Paxson argues that the liquidation preference is equal to the original issue price of $10,000 and does not include any accumulated dividends.

In addition, NBC received certain warrants and a call option that gave NBC the right, but not the obligation, for a period of ten years, to purchase a controlling interest in Paxson. As of the time the complaint was filed, NBC has not exercised these warrants and the call option.

The COD also made the Stock subject to redemption at the option of the holder of the Stock, in accordance with certain provisions in an Investment Agreement, dated September 15, 1999, entered into between Paxson and NBC (the "Investment Agreement"). Article IX, Section 9.1 of the Investment Agreement states, in pertinent part:

> (a)(ii) beginning with the third anniversary of the Closing and on each anniversary thereafter, then, in each case, [NBC], at its sole option, will have a period of 60 days during which to demand redemption, by payment in cash, of all or any portion of the [Stock] at a price per share equal to the Original Issue Price plus any accrued and unpaid dividends through and including the date of redemption (the "Par Value Price").

> (b) [Paxson] or its assignee pursuant to Section 9.3 will have a period of one year (the "Involuntary Redemption Period") from the date of any such demand to consummate the redemption; provided that if at any time during such one-year period, [Paxson's] outstanding debt and preferred stock covenants do not prohibit a redemption and [Paxson] has funds on hand to consummate such redemption [Paxson] or its assignees shall consummate such redemption at such time . . . .

On November 13, 2003, NBC sent a notice of demand for redemption to Paxson pursuant to Section 9.1(a)(ii) of the Agreement, thereby triggering the one-year Involuntary Redemption Period set forth in Section 9.1(b).

Several months later, on March 24, 2004, NBC wrote to Paxson's Chief Legal Officer regarding the process for determining the Reset Rate. In the letter, NBC advised Paxson that it did not consider either Bear Stearns & Co., Inc. or Citigroup, Inc. to be independent under the terms of the COD. NBC also informed Paxson that it had retained Goldman, Sachs & Co. and UBS Investment Bank in connection with the Reset Rate.

On May 12, 2004, Paxson's Chief Legal Officer wrote in response to NBC. In that letter, Paxson acknowledged NBC's advance objection to using either Bears Stearns or Citigroup as the investment bank to calculate the Reset Rate, and stated that it would take NBC's objection into account when selecting the investment bank. In addition, Paxson informed NBC of its opinion that it was neither able nor required to redeem the Stock for cash, pursuant to NBC's request under the Agreement.

On August 19, 2004, NBC filed its first complaint. On September 2, 2004, this court entered a Scheduling Stipulation and Order. The Scheduling Stipulation and Order required Paxson to cause an investment bank to determine the Reset Rate, as of September 15, 2004, and as provided for in the COD. After NBC advised Paxson that NBC would prefer that neither Bear Stearns nor Citibank be used, Paxson selected CIBC World Markets Corp. to determine the Reset Rate. The Scheduling Stipulation and Order also required NBC to take the deposition of the investment bank before September 24, 2004, and to file any amended complaint by September 28, 2004.

On September 28, 2004, NBC filed the First Amended Complaint (hereinafter the "complaint"). The complaint makes two main contentions. First, NBC claims that CIBC is not an "independent investment banking firm," as that term is used in the COD. Second, NBC claims that CIBC miscalculated the Reset Rate, based on improper instructions from Paxson. Specifically, NBC complains that Paxson instructed CIBC to assume that investors purchasing the Stock would receive the $166 million in accumulated, unpaid dividends, without having to pay for those dividends. As a result of this directive, CIBC declared the Reset Rate to be 16.2% per annum. Were these "free dividends" not included, CIBC found that the proper market rate would be 28.3% per annum. NBC also complains that CIBC used the incorrect "spread" to calculate the Reset Rate.

A. CIBC's Calculation Of The Reset Rate

CIBC determined the Reset Rate by determining the rate of return (or yield-to-redemption) that an investor purchasing the Stock would require, given the risk profile of the security. Because the Stock does not trade on a liquid market, CIBC looked at Paxson's other securities for determining the proper dividend rate for the Stock. CIBC concluded that Paxson's 14.25% Preferred Stock, which is two levels more senior than the Stock, was the appropriate reference security for the Stock. It further determined that the rate of return for Paxson's 14.25% Preferred Stock was 22.3%.

To determine the rate of return (and thereby the Reset Rate) for the Stock, CIBC next needed to calculate the "spread" that the Stock would trade at over the 14.25% Preferred Stock. Generally, the yield is higher for more junior securities than it is for more senior securities in a capital structure, due to the lower priority for junior securities in liquidation. This higher yield is necessary to compensate investors for the greater risk they take on by purchasing a more junior security. This risk premium (or risk discount) is referred to as the security's "spread."

CIBC determined the spread for the Stock by looking at the 12 1/2-month trailing average spread between the 14.25% Preferred Stock and the Stock, which was 6.5%. It then determined that the proper spread was 6%. Applying the 6% spread, CIBC determined that the yield for the Stock would be 28.3% (i.e. 6%

higher that the 22.3% yield for the 14.25% Preferred Stock). However, CIBC reduced the Reset Rate to 16.2%, based on the instruction from Paxson that it assume that investors purchasing the Stock would receive the accrued and unpaid dividends, without having to pay for them. As a result of this assumption, CIBC reached the incongruous decision to set the Reset Rate at a rate 6.1% *lower* than that which CIBC determined was the proper yield for the *more senior* 14.25% Preferred Stock.

NBC claims that, in addition to improperly assuming that investors purchasing the Stock would receive the accrued and unpaid dividends, CIBC also used the wrong spread. This is because CIBC used the 12 ½- month trailing average spread. The COD requires that the Reset Rate be based on the market conditions as of September 15, 2004. NBC further argues that, due to Paxson's increasing financial difficulties as of that date, the spread should have been 2.1% higher, i.e. 8.1%, producing a Reset Rate of 30.4%.

B. <u>Procedural Posture</u>

The complaint is set out in four Counts. Count I seeks a declaration that CIBC is not a "nationally recognized independent investment banking firm" as that term is used in the COD, and that Paxson must select a new investment banking firm consistent with the independence requirements of the COD. Count II seeks a declaration that the liquidation preference to be used in calculating the Reset Rate

is $14,000 per share, and not the original liquidation preference of $10,000 per share. In the alternative, if the court concludes that the liquidation preference amount to be used in calculating the Reset Rate is $10,000 per share, Count II seeks a declaration that the Reset Rate must be calculated assuming that the Stock would trade without its previously accrued dividends. Count III seeks a declaration that the Reset Rate must be determined using a spread as of September 15, 2004, and not the 12 1/2-month trailing average used by CIBC. Finally, Count IV seeks a declaration that Paxson breached the COD and seeks specific performance of the COD.

On October 14, 2004, Paxson filed its Answer and Counterclaim, wherein it contests NBC's interpretation of the COD and the Agreement and seeks declaratory relief. First, Paxson seeks a declaration that CIBC is an "independent investment banking firm." Second, Paxson seeks a declaration that the "liquidation preference" to be used in determining the Reset Rate under the COD is $10,000 per share (or an aggregate of $415 million). Third, Paxson seeks a declaration that it and NBC are bound by the 16.2% Reset Rate determined by CIBC. Fourth, Paxson seeks a declaration that it was not required by the terms of the Investment Agreement to redeem the Stock by November 13, 2004.[1]

[1] In its complaint, NBC does not ask for a determination that Paxson is required to redeem the Stock under the Agreement. However, in its papers and at oral argument, NBC has disputed this issue. Therefore, the disposition of this issue is properly before the court.

On October 14, 2004, Paxson filed for a motion for judgment on the pleadings. On November 23, 2004, NBC filed a cross-motion for judgment on the pleadings or, in the alternative, summary judgment. This is the court's opinion on the cross-motions for judgment on the pleadings, and NBC's cross-motion for summary judgment.

II.

Motions under Court of Chancery Rules 12(b)(6) and 12(c) are governed by the same standard: the court accepts all well-pleaded facts as true and construes any inferences from those facts in the light most favorable to the nonmoving party.[2] A motion to dismiss pursuant to Rule 12(b)(6) for failure to state a claim will be granted if it appears with reasonable certainty that the plaintiff could not prevail on any set of facts that can be inferred from the pleading.[3] In considering a motion to dismiss under Rule 12(b)(6), the court is required to assume the truthfulness of all well-pleaded allegations of fact in the complaint.[4] Similarly, under Rule 12(c), this court will grant a motion for judgment on the pleadings only where there are no material issues of fact and the movant is entitled to judgment as a matter of law.[5] On a Rule 12(c) motion, the court takes the well-pleaded facts

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[2] *Highlands Ins. Group, Inc. v. Halliburton Co.*, 2001 WL 287485, at *3 (Del. Ch. Mar. 21, 2001).
[3] *Kohls v. Kenetech Corp.*, 791 A.2d 763, 767 (Del. Ch. 2000).
[4] *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988).
[5] *Desert Equities v. Morgan Stanley Leveraged Equity Fund,* 624 A.2d 1199, 1205 (Del. 1993).

alleged in the complaint as true, and views those facts and any inferences drawn therefrom in the light most favorable to the nonmoving party.[6]

Generally, matters outside the pleadings should not be considered in ruling on a motion for judgment on the pleadings.[7] For example, Court of Chancery Rule 12(b) provides:

> If, on a motion asserting the defense numbered (6) to dismiss for failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the Court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Therefore, if a party presents documents in support of its Rule 12(b)(6) or 12(c) motion and the court considers the documents, it generally must treat the motion as one for summary judgment.[8] Before a motion for summary judgment is ripe for decision, the nonmovant normally should have an opportunity for some discovery.[9]

III.

A corporate certificate of designation is interpreted using standard rules of contract interpretation.[10] Either judgment on the pleadings or summary judgment is a proper framework for enforcing unambiguous contracts because there is no

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[6] *Id.*
[7] *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 69 (Del. 1995).
[8] *Id.*
[9] *See* Del. Ch. Ct. R. 56(e); *Santa Fe*, 669 A.2d at 69.
[10] *Kaiser Aluminum Corp. v. Matheson*, 681 A.2d 392, 395 (Del. 1996).

need to resolve material disputes of fact. Rather, a determination of whether a contract is ambiguous is a question for the court to resolve as a matter of law.[11] The starting point of contract construction is to determine whether a provision is ambiguous, i.e. whether it is reasonably subject to more than one interpretation.[12] Toward that end, contract language "is not rendered ambiguous simply because the parties in litigation differ concerning its meaning."[13] Nor is it rendered ambiguous simply because the parties "do not agree upon its proper construction."[14] A contract is ambiguous "only when the provisions in controversy are reasonably or fairly susceptible of different interpretations or may have two or more different meanings."[15]

Delaware adheres to the "objective" theory of contracts, i.e. a contract's construction should be that which would be understood by an objective, reasonable third party.[16] Thus, as the Delaware Supreme Court stated: "Contract terms themselves will be controlling when they establish the parties' common meaning

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[11] *Pellaton v. The Bank of New York*, 592 A.2d 473, 478 (Del. 1991); *Reardon v. Exch. Furniture Store, Inc.,* 188 A. 704, 707 (Del. 1936).
[12] *Cantera v. Marriott Senior Living Serv., Inc.*, 1999 WL 118823, at *4 (Del. Ch. Feb. 18, 1999).
[13] *City Investing Co. Liquidating Trust v. Cont'l Cas. Co.,* 624 A.2d 1191, 1198 (Del. 1993); *accord Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.,* 616 A.2d 1192, 1196 (Del. 1992).
[14] *Rhone-Poulenc.,* 616 A.2d at 1196.
[15] *Id.*
[16] *Cantera*, 1999 WL 118823, at *4.

so that a reasonable person in the position of either party would have no expectations inconsistent with the contract language."[17]

IV.

A. <u>Is Either Party Entitled To Judgment On The Pleadings With Respect To The Issue Of The Proper Interpretation Of The Term "Liquidation Preference?"</u>

Both NBC and Paxson argue that the term "liquidation preference," as it is used in the COD, is clear and unambiguous. They differ, of course, on just what that clear and unambiguous meaning is.

While not specifically defined in the "definitions" section of the COD, the COD does unambiguously state "[t]he liquidation preference of the Series B Convertible Stock shall be $10,000.00 per share."[18] The "RESOLVED" section of the COD also states that: "[T]he Board of Directors does hereby create, authorize and provide for the issuance of 8% Series B Convertible Preferred Stock, par value $.001 per share, *with a liquidation preference of $10,000 per share* . . . ." (Emphasis added).

In addition, paragraph (d) of the COD (titled "Liquidation Preference") uses this definition of liquidation preference (i.e. the original issue price of the Stock of $10,000, not including accrued and unpaid dividends) consistently. The terms "liquidation payments" or "liquidation amount" are used when the COD refers to

[17] *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.,* 702 A.2d 1228, 1232 (Del. 1997).
[18] COD at 1, ¶ a.

the liquidation preference, plus the accrued and unpaid dividends. For instance, paragraph (d) partially states:

> If the assets of the Corporation are not sufficient to pay in full the *liquidation payments* payable to the Holders of outstanding shares of the [Stock] and all Parity Securities, then, (x) should the holders of the [Stock] be entitled to receive the *liquidation amount* described in clause (A) above, the holders of all such shares shall share equally and ratably in such distribution of assets first in proportion to the full *liquidation preference* to which each is entitled until such preferences are paid in full, and then in proportion to their respective *accumulated but unpaid dividends* and (y) should the holders of the [Stock] be entitled to receive the liquidation amount described in clause (B) above, the holders of all such shares shall share equally and ratably in such distribution of assets in proportion to the full liquidation payments to which each is entitled. (Emphasis added).

In this section, the COD makes reference to the "liquidation preference" and states that, in the event of liquidation, the holders of the stock are to be paid back their original investment (i.e. $10,000 per share) first, before being paid any accrued, unpaid dividends. The COD then makes separate reference to the accumulated, unpaid dividends which are to be given lesser priority. Therefore, this section only makes sense if liquidation preference is interpreted as the original issue price of the Stock without including the accumulated, unpaid dividends.

NBC points to two clauses in the COD in which, it contends, the liquidation preference does not, and cannot, equal the original issue price of $10,000. First, NBC cites paragraph (d)(i) of COD. This section states that upon liquidation the holders of the Stock will be paid the greater of:

> (A) *the liquidation preference* for each share outstanding, plus without duplication, an amount in cash equal to *accumulated and unpaid dividends* thereon to the date fixed for liquidation, dissolution or winding up, and (B) the amount per share payable upon liquidation, dissolution or winding up to the holders of shares of the Corporation's Class A Common Stock (without duplication for the *liquidation preference* otherwise payable pursuant to clause (A) hereof), multiplied by the number of such shares into which the shares of [the Stock] are then convertible. (Emphasis added).

NBC contends that the "liquidation preference" in subsection (B) refers to the liquidation preference *plus* dividends referred to in subsection (A). However, this is not necessarily so. Section (g) of the COD gives NBC the right to convert the Stock into Paxson's common stock. Obviously, in the event of a liquidation, if the amount that a common shareholder would get would be greater than the amount that NBC would get from the Stock, NBC would exercise that right. Subsection (B) merely clarifies that NBC would not get two bites at the apple, taking its liquidation preference and then attempting to convert to common stock and getting that liquidation payment as well. Instead, if it chooses to convert, it would not get the liquidation preference as well. Therefore, this provision is entirely consistent with the liquidation preference being equal to $10,000.

Second, NBC cites the definition of "Cost of Capital Dividend Rate" contained in the COD. "'Cost of Capital Dividend Rate' means a rate per annum equal to the dividend rate on the [Stock] at which the [Stock] would trade at its liquidation preference on such date of determination." NBC argues that "on such

date of determination" modifies "liquidation preference" and that, therefore, the liquidation preference changes over time to reflect the amount of unpaid dividends.

In support of this last contention, NBC cites "the last antecedent rule," which "requires that a qualifying or modifying phrase be construed as referring to its nearest antecedent."[19] However, the last antecedent rule is but one of numerous rules designed to assist in the discovery of intent and is not to be inflexibly or uniformly applied.[20] Instead, "[w]hen the sense of the entire [document] requires that a qualifying word or phrase apply to several preceding or succeeding sections, the word or phrase will not be restricted to its immediate antecedent."[21] Furthermore, "[i]n discerning the intent of the parties, the Certificate [of Designation] should be read as a whole and, if possible, interpreted to reconcile all of the provisions of the document."[22]

A better reading of this clause, then, is that "on such date of determination" modifies "trades," or, more properly, the entire antecedent phrase "trades at its liquidation preference." This reading acknowledges the commonplace usage of "trading at" a particular value, such as par value, face value, or liquidation value. In any case, even if there were some slight ambiguity as to how the phrase

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[19] *New Castle County v. Nat'l Union Fire Ins. Co.*, 174 F.3d 338, 348 (3d Cir. 1999).
[20] *E.I. DuPont de Nemours & Co. v. Green*, 411 A.2d 953, 956 (Del. 1980).
[21] *Id.* (quoting 2A SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTIONS, § 47.33 (4th ed. 1973)).
[22] *Kaiser*, 681 A.2d at 395.

"liquidation preference" is used in that clause, the COD plainly states, in two separate places, that the liquidation preference *will be* $10,000. A minor ambiguity in the use of the phrase cannot overcome the plain meaning of the document.

For all of the above reasons, the court concludes that the term "liquidation preference," as used in the COD means the original purchase price of the Stock, $10,000.00 per share.

B. Is Either Party Entitled To Judgment On The Pleadings With Respect To The Issue Of Whether CIBC Is Independent?

NBC argues that Paxson abused its discretion in choosing CIBC to calculate the Reset Rate. As noted earlier, Paxson chose CIBC after NBC stated its opposition to either Bear Stearns or Citibank being the investment bank. The COD gives Paxson the discretion to choose the investment banking firm to determine the Reset Rate, but requires that it be both nationally recognized and independent. While NBC does not, and cannot, argue that CIBC is owned or controlled by Paxson, NBC nevertheless complains that CIBC is not independent. In particular, NBC cites the following contacts between Paxson and CIBC and its affiliates: (1) CIBC was co-manager for Paxson's offering of $365 million in Senior Secured Floating Rate Notes on January 12, 2004; (2) CIBC was co-manager for Paxson's offering of $200 million in 10.75% Senior Subordinated Notes on July 12, 2001; (3) CIBC Inc. was a lender and the co-documentation agent for Paxson's

$360 million credit facility on July 12, 2001; (4) CIBC Oppenheimer was the sole bookrunner for Paxson's offering of $200 million in 13.25% Preferred Stock on June 5, 1998; (5) CIBC Wood Gundy was co-manager for Paxson's initial public offering of $248 million in Class A Common Stock on March 29, 1996; (6) CIBC Inc. was a lender and the documentation agent for Paxson's credit facility of $100 million on December 19, 1995; and (7) CIBC Wood Gundy was an initial purchaser for Paxson's offering of $227 million in 11.625% Senior Subordinated Notes on September 21, 1995.[23] Paxson admits to having paid CIBC approximately $3 million since 1999.[24]

Neither Paxson nor NBC has identified a case in which a court determined whether an investment banking firm qualified as "independent" under a contract or certificate of designation. Therefore, the court looks to analogous situations of independence for guidance in interpreting the COD. In *Nakahara v. NS 1991 Am. Trust*,[25] this court held that counsel was independent when the attorney has no disqualifying conflict of interest.[26] Delaware law *does not* require that counsel have no prior contact to any party.[27] Similarly, in *Aronson v. Lewis*,[28] the Delaware Supreme Court stated that a director was independent when "a director's decision

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[23] Compl. ¶ 22.
[24] Countercl. ¶ 25.
[25] 739 A.2d 770, 789 (Del. Ch. 1998).
[26] *Id.*
[27] *Id.*
[28] 473 A.2d 805, 816 (Del. 1984).

is based on the corporate merits of the subject before the board rather than extraneous considerations or influences." In addition, the Delaware Supreme Court held that, in order to claim that a director was not independent, a shareholder plaintiff must show "the materiality of a director's self-interest to the given director's independence."[29]

The facts alleged by NBC are not sufficient to find that CIBC was not a "nationally recognized independent investment banking firm." This is true for several reasons. First, the complaint is devoid of allegations that CIBC was "materially" conflicted. The complaint simply lists the work that CIBC did for Paxson over a period of years. However, according to the financial information contained in CIBC's Form 10-K, the fees received from Paxson over the past five years represent less than 1/100 of 1% of CIBC's total revenue for the five years ending December 31, 2003.[30] As Paxson points out in its brief, this is the equivalent of saying that a director with an income of $1 million over five years is disqualified from being independent because he or she did $83 of business with the company over that period.

Second, the COD requires that the investment bank be not only "independent" but also "nationally recognized" and grants Paxson broad discretion in choosing among them. Independence obviously means not only independent of

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[29] *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1167 (Del. 1995).
[30] Answer ¶ 25.

Paxson, but also independent of NBC. NBC is owned by General Electric Company ("GE"). GE also owns GE Capital Corporation. GE is one of the largest companies in the world, and GE Capital is one of the largest financial service companies in the world. There are but a handful of nationally recognized investment banks that would both be nationally recognized and would have no ties to GE, GE Capital, NBC, or Paxson. In the circumstances, it is unreasonable to conclude that the parties intended to exclude all nationally recognized investment banks that, while having some history of working for either Paxson or NBC, are not shown to derive a material part of their revenue from such engagements. NBC simply has not alleged enough to raise a litigable issue as to the selection of CIBC as the "independent" and "nationally recognized" investment banker.

This conclusion is reinforced by the fact that, NBC generally agrees with the methodology and the conclusions of CIBC. At oral arguments and in its brief, NBC acknowledged that CIBC's methodology for determining the Reset Rate (i.e. adding the spread to the 14.25% Preferred Stock's yield) was proper. NBC's only complaint with CIBC is that it used too long a period (i.e. the 12 1/2-month trailing average, as opposed to a 90-day trailing average) to calculate the spread. This is a small difference, and one that does not undermine the court's confidence in the independence of CIBC's work.

NBC's other contention, that CIBC improperly assumed that any investor would obtain the benefit of the accrued but unpaid dividends of the Stock, cannot credibly be blamed on CIBC. It originally calculated the Reset Rate *without* this assumption. In addition, in its opinion letter, CIBC expressly disavowed any opinion as to whether this assumption was correct.[31]

For all of the above reasons, the court concludes as a matter of law that Paxson did not abuse its discretion in choosing CIBC as the investment bank to calculate the Reset Rate.

C. Should The Reset Rate Be Calculated Assuming That The Stock Would Trade Without Its Previously Accrued, Unpaid Dividends?

In calculating the Reset Rate, CIBC, as instructed by Paxson, assumed that anyone purchasing the Stock would be entitled to the Stock's accumulated, but unpaid, dividends. As a result, CIBC reduced the calculated Reset Rate from 28.3% to 16.2%. NBC argues that this violated the COD, which required the Reset Rate to be set at Paxson's then cost of capital; i.e. the market rate of return for the Stock.

Section (b)(i) of the COD states that:

> [T]he Holders of each share of the outstanding shares of [Stock] shall be entitled to receive, when, as and if declared by the Board of Directors, out of funds legally available therefor, dividends on each share of [Stock] at the higher of (determined on a cumulative basis from the Issue Date to the date of such determination) (x) a rate per

[31] Compl. ¶ 34; CIBC Ltr. at 2.

> annum equal to 8% of the Original Issue Price, which rate shall be adjusted on the fifth anniversary of the Issue Date to equal the Cost of Capital Dividend Rate, which rate shall remain in effect thereafter for so long as the [Stock] shall be outstanding[.]

The COD defines the "Cost of Capital Dividend Rate" as follows: "'Cost of Capital Dividend Rate' means a rate per annum equal to the dividend rate on the [Stock] at which the [Stock] would trade at its liquidation preference on such date of determination."

Generally, "cost of capital" is defined as the "rate of return that a business could earn if it chose another investment with equivalent risk—in other words, the opportunity cost of the funds employed as the result of an investment decision."[32] The cost of capital "depends on the general level of interest rates and the amount of premium for risk that the market demands, as well as the risks attributable to the subject business."[33] This so-called "market" cost of capital is exactly what CIBC calculated, before Paxson instructed it to assume that the Stock's accrued, unpaid dividends would go to a purchaser of the Stock for free. This assumption led CIBC to adjust the Reset Rate dramatically from 28.3% to 16.2%.

Paxson claims that its instruction to CIBC is based on the clear language of the COD, but the court is unable to read the COD as supporting this claim. Rather,

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[32] DICTIONARY OF FINANCE AND INVESTMENT TERMS 123 (5th ed. 1995).
[33] SHANNON PRATT, VALUING A BUSINESS 405 (4th ed. 2000).

the court concludes that Paxson's reading of the COD is at odds with the plain language of the COD and is patently unreasonable.

Words in a contract are interpreted using their common and ordinary meaning, unless the contract clearly shows that the parties' intent was otherwise.[34] The COD defines the "Cost of Capital Dividend Rate" as "a rate per annum equal to the dividend rate on the [Stock] at which the [Stock] would trade at its liquidation preference on such date of determination." It is possible, as Paxson argues, to read this language as referring to the 41,500 shares of Stock owned by NBC, with all the attributes of those shares, including their accumulated and unpaid dividends. That reading, if accepted by the court, would support Paxson's argument that CIBC's job was to determine the rate of return required to make *those particular shares* trade at $10,000 on the reset date.

This interpretation, however, is clearly at odds with the general understanding of cost of capital. The general understanding is that a provision of this sort is intended to reset the yield on a security at the current market level; i.e. the dividend rate (or, in the case of a debt instrument, the interest rate) that the issuer would have to pay to sell a new unit of the security at par on the reset date.

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[34] *See, e.g., Northwestern Nat'l Ins. Co. v. Esmark, Inc.*, 672 A.2d 41, 44 (Del. 1996) (interpreting unambiguous contract terms using dictionary definitions); *Neary v. Philadelphia, W. & B. R. Co.*, 9 A. 405, 407 (Del. 1887) ("All written contracts, as well as legislative Acts, are to be read, understood and interpreted according to the plain meaning and ordinary import of the language employed in them.").

This was, in fact, exactly what CIBC calculated, before being told by Paxson to change its assumptions.

Paxson's suggested reading of the COD would also lead to highly anomalous and illogical results. First, a higher risk security (the Stock) would have a lower rate of return than Paxson's more senior securities. To follow this interpretation, the court would have to assume that NBC made the choice to accept *less* return for *more* risk.

Second, accepting Paxson's reading of the COD means that the Reset Rate and the amount of accrued, unpaid dividends would be negatively correlated; i.e. the more dividends accrue, the lower the Reset Rate. Admittedly, Paxson has not paid the dividends that have accrued on the Stock, nor were they obligated to do so. However, under Paxson's interpretation of the Reset Rate, had it done so, the Reset Rate would have been *higher*. That is, had Paxson paid all or part of its obligations to NBC, Paxson would have had to pay a higher return on the Stock as of the Reset Date. Similarly, all else being equal, the sooner the reset occurs, the smaller the amount of unpaid dividends and, therefore, the higher the Reset Rate would be. These are strikingly anomalous results that fly in the face of financial theory (and common sense), which holds that a company that pays its obligations sooner rather than later is less risky, and need pay less of a risk premium. In

essence, this view treats the accrued, unpaid dividends, which are a Paxson liability, as a Paxson asset.

This point can best be illustrated by an example. If Paxson had paid all of the accrued dividends to NBC, then it is undisputed that the proper Reset Rate would be 28.3%. However, because they did not pay those dividends, to which NBC is undeniably entitled, the Reset Rate is supposedly only 16.2%. As another illustration, if the initial dividend rate had been 15.3%, then the Reset Rate would be 0%. If it had been more than 15.3%, then the Reset Rate would be negative. These results flow directly from Paxson's interpretation of the COD and strongly suggest its interpretation is unreasonable.

Moreover, CIBC has expressly disavowed any opinion as to whether the inclusion of the accrued, unpaid dividends in calculating the Reset Rate was proper. The fact that even Paxson's own expert will not support its interpretation is further evidence of its unreasonableness.[35]

Finally, the court also notes that Paxson's reading of the COD would treat dividends inconsistently. It would not include dividends in the calculation of the Liquidation Preference, but would include them in the calculation of the Reset

[35] In contrast, NBC has introduced the affidavit of an expert in the area of corporate finance specifically supporting its reading of the COD. However, because the court decides this motion on the pleadings, it does not rely upon this extrinsic evidence.

Rate. The court finds this asymmetrical treatment of dividends to be both unreasonable and inconsistent with the terms of the COD.

* * *

The court must construe the COD as a whole in light of normal principles of corporate law and finance. Taken as a whole, the meaning of the COD is unambiguous: The Reset Rate is to be determined without regard to the amount of the accumulated, unpaid dividends. In other words, the proper Reset Rate is that required by the market as of September 15, 2004 to sell a share of the Stock at $10,000 with regard to only future principal and dividend payments.

D. <u>Did CIBC Improperly Calculate The Spread?</u>

NBC also questions CIBC's judgment in determining that the proper spread was 6.0%, rather than 8.1%. CIBC calculated the spread by looking at the 12 1/2-month trailing average difference between the Stock and CIBC's 14.25% Preferred Stock. NBC contends that this was an improperly long period of comparison because the COD requires that the Reset Rate be calculated as of the "date of determination," i.e. September 15, 2004. CIBC's error is evidenced, NBC claims, by the fact that CIBC chose to use the 90-day trailing average to calculate the rate of return for CIBC's 14.25% Preferred Stock.

CIBC's choice of data sets surely is a matter of judgment, and NBC has not advanced a sufficient reason to upset CIBC's judgment in that regard. In

determining what the proper Reset Rate was as of September 15, 2004, CIBC properly looked at a variety of historical data, as the court would expect any competent investment bank to do. The fact that it based its judgment about the proper spread between the Stock and the 14.25% Preferred Stock on one subset of historical data, as opposed to another that would be more beneficial to NBC, evidences neither bias nor error. NBC accepted CIBC's use of the 90-day trailing average to calculate the rate of return for CIBC's 14.25% Preferred Stock. It cannot now credibly claim that only data from September 15, 2004 can be used in calculating the rate of return. But NBC agreed to have the Reset Rate decided by an independent, nationally recognized investment bank. It is now bound to that decision.[36]

This deference to the decision of the investment bank is entirely consistent with the court's requirement that the Reset Rate be calculated without assuming that any purchaser would receive these dividends. CIBC originally calculated the Reset Rate *without* this assumption, and *recalculated* the Reset Rate at the insistence of Paxson. In fact, CIBC specifically refused to state any opinion as to

[36] Paxson argues that CIBC chose to use the 12 1/2-month trailing average to determine the spread, as opposed to the 90-day trailing average, because the threat of NBC's lawsuit added to the Stock's volatility. Paxson further contends that NBC should not be able to increase the value of its holding by threatening a lawsuit. This evidence for the basis of CIBC's decision is not properly before the court, and the court does not base its decision upon it. However, it does exemplify the myriad of complex considerations that an investment bank must evaluate in valuing a security or determining a security's proper rate of return. It is further proof that such subjective findings should be left to the sound judgment of disinterested experts in valuation, whenever possible.

the propriety of this assumption. This decision was made, therefore, not on the basis of CIBC's professional judgment, but on the basis of Paxson's self-serving misreading of the COD.

For the above reasons, the court concludes that the 28.3% Reset Rate that CIBC calculated is the correct Reset Rate.

E. Is Either Party Entitled To Judgment On The Pleadings With Respect To The Issue Of Whether NBC Can Force Paxson To Redeem The Stock?

Paxson has moved for a declaration that it is not required to redeem the Stock. NBC opposes that motion, and likewise seeks a declaration that Paxson is required to redeem the Stock.

Paragraph (e)(iii) of the COD states: "The [Stock] is subject to redemption at the option of certain Holders in accordance with the terms and conditions set forth in Article XI of the [Agreement]." Article XI, section 9.1 states, in pertinent part:

> . . . [B]eginning with the third anniversary of the Closing and on each anniversary thereafter, then, in each case, [NBC], at its sole option, will have a period of 60 days during which to demand redemption, by payment in cash, of all or any portion of the Shares at a price per share equal to the Original Issue Price plus any accrued and unpaid dividends through and including the date of redemption (the "Par Value Price") . . . (b) [Paxson] or its assignees. . . will have a period of one year (the "Involuntary Redemption Period") from the date of any such demand to consummate the redemption; provided that if at any time during such one-year period, [Paxson's] outstanding debt and preferred stock covenants do not prohibit a redemption and [Paxson]

> has funds on hand to consummate the redemption, then [Paxson] or its assignee shall consummate such redemption at such time . . . .

Paxson argues that the COD and the Agreement do not give NBC the right to force redemption. Instead, Paxson contends that Article IX of the Agreement simply gives NBC the right to *demand* redemption. Under this reading of the Agreement, should Paxson fail to effectuate a redemption within a year of the demand, NBC would gain certain rights. For instance, in the event that Paxson fails to redeem within a year of demand, Section 9.4 of the Agreement gives NBC the right to sell the Stock, free of the transfer restrictions contained in the Agreement. Paxson further argues that the Agreement could not have given NBC an absolute right to redeem, because this would have violated the governing provisions of indentures in other, more senior securities of Paxson.

In opposition, NBC argues that the clear language of the Agreement gives it an absolute right to redeem. It emphasizes that Section 9.1(b) of the Agreement states that Paxson "will have a period of one year . . . from the date of any such [redemption demand by NBC] to consummate the redemption." NBC points out the plain meaning of "consummate" is to "bring to completion or fulfillment" or "finish."[37] NBC also argues that this one-year period is defined as the "Involuntary Redemption Period," and that Paxson's reading of the subsection does not give NBC a right of redemption, but only a right to sell free of restrictions.

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[37] WEBSTER'S NEW WORLD DICTIONARY OF THE AMERICAN LANGUAGE (2d ed. 1979).

It is obvious from a reading of the redemption provisions at issue that the structure and terms of this aspect of the Agreement are highly idiosyncratic. Before reaching any conclusion about the operation or meaning of these unusual provisions, the court believes that it is both necessary and prudent to allow for the development and presentation of a factual record of the parties' negotiations and dealings. Thus, the court declines to enter judgment on this issue.

IV.

For the forgoing reasons, the motions for judgment on the pleadings and summary judgment are denied in part and granted in part. The parties are directed to submit an appropriate for of order within seven days of the date hereof.