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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

JAMES E. HENKE and FIRST OF AMERICA BANK - INDIANA as custodian of JAS. E. HENKE IRA Account No. 56071103,	)	
Petitioner,	)	
v.	)	Civil Action No. 13155
TRILITHIC INCORPORATED,	)	
Respondent.	)	

MEMORANDUM OPINION

Submitted: June 6, 2005
Decided: October 28, 2005

Joseph Grey, Esquire, Thomas G. Whalen, Jr., Esquire, STEVENS & LEE, P.C., Wilmington, Delaware, *Attorneys for Petitioner*

Michael A. Weidinger, Esquire, Linda Martin Gilchrist, Esquire, MORRIS, JAMES, HITCHENS & WILLIAMS LLP, Wilmington, Delaware, *Attorneys for Respondent*

PARSONS, Vice Chancellor.

This is an appraisal action pursuant to 8 *Del. C.* § 262. Petitioner was a stockholder of Trilithic, Inc. ("Trilithic" or the "Company"), a Delaware corporation, until it merged with and into an Indiana corporation of the same name. At trial, both parties presented expert opinions as to the fair value of the shares of Trilithic as of June 1, 1993 (the "Merger Date"). For the reasons set forth below, the Court concludes that the per share fair value of Trilithic as of the Merger Date was $217.02. Petitioner's 750 shares are therefore worth $162,765.54.

I. BACKGROUND

A. The Parties

The Company was founded in 1987 by Bruce Malcolm ("Malcolm") and Robert Binninger ("Binninger"). Malcolm is an engineer and was President of Trilithic from at least 1989 until after the Merger Date.[1] Trilithic was and still is closely held; as of the Merger Date, it had five stockholders.[2]

Petitioner James E. Henke held 25% of the outstanding common stock of Trilithic as of the Merger Date.[3] Henke dissented from the merger and perfected his appraisal right.[4]

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[1] *See* Trial Ex. 9 at T4119.

[2] Trial Ex. 102 at T2578.

[3] *Id.* Petitioner First of America Bank – Indiana is the custodian of an IRA into which Henke transferred his shares of Trilithic stock. For convenience, Petitioners are referred to as "Henke" or "Petitioner."

[4] Joint Pretrial Order ¶ 2.4; *see also* Trial Ex. 102 at T2580.

B. The Company

There is scant evidence in the record concerning Trilithic's business in 1987 and 1988, but in late 1988 Trilithic was presented with the opportunity to purchase the instruments division of Texscan Corp.,[5] a publicly traded company for whom Malcolm had worked in the 1970s.[6] The instruments division of Texscan manufactured testing and measurement instruments and components for the cable television industry.[7] Trilithic, however, could not afford to make the purchase on its own; in 1988, the Company's gross revenue was approximately $100,000[8] and it began 1989 with a deficit of $48,460.[9] Enter Petitioner.

Henke owned JDJ Leasing ("JDJ"), which was in the business of leasing equipment and motor vehicles.[10] In March 1989, JDJ, with additional capital from Henke and James Guttman ("Guttman"), purchased Texscan's instruments division for

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[5] *See generally* Trial Ex. 9 (Letter of Intent from Trilithic to Texscan).

[6] Trial Ex. 32 at 2646.

[7] Trial Ex. 13.

[8] Tr. at 25 (Henke). Citations in this form are to the trial transcript ("Tr.") and indicate the page and, where applicable, the witness testifying.

[9] Trial Ex. 30 at T156. Trilithic's only financing in 1989 was a "factor." Tr. at 330 (Malcolm) (testifying that a factor "is a guy that buys receivables and gives you a discounted amount. The quicker your customers pay, the higher the interest rate.").

[10] Tr. at 6 (Henke).

$700,900.[11] JDJ then leased the Texscan equipment to Trilithic[12] and assigned the Texscan inventory to Henke and Guttman for nominal consideration.[13] Henke and Guttman then sold the inventory to Trilithic for 750 shares of Trilithic common stock each, which represented 50% of the authorized stock.[14] Henke and Guttman were also made directors of Trilithic.[15]

In essence, Trilithic purchased a going concern from Texscan by way of JDJ, Henke and Guttman.[16] The instruments division of Texscan thus became the instruments division of Trilithic. At various times between the acquisition of the instruments division in March 1989 and the Merger Date, Trilithic operated other lines of business, including the manufacturing of electrical components, electronic filters and refrigeration monitors and the design of electrical subsystems and local area network ("LAN") switching devices, but the instruments division remained its primary source of revenue.

C. The Instruments Division and the Cable Television Industry

The instruments division was heavily influenced by the Federal Communication Commission's ("FCC") regulation of the cable television industry. Two regulations are

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[11] Trial Ex. 18 at T3510.

[12] Trial Ex. 17. At the conclusion of the lease, the equipment was simply given to Trilithic. Tr. at 10 (Henke).

[13] Tr. at 8 (Henke).

[14] Trial Exs. 22 & 23.

[15] Tr. at 27 (Henke).

[16] *See, e.g.,* Tr. at 23 (Henke) ("Trilithic took over [Texscan's] plant.").

pertinent to this case: The first, FCC Regulation 76.610 ("Reg. 76.610"), required cable operators to monitor their systems for radio frequency leakage and to compare the data to an industry index.[17] Reg. 76.610 mandated compliance by July 1990. The second, FCC Regulation 76.605 ("Reg. 76.605"), required monitoring and logging of video signal and leakage data.[18] Reg. 76.605 mandated compliance by December 30, 1992.

From Texscan, Trilithic acquired the Searcher+, a product designed to meet demand created by Reg. 76.610.[19] The Searcher+ was a handheld device that measured leakage of RF signals from cable systems.[20] Sales of the Searcher+ peaked in the months leading up to the compliance deadline of July 1990 and fell significantly after the deadline.[21] During this period, Trilithic's revenues increased from approximately $100,000 in 1988 to $5.68 million for the twelve months ended December 30, 1989.[22] For the twelve months ended December 29, 1990, Trilithic turned a profit of $310,448 on revenue of $8.67 million.[23]

To meet demand generated by Reg. 76.605, Trilithic developed a new product called the Tricorder. Although cable operators could have used the Searcher+ and

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17 Tr. at 266-67 (Bush).

18 Tr. at 267 (Bush).

19 Tr. at 265 (Bush); Tr. at 25–26 (Henke).

20 Tr. at 264 (Bush).

21 Trial Ex. 161 at 7, Ex. D.

22 Trial Ex. 30 at T156.

23 Trial Ex. 47 at T145.

another Trilithic product, the SP 1700 signal meter ("SP 1700"), to comply with the new regulation, only the Tricorder could digitally log test results.[24] Trilithic introduced the Tricorder to the cable industry at a summer 1992 tradeshow and began shipping it in October 1992.[25] The Tricorder was an immediate success; by the time it shipped the first unit, Trilithic had an order backlog valued at over $380,000.[26] The sale of the Tricorder, however, cannibalized sales of the SP 1700 and the Searcher+. From January to May 1993, sales of the SP 1700 fell to less than half of their 1992 level for the same period, while sales of the Searcher+ fell over 35% from their 1992 level.[27]

In order to meet demand, Trilithic rushed the production of Tricorders and used volunteers from its sales force and board of directors to build and test Tricorders because it could not afford to pay hourly workers.[28] Partially as a result of using volunteer labor, a high percentage of Tricorders came off of the assembly line with defects, while a similarly high percentage were returned for repair.[29]

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[24] Tr. at 279 (Bush).

[25] Tr. at 331 (Malcolm); Trial Ex. 161 at 10.

[26] Trial Ex. 161 at 10.

[27] *Id.* at 11.

[28] Tr. at 333 (Malcolm); Tr. at 417 (Woodcock). Trilithic had a net loss of $631,929 for the year ended December 28, 1991, Trial Ex. 107 at T122, and was "managing cash on a weekly basis" in late 1992, Tr. at 333 (Malcolm). *See infra* at I.E. Trilithic's Financial Difficulties.

[29] *See, e.g.,* Trial Ex. 101 (showing 37 defective Tricorders out of the 107 manufactured from May 10 to May 14, 1993); Tr. at 273–74 (Bush) (testifying to initial Tricorder repair rate of approximately 20%).

Owing in large part to sales of the Tricorder, Trilithic had gross revenue of $7.5 million for 1992 and a net loss of just $5,635.[30] For the period ended May 2, 1993, Trilithic had sales of $3.66 million and net income of $314,459.[31]

D. Trilithic's Other Lines of Business

In 1990, Trilithic's sales of electrical components increased 22%, but fell 19.2% in 1991 and 13.7% in 1992.[32] In 1992, sales of electrical components accounted for 17.3% of Trilithic's total revenues. Similarly, sales of electrical filters increased considerably in 1990, the first full year after the acquisition of Texscan's instrument division. Sales of electrical filters continued to grow through 1993, but some of this growth is likely attributable to the acquisition of Cir-Q-Tel in April 1992.[33] In 1992, sales of electrical filters accounted for 18.4% of Trilithic's total revenues. None of these two lines of Trilithic's business, the manufacture of refrigeration monitors or the development of LAN switches, addressed below, pertained to the cable television industry.

In January 1992, Trilithic and Eagle Creek Technology Corp. ("Eagle Creek") entered into an agreement to design, manufacture and sell infrared gas monitors for the refrigeration market.[34] In 1992, Trilithic sold just 42 such monitors for $93,000; it sold

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30 Trial Ex. 107 at T122. In 1992, the instruments division provided 60% of Trilithic's gross revenue. Trial Ex. 161 at 3.

31 Trial Ex. 108 at T108.

32 Trial Ex. 161 at Ex. G.

33 Trial Ex. 161 at 14; *see also* Tr. at 296 (Bush) (testifying that in acquiring Cir-Q-Tel, Trilithic had acquired a going concern).

34 Trial Ex. 161 at 4.

none in the first five months of 1993.[35] On July 20, 1993, Trilithic sold the refrigerator monitor business to Eagle Creek for $537,000.[36]

Trilithic's last line of business was the development and sale of LAN switches. In the late 1980s and early 1990s, Trilithic developed LAN switches based on RF technology.[37] In the early 1990s, however, the industry moved to fiber optics and stopped using RF technology.[38] As of the Merger Date, Trilithic had no LAN switch sales.[39]

E. Trilithic's Financial Difficulties

From March 1989 until the Merger Date, Trilithic experienced severe financial difficulties. In 1989, it maintained a $750,000 line of credit with First of America Bank and had drawn $658,000.[40] Although the line of credit was issued to Trilithic, Malcolm, Binninger and Terry Bush ("Bush")[41] had to personally guarantee repayment because Trilithic could not borrow on its own credit.[42] By May 1992, Trilithic had extended the line to $1 million and drawn the full amount. The next month, First of America Bank

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35 Tr. at 451 (Margolin).

36 Trial Ex. 112 at T4502.

37 Tr. at 249 (Bush).

38 Tr. at 250 (Bush).

39 Tr. at 253 (Bush); Trial Ex. 161 at 5.

40 Trial Ex. 161 at 14.

41 As of the Merger Date, Bush was Trilithic's Vice President of Sales and Marketing. Tr. at 271 (Bush).

42 Tr. at 330 (Malcolm).

informed Trilithic that it wanted the line of credit replaced and that it would give Trilithic until the end of June to find alternative financing.[43] Sometime after the Merger Date, First of America Bank extended the line of credit to September 1993 even though Trilithic was not in compliance with various covenants governing it.[44] Trilithic remained in violation of the covenants and had not replaced the line of credit or paid it down as of the Merger Date.

Trilithic was also in breach of covenants on a loan from the Indiana Business Modernization and Technology Corporation ("BMT"). Trilithic obtained $381,200 from the BMT in May 1990 to develop its LAN switching device and was obligated to repay double what it had borrowed. Repayment was tied to revenue from LAN sales, of which Trilithic had none. As of the Merger Date, Trilithic had not made any payments on the loan.[45]

Indicative of Trilithic's dire financial position, its CFO, Jeri Woodcock ("Woodcock"), went to great lengths to ensure that Trilithic could pay its bills. In the months preceding the Merger Date, Woodcock prepared weekly cash flow charts to prevent Trilithic from overdrawing its accounts.[46] She also depended on bank float time

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43 Trial Ex. 73 at T2567.

44 Trial Ex. 107 at T126.

45 Trial Ex. 108 at T115.

46 Tr. at 405 (Woodcock); Trial Ex. 92.

to ensure that Trilithic had sufficient funds to pay its bills and assigned priority numbers to vendors to determine in what order to pay them.[47]

In its audited financials for the four months ended May 2, 1993, Trilithic's independent auditor, Deloitte & Touche, would not issue an unqualified opinion that Trilithic was a going concern.[48]

F. The Merger

By an Agreement of Merger dated April 28, 2003, Trilithic merged with and into an Indiana corporation of the same name.[49] The boards of both companies subsequently approved the merger and the Certificate of Merger was filed with the Delaware Secretary of State on June 1, 1993.

The Company contended that the purpose of the merger was to facilitate raising capital and to obtain more favorable tax treatment.[50] Regardless of the reason(s) for the merger, neither Trilithic's management nor its business plan changed as a result of the merger. The shareholders of the Delaware corporation received stock in the new Indiana

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47 Tr. at 407–08 (Woodcock).

48 Trial Ex. 108 at T105 ("The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. . . . [T]he Company's $1,000,000 line-of-credit facility expires on September 2, 1993 and the Company has yet to obtain replacement financing. The Company's continuation as a going concern is dependent upon its ability to obtain additional financing and to generate sufficient cash flows to meet its obligations on a timely basis.").

49 Trial Ex. 94.

50 Resp't's Post-Trial Answering Br. ("RAB") at 2, 5.

corporation and no cash changed hands.[51] Henke communicated his intent to dissent from the merger in a letter dated May 12, 1993[52] and voted against the merger at a May 21, 1993 meeting of the Trilithic board.[53] He filed this action on September 28, 1993.

II. APPRAISAL

Under 8 *Del. C.* § 262, Petitioner is entitled to his pro rata share of the "fair value" of Trilithic's common stock as of the Merger Date.[54] In the context of an appraisal, fair value is defined as the stockholder's "proportionate interest in [a] going concern."[55] "The underlying assumption in an appraisal valuation is that the dissenting shareholder[] would be willing to maintain [his] investment position had the merger not occurred."[56]

In an appraisal, both sides have the burden of proving their respective valuations by a preponderance of the evidence.[57] Any "techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court" may

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51 Trial Ex. 94 at T5251.

52 Trial Ex. 97.

53 Trial Ex. 102 at T2580.

54 *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at *6 (Del. Ch. Apr. 25, 2002).

55 *Cavalier Oil Corp. v. Harnett*, 564 A.2d 1137, 1144 (Del. 1989) (quoting *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950)).

56 *Pakill Corp. v. Alcoma Corp.*, 747 A.2d 549, 553 (Del. 2000) (citing *Cavalier Oil Corp.*, 564 A.2d at 1145).

57 *M.G. Bancorp., Inc. v. LeBeau*, 737 A.2d 513, 520 (Del. 1999).

be used.[58] If neither party satisfies its burden, then the court must use its own independent judgment to determine the fair value of Petitioner's shares.[59]

A. The Parties' Experts

Petitioner's expert was R. Victor Haas ("Haas"), an Accredited Senior Appraiser and President of Haas Business Valuation Services, Inc. Before founding his eponymous company, Haas received an MBA from the Wharton School at the University of Pennsylvania. Haas performed a discounted cash flow ("DCF") analysis based on Trilithic's audited financials for the four months ended May 2, 1993 and arrived at an equity value of $6,494,526.[60] Haas therefore appraised Petitioner's 25% interest to be worth $1,623,631.50.

Trilithic's expert was Brett A. Margolin ("Margolin"), a Managing Economist at LECG, Inc. He received a Ph.D. in economics from George Mason University. Margolin first performed a DCF analysis. He neither believed that reliable management projections made contemporaneously with the merger existed nor did he consider it appropriate to use the 1993 stub period financials in his DCF analysis. Margolin thus developed and used his own financial projections for Trilithic. Ultimately, he arrived at a negative value for the Company's common equity. Second, Margolin performed a comparable company analysis, but he did not assign a weight to the result of this method

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58 *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

59 *See Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 361 (Del. 1997) (noting this Court's responsibility to "*independently* determine the value of the shares that are the subject of the appraisal action") (emphasis added).

60 Trial Ex. 152 at 7–8.

in his final conclusion because he did not believe that he could compensate for the differences in size between Trilithic and the comparable companies in a nonsubjective manner.[61] Finally, Margolin used a subject company transaction analysis based on Trilithic's purchase of Texscan's instruments division. This analysis yielded an equity value of between $0 and $292,312.[62] To this number, Margolin added $152,537, the value of the tangible refrigeration monitor assets sold to Eagle Creek, and concluded that the common equity of Trilithic was worth between $0 and $448,849.[63] Taking the midpoint of this range—$222,425—Margolin concluded that Petitioner's 25% interest is worth $55,606.

B. The Experts' Valuation Methodologies

The parties' experts have presented remarkably divergent valuations. As is often the case in an appraisal action, the Court does not find either party to have fully satisfied its burden of persuasion regarding its valuation. The Court therefore must conduct its own independent valuation.[64]

Haas relied on a DCF analysis to perform his valuation. Although Margolin did not rely on his DCF analysis, both experts agree on the basic methodology.[65] A DCF

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61 Trial Ex. 161 at 34.

62 Trial Ex. 161 Ex. L.

63 Trial Ex. 161 at 43.

64 *See, e.g., Taylor v. Am. Specialty Retailing Group*, 2003 WL 21753752, at *2 (Del. Ch. July 25, 2003); *Doft v. Travelocity.com, Inc.*, 2004 WL 1152338, at *4 (Del. Ch. May 20, 2004).

65 *Compare* Trial Ex. 152 at 37 *with* Trial Ex. 161 at 6.

analysis involves (1) projecting operating cash flows out to a valuation horizon, (2) determining a terminal value which represents the business's value at the horizon, and (3) discounting all cash flows to their present value.[66] A DCF analysis "is an exercise in appraising the present value at a set date of the expected future cash flows earned by the company."[67] "This method is widely accepted in the financial community and has frequently been relied upon by this Court in appraisal actions."[68]

There are several problems with Haas's DCF that render it unacceptable to the Court. First, Haas's use of a 10% rate of annual revenue growth for all of the Company's lines of business is not a reasonable projection supported by the record. The 10% rate is "substantially based upon the rate of growth in cable TV and attendant regulation,"[69] yet only the instruments division manufactured products for the cable television industry. Further, the maturation of the cable television industry in the early 1990s,[70] and the impossibility of predicting future government regulation of that industry, made a 10% rate of growth highly unlikely even for the instruments division. Another flaw in the Haas valuation is the method used to project Trilithic's revenue for the remainder of

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[66] *See* Richard A. Brealey & Stewart C. Myers, *Principles of Corporate Finance* 80 (6th ed. 2000); *Doft*, 2004 WL 1152338, at *5.

[67] *Doft*, 2004 WL 1152338, at *5.

[68] *Gholl v. eMachines, Inc.*, 2004 WL 2847865, at *5 (Del. Ch. Nov. 24, 2004) (internal citations omitted).

[69] Trial Ex. 152 at 37.

[70] *See* Trial Ex. 79 at 109 (reporting reduction in growth rate of cable subscriptions and homes passed).

calendar year 1993: Haas simply multiplied the revenue from the first four months by three.[71] Such a method ignores the seasonality of Trilithic's sales[72] and simply assumes that the Tricorder would continue to sell at its introductory rate.

Although Margolin did not rely on his DCF analysis, the Court finds it methodologically sound and will use it as a starting point for its own DCF analysis, modifying it as appropriate.[73] Petitioners attack Margolin's DCF analysis because of its failure to acknowledge projections of Trilithic's annual revenue made on June 2, 1993 for purposes of negotiating a payment schedule for the BMT loan (the "BMT Projections").[74] This Court has held that "[c]ontemporary pre-merger management projections are particularly useful in the appraisal context because management projections, by definition, are not tainted by post-merger hindsight and are usually created by an impartial body."[75] The usefulness of the BMT Projections, however, is limited by their

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71 Trial Ex. 152 at 37.

72 *See* Trial Ex. 161 Ex. P.

73 *See Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *9 (Del. Ch. Aug. 19, 2005) ("In making the fair value determination, the court may look to the opinions advanced by the parties' experts, select one party's expert opinion as a framework, fashion its own framework or adopt, piecemeal, some portion of an expert's model methodology or mathematical calculations.") (internal citations omitted).

74 Pet'r's Opening Post-Trial Br. ("POB") at 23. The projections are contained in Trial Ex. 124 at T4320.

75 *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *7 (Del. Ch. Dec. 31, 2003).

lack of detail and their provenance. The projections are simply for "annual sales."[76] As such, there is no way of knowing what went into the numbers or, for example, to what lines of business the sales are attributable and what profit margins were assumed for those lines of business. There is neither evidence that management used these projections to run the Company[77] nor evidence concerning their creation.[78] In fact, Bush, who did "all of the forecasting for instrumentation," testified that he was not involved in the creation of the BMT Projections.[79]

Although these projections lack the indicia of reliability that normally lead this Court to find contemporaneous management projections "particularly useful,"[80] the Court is wary of disregarding them in their entirety. The BMT Projections were presented to a state government agency; presumably, Trilithic did not present false or misleading information to such an agency.[81] Further, the annual sales numbers in the BMT

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[76] Trial Ex. 124 at T4320.

[77] *See* Tr. at 388 (Malcolm) ("the annual sales are speculative . . . really done to create a payment schedule."); *cf. Gholl*, 2004 WL 2847865, at *7-10 (using management projections that the Court found management used to run the company).

[78] *See* Tr. at 440–41 (Woodcock) (testifying only that she prepared these projections with no accompanying detail).

[79] Tr. at 286–87 (Bush).

[80] *Cf. In re U.S. Cellular Operating Co.*, 2005 WL 43994, at *12 n.65 (Del. Ch. Jan. 6, 2005) (collecting cases where this Court found projections were made in the ordinary course of business and used them in its valuation).

[81] *Cf.* Ind. Code Ann. § 23-1-18-10 (2005) (criminalizing signing of a document known to be false in any material respect if document is to be delivered to Secretary of State for filing).

Projections provided the basis for determining Trilithic's proposed future payments. Trilithic had an incentive to understate, not overstate, these numbers. Under the terms of the amendment, however, if Trilithic paid half of the proposed payment each month, then the BMT could not take it into default.[82] The annual sales numbers with real consequence for Trilithic are thus one-half of the BMT Projections. Trilithic thus projected that it could achieve annual sales for the year ending 1994 of between $5.25 million and $10.5 million; for the year ending 1995 of between $6.48 million and $12.96 million; for the year ending 1996 of between $7.78 million and $15.55 million; and for the year ending 1997 of between $9.33 million and $18.66 million. Assuming that the BMT Projections are reliable contemporaneous management projections, the annual sales projections the Court has used in its DCF analysis fall comfortably within the effective range implied by the BMT Projections.[83]

Ultimately, Margolin relied on his subject company transaction analysis to value Trilithic as of the Merger Date. In that analysis, Margolin used the price JDJ paid for the

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[82] *See* Trial Ex. 124 at T4315 ("in no event shall [Trilithic's] monthly payments to BMT after the date of this First Amendment be less than one-half (1/2) of the proposed monthly payment for that month set forth on Schedule F").

[83] The Court further observes that the BMT Projections assumed annual revenue growth of approximately 20% from calendar year 1994 to 1995, 1995 to 1996, and 1996 to 1997. Given the state of Trilithic's business as of the Merger Date, the predicted rate of growth in the cable television industry and the historic rates of growth for Trilithic's other lines of business, the Court finds such optimism unwarranted. Accordingly the Court's projections assume a lower rate of growth, but a rate that results in annual sales within the range of projections implied by the BMT Projections.

Texscan instruments division to derive various multiples with which to value Trilithic.[84] Margolin then used the only multiple that generated a positive number, the earnings before general and administrative expenses multiple, to conclude that the value of Trilithic's common equity was, assuming recurring Tricorder sales of 45% of introductory levels, negative $55,702, and, assuming recurring Tricorder sales of 73%, $292,312.[85]

The Court finds Margolin's use of a single transaction that occurred four years before the valuation date unreasonable.[86] Trilithic was a different company in 1993 than it was in 1989. It had developed new products and new lines of business. Further, the Texscan instruments division only became the Trilithic instruments line of business, not 100% of Trilithic, a fact not addressed by Margolin. The Court therefore will afford no weight to a subject company transaction analysis.

C. The Court's DCF Analysis

Before commencing its DCF analysis, the Court recognizes that

> [V]aluation decisions are impossible to make with anything approaching complete confidence. . . . This effort should . . . not be understood, as a matter of intellectual honesty, as resulting in the fair value of a corporation on a given date. . . . [A corporation's] value is not a point on a line, but a range of

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84 Trial Ex. 161 at 30 & Ex. L (deriving a revenue multiple of 0.16, a gross profit multiple of 0.46 and an earnings before general and administrative expenses multiple of 1.80).

85 Trial Ex. 161 at 31 & Ex. L.

86 *See Andaloro*, 2005 WL 2045640, at *16 (finding a subject company transaction analysis based on a single transaction that occurred four years before the merger date unreasonable).

> reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value . . . based on the considerations of fairness.[87]

In performing its task, the Court must consider "all relevant factors" involving the value of the Company.[88] All facts that "were known or which could be ascertained as of the date of the merger" are to be considered.[89] To value Trilithic, the Court must determine: (1) the rate of revenue growth; (2) the appropriate tax rate; (3) the discount rate; (4) the rate of change in working capital; (5) the rate of growth during the terminal period; (6) the value of Trilithic's debt; and (7) the value of the assets sold to Eagle Creek in July 1993. Both Haas and Margolin used five-year valuation horizons and so, too, will the Court.

1. Revenue growth

In the absence of detailed management projections, the Court must first project the Company's revenue. Because Trilithic had multiple lines of business selling products to consumers in various industries, the Court must make these determinations for each line of business.

As of the Merger Date, the instruments division of Trilithic sold the SP 1700, the Searcher+ and the Tricorder to cable television operators. In projecting Tricorder sales, Trilithic's experience with the Searcher+ is instructive because Trilithic created both

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87 *Prescott Group Small Cap, L.P. v. Coleman Co.*, 2004 WL 2059515, at *31 (Del. Ch. Sept. 8, 2004) (quoting *Cede & Co.*, 2003 WL 23700218, at *2).

88 8 *Del. C.* § 262(h).

89 *Tri-Continental Corp.*, 74 A.2d at 72.

products to assist cable operators in achieving compliance with FCC regulations. The Searcher+ enjoyed strong sales leading up to the compliance deadline for Reg. 76.610, but sales fell in the two years following the compliance deadline to an average of 45% of introductory levels. The transition from regulatory driven demand to market driven demand explains this decline in sales.

Circumstances unique to the Tricorder's introduction made such a drastic decline in sales unlikely as of the Merger Date. First, as of that date, the Tricorder was the only product on the market that combined all of the functions necessary to comply with Reg. 76.605 in one device. Second, Trilithic began shipping the Searcher+ long before the compliance deadline, whereas it began shipping the Tricorder in volume only six months before the compliance deadline. A number of cable television operators thus had not yet purchased Tricorders at the conclusion of the introductory sales period. Cable operators would continue to purchase Tricorders as they updated equipment or sought an easier way to comply with Reg. 76.605.[90] Third, purchase of the Tricorder was not necessary to comply with Reg. 76.605.[91] Thus, in comparison to the Searcher+, cable operators had fewer incentives to purchase the Tricorder immediately. Cable operators purchased the Searcher+ because they needed it to comply with Reg. 76.610. The Tricorder was thus unlikely to experience as drastic a transition from regulatory to market driven demand as the Searcher+.

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[90] *See* Tr. at 270 (Bush) (testifying that the 1990 regulation had a greater impact on Trilithic's sales).

[91] Tr. at 279 (Bush).

Given the differences between the Searcher+ and the Tricorder, the Court concludes that Tricorder sales were likely to recur at the midpoint of Margolin's projections, i.e., at 73% of introductory sales. Conversely, the Court concludes that Searcher+ sales would have continued at approximately 75% of their pre-June 1992 level, a blend of the rates experienced after the introduction of the Tricorder.[92] The Court also assumes that sales of the SP 1700 would have virtually disappeared. From January to May 1993, sales of the SP 1700 fell by half and Trilithic intended to phase out this previous generation signal level monitor.[93]

As of the Merger Date, Trilithic had no other products in development.[94] Trilithic also had little staff or capital with which to develop new products.[95] As such, significant increases in revenue from the introduction of new products in the years immediately

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[92] Trial Ex. 161 at 21. From June 1992 – the month Trilithic introduced the Tricorder – through May 1993, Trilithic sold 1635 Searcher+ units, whereas it sold 1940 units from June 1991 through May 1992, a decline of 15.7%. From October 1992 – the month Trilithic began shipping the Tricorder – through May 1993, Trilithic sold 1139 Searcher+ units, whereas it sold 1432 units from October 1991 through May 1992, a decline of 20.5%. Finally, Trilithic sold 642 Searcher+ units from January through May 1993, whereas it sold 991 from January through May 1992, a decline of 35.2%. *See* Trial Ex. 161 Ex. D.

[93] Tr. at 301 (Bush) (testifying that Trilithic stopped producing the SP 1700 when it began producing the Tricorder in volume); Trial Ex. 161 at 21.

[94] Trial Ex. 76 at T2569 (minutes of Trilithic's board of directors meeting on December 7, 1992 noting that "[t]he Instrument Engineering Department does not have a clearly defined project to undertake upon completion of the Tricorder project."); Tr. at 303 (Bush).

[95] *See* Tr. at 361 (Malcolm) (testifying that "[Trilithic] didn't have any spare engineering dollars.").

following the Merger Date were unlikely as of the Merger Date. Growth for the instruments division thus depended on growth in the cable television industry.

There are two measures of growth in the cable television industry: homes passed, i.e., the number of homes with access to cable by virtue of wires being laid near the home, and subscriptions. The growth of both had slowed in the years leading up to the Merger Date and a low growth rate was expected to continue.[96] Demand for the Tricorder was driven primarily by the number of homes passed because it was used to test infrastructure.[97] Trilithic hoped, however, that cable operators would begin to use the device in subscribers' homes to test signal strength.[98] The Court therefore finds that a reasonable projection of growth in demand for Trilithic's instruments must correlate with the expected rate of growth in both homes passed and subscribers. A blending of the projected growth rates for homes passed and subscribers results in a predicted rate of growth of approximately 2% per year through 1998.[99]

Assuming recurring Tricorder sales at 73% of introductory levels, approximately 2% growth in instruments sales beyond 1993 and average instruments division product price increases of 3% per year yields revenues from the entire instruments line for the twelve months ending May 31 for each year from 1994 through 1998 as follows:

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96 *See generally* Trial Ex. 79.

97 Tr. at 258–60 (Bush).

98 Trial Ex. 161 at 24.

99 *See* Trial Ex. 79; Trial Ex. 161 at Ex. I.

Year	Revenue (in millions)
1994	$6.07
1995	$6.40
1996	$6.73
1997	$7.06
1998	$7.39

To these totals, the Court must add the revenue from Trilithic's other lines of business.

There is no evidence in the record that suggests that the historical growth or contraction of Trilithic's other lines of business would not continue into the future. As of the Merger Date, Trilithic had no LAN sales and no LAN product in development; thus, the Court assumes no revenue from this line of business. Similarly, Trilithic did not sell any refrigeration monitors in the first four months of 1993 and there is no evidence that management expected to sell any in the remaining months of 1993. The Court thus assumes zero revenue from this line of business. Assuming the historical rates of growth or contraction would continue for Trilithic's remaining lines of business, the Court finds that electronic filters and electrical subsystems would have grown at rates of 6.8% and 5%, respectively, and that sales of electronal components would have continued to decline at an annual rate of 4.5%.

Adding revenues from these lines of business to those of the instruments line, the Court projects total revenues for Trilithic for the twelve months ending May 31 for each year from 1994 through 1998 as follows:

Year	Revenue (in millions)
1994	$9.26
1995	$9.67
1996	$10.03

1997	$10.53
1998	$10.98

In order to project EBIT, the Court must project the gross profit margins for Trilithic's various lines of business. Based on the absence of contrary evidence, the Court assumes that Trilithic would have continued to achieve historical profit margins for all of its products and lines of business with the exception of the Tricorder.

From October 1992 through February 1993, Trilithic directors and employees worked a significant number of hours without pay to produce the Tricorder.[100] The Tricorder's gross profit margin of 44.2% for these first five months of production was thus unsustainable going forward. In fact, in April 1993—after Trilithic stopped using volunteers to produce the Tricorder—the margin dropped to 32.3%.[101]

A year or two after Trilithic stopped using volunteers, Woodcock prepared a chart that listed the number of hours volunteered and calculated the savings to Trilithic.[102] Petitioner argued for exclusion of this document on the ground that it is not a contemporaneous record, but that objection goes more to the weight of the evidence than its admissibility. The record shows that Woodcock prepared the chart based on her

100 Trial Ex. 77 at T5209 (minutes of a Trilithic board meeting noting that "Tricorders are shipping, but only due to the extraordinary efforts of the salaried employees working in the evenings."); Tr. at 333 (Malcolm), 417 (Woodcock).

101 Trial Ex. 161 at 12.

102 *See* Trial Ex. 84 (showing 10,100 volunteer hours); *see also* Tr. at 437–38 (Woodcock) (testifying that she prepared the chart in 1994 or 1995).

personal knowledge.[103] Therefore, it will be admitted. The Court will discount the number of hours listed on the document by 25%, however, because it was not contemporaneously prepared, Woodcock had an obvious bias at the time she prepared it and the numbers themselves (an average of 3.9 hours of volunteer time per working day) appear to be inflated.[104] Adding the cost of these adjusted hours to the Tricorder's cost of sales for the pre-merger periods yields a gross profit margin for the Tricorder of 35.1%. Although this margin is slightly higher than the 32.2% margin Trilithic realized in April 1993, the Court assumes that over time Trilithic would have both achieved some efficiencies in production and reduced the number of Tricorders returned for repair, thereby realizing an increase in its gross margins. Accordingly, the Court will use a 35.1% Tricorder margin for purposes of its DCF analysis.

The Court projects EBIT for Trilithic for the twelve months ending May 31 for each year from 1994 through 1998 as follows:

Year	**EBIT**
1994	$601,270
1995	$663,530
1996	$725,322
1997	$784,942
1998	$843,410

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[103] DRE 602. *See* Tr. at 437–38 (Woodcock) (testifying that she "was on the bench with [the volunteers]" and confirmed the numbers with the various individuals).

[104] If the Court accepts the total number of hours volunteered shown on the document, each Trilithic volunteer must have worked 19.2 hours per week *in addition* to their regular hours for 21 straight weeks. Assuming 75% of the hours shown were actually volunteered, each volunteer would have worked an extra 14.4 hours per week.

2. Tax rate

Trilithic's financial statements for the four months ended May 2, 1993, show a federal tax rate of 34%.[105] To this rate, Margolin added 6% for state and local taxes and used a marginal tax rate of 40% in his DCF analysis.[106] In contrast and without explanation, Haas used a tax rate of 30%.[107] Because of the transitory nature of tax deductions and credits and the requirement that firms eventually pay their deferred taxes, the Court considers it more reasonable to use a marginal tax rate of 40% for Trilithic in its DCF analysis.[108]

3. Discount rate

Both Haas and Margolin assumed capital structures consisting of 100% equity for Trilithic.[109] The Court finds this assumption reasonable given that First of America Bank had requested replacement of its line of credit and Trilithic (1) could not find alternative financing to replace the line, (2) was in breach of covenants related to both the line of

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105 Trial Ex. 108 at T112.

106 Trial Ex. 161 at 25.

107 Trial Ex. 152 at 39. For the four months ended May 2, 1993, the Company paid taxes at an effective rate of 30% because of the availability of certain adjustments. Trial Ex. 108 at T112.

108 *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *10 (Del. Ch. Feb. 10, 2004) (finding tax rate published in annual report most reliable source of tax rate).

109 Margolin made his assumption explicit. Trial Ex. 161 at 27. Although Haas did not, he used a discount rate based entirely on his determination of the cost of equity. *See* Trial Ex. 152 at 40–42. Henke adopted the 100% equity assumption in post-trial briefing. POB at 17.

credit and the BMT loan, (3) had not made any payments on the BMT loan and (4) could not borrow in its own name.

Both Haas and Margolin used the build-up method to determine Trilithic's cost of equity capital.[110] Haas concluded that Trilithic's cost of equity was 26%, while Margolin concluded that it was at least 22.6%. Haas used an 8% company specific premium to account for risk factors specific to Trilithic, such as its credit worthiness and performance history.[111] In contrast, while Margolin concluded that it was appropriate to add a company specific premium to the discount rate,[112] he declined to calculate that number given the subjective nature of doing so.[113] The Court agrees that an upward adjustment is appropriate and will use a 24% cost of equity, which is comfortably within the range of discount rates used by Margolin.

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[110] The build-up method begins with the risk free rate as a base. Additional rates representing the security's unique risks are then added to the risk-free base. Shannon P. Pratt, *The Lawyer's Business Valuation Handbook* 122 (2000).

[111] Trial Ex. 152 at 42. Haas's use of an 8% company specific premium is confusing given his identification of nine positive company specific factors and just two negative factors. Haas testified, and Petitioner argued in briefing, that he used such a high number to account for the imprecision of his revenue projections. Tr. at 133–34; POB at 16. Haas provided no explanation of why an 8% rate, as opposed to 6 or 10%, was appropriate. Therefore, the Court gives little credence to Haas's discount rate.

[112] Trial Ex. 161 at 28. Margolin thus performed a DCF analysis using rates ranging from 22.6% to 26.6%. *Id.* at 28, Ex. K.

[113] Tr. at 499 (Margolin).

4. Working capital

Having reviewed the parties' experts' supplemental submissions, along with their original reports and trial testimony, the Court finds that Trilithic had average working capital needs of 23.3% of gross revenue for the fiscal years 1989 to 1992. In 1990, 1991 and 1992, Trilithic's working capital was 21.7% of gross revenue. The Court also credits Margolin's determination that Trilithic's working capital needs would increase by 19.6% of any increase in gross revenues.[114] In his calculations, Margolin assumed a 71% cost-of-goods-sold-to-sales ratio, which is consistent with the Court's projections, and assumed Trilithic would continue to improve its inventory management. Therefore, the Court will assume an increase in working capital needs of 19.6% of Trilithic's projected increases in gross revenues for purposes of its DCF analysis.

5. Terminal value

Both Haas and Margolin used the growth in perpetuity model to compute terminal value. This Court has previously accepted use of this model.[115] Both experts used their previously determined discount rate, but differed in their selection of a growth rate. Haas assumed 6% growth in perpetuity, while Margolin calculated the terminal value using rates ranging from two to four percent. The Court will assume continued growth of 5%

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[114] The Court does not find Haas's subjective assumption that Trilithic would have working capital needs of 10% credible. The 10% figure is at least 20% higher than Haas's calculations of Trilithic's historic working capital needs. Further, no attempt is made to use standard formulas to calculate working capital needs.

[115] *See, e.g., Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2004 WL 1752847, at *31 (Del. Ch. July 30, 2004) (applying a 5% growth rate in perpetuity).

into the terminal period. Assuming an inflation rate of 2–3%,[116] 5% growth implies 200 to 300 basis points of real growth in the cable television industry. This rate of growth is consistent with the forecasts relied on by both experts.[117]

Performing a DCF analysis using these parameters, the Court arrives at a debt-free value of Trilithic's common equity of $1,858,134.07.

6. Value of debt

The Court must now make adjustments to the value of common equity to account for Trilithic's debt.[118] As of the Merger Date, there were five components to Trilithic's debt: the line of credit from First of America Bank, the loan from the BMT, lease payments, assorted notes payable and cash overdrafts.

As of the Merger Date, First Bank of America had requested that its $1 million line of credit be replaced. In *In re Vision Hardware Group, Inc.*, Chancellor Allen concluded that

> [W]here the company is not financially able to refinance its debt (and thus itself realize some value from the spread between the market value of its debt and the face amount of the legal liability), is insolvent and on the verge of bankruptcy, the appraisal value of its stock, insofar as

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116 Tr. at 508 (Margolin).

117 *See* Trial Ex. 79; Resp't's Opening Post-Trial Br. ("ROB"), Ex. C (pages of forecast relied on by Petitioner's expert).

118 *See Kleinwort Benson, Ltd. v. Silgan Corp.*, 1995 WL 376911, at *9 (Del. Ch. June 15, 1995) (arriving at a debt free present value of company being valued and subtracting value of debt).

> affected by its debts, is determined by reference to the amount of its legal liability to pay its debt.[119]

Although Trilithic was neither insolvent nor on the verge of bankruptcy as of the Merger Date, it could not refinance the line of credit and thus could not take advantage of the spread between its face value and its market value. The line of credit essentially had been called; First of America Bank had the right to demand immediate repayment or to take the company into default. The principle expounded by Chancellor Allen is thus applicable here: since Trilithic could not take advantage of the difference between the face value and market value of its line of credit because $1 million was immediately due as of the Merger Date, the line must be subtracted from the value of the common equity at its full face value.

In contrast, the BMT loan should not be subtracted from the total enterprise value at face value.[120] Although Trilithic was in violation of certain covenants, BMT had not demanded repayment and, in fact, did not have the right to demand immediate repayment.[121] As of the Merger Date, Trilithic and BMT had not agreed on a new payment schedule. Consequently, the Court must assume that Trilithic was going to repay the loan per its terms, i.e., payments of 3% of gross revenues beginning in 1996

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[119] 609 A.2d 671, 672 (Del. Ch. 1995).

[120] *See Andaloro*, 2005 WL 2045640, at *14 (discounting stream of loan payments at discount rate used for company making payments).

[121] *See* Trial Ex. 32.

until twice the amount borrowed was repaid.[122] Using the revenues projected by the Court and discounting these payments back at the same discount rate used for the Company yields a present value of the payments of $309,340.92.[123]

Trilithic's audited financials for the four months ended May 2, 1993 show total lease payments and payments on notes of $218,941, discounted to their present value. Finally, Trilithic had a cash overdraft of $31,327 as of May 2, 1993. Deducting these four amounts from the total value of Trilithic's equity yields an enterprise value of $298,525.07.

7. Value of assets sold to Eagle Creek

The final adjustment to the value of the common equity is for the refrigeration monitor assets sold to Eagle Creek in July 1993. Trilithic had no sales of refrigeration monitors in the first four months of 1993 and the Court did not include any revenue from

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122 Trial Ex. 32 at T2589. Although Trilithic's audited financial statements for the four months ending May 2, 1993 report accrued interest of $130,570 on the BMT loan, Trial Ex. 108 at T115, the Court has not included the interest in its calculation of payments because the loan document does not provide for the accrual or payment of interest.

123 The formula for present value is as follows: Present Value = Future Value / ((1 + discount rate) ^ periods to present). The calculation is as follows: ((calendar year 1996 gross revenue * 3%) / ((1 + discount rate of 24%) ^ (years from June 1, 1993))) + ((calendar year 1997 gross revenue * 3%) / ((1 + discount rate of 24%) ^ (years from June 1, 1993))) + (remaining amount owed on loan / ((1 + discount rate of 24%) ^ (years from June 1, 1993))); in numerical form: (($10,442,877.03 * 0.03) / (1.24^3.5)) + (($10,975,93618 * 0.03) / (1.24^4.5)) + ($119,835.60 / (1.24^5.5)) = $309,340.92.

this line of business in its DCF analysis. As such, the assets are nonoperating and their value should be added to the total enterprise value of Trilithic.[124]

Although the sale was completed after the Merger Date, nothing changed with regard to the assets between the Merger Date and the sale on July 20, 1993. It is thus not relevant whether the prospect of a sale was known or knowable as of the Merger Date because the sale is being used only as a method of valuation. If there had been no sale, then the Court independently would have had to value the nonoperating assets.[125]

The Asset Purchase Agreement with Eagle Creek establishes a total purchase price of $383,880.09, "which together with other payments by Purchaser of outstanding obligations to [Trilithic] aggregate" to $537,000.[126] The "outstanding obligations" owed by Eagle Creek to Trilithic had no bearing on the value of the assets sold. The sale of technical engineering assistance to Eagle Creek also has no bearing on the value of the refrigeration monitor assets sold.[127] The Court thus concludes that the value of the assets

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124 *See Gonsalves v. Straight Arrow Publishers, Inc.*, 2002 WL 31057465, at *8 (Del. Ch. Sept. 10, 2002) (concluding that if the parties could prove an asset was nonoperating then its value would be added to the total enterprise value of the company being appraised).

125 The Court has not valued the assets of the LAN business because there is no evidence in the record that the assets had any value.

126 Trial Ex. 112 at T4502.

127 If it was known or knowable as of the Merger Date that Trilithic would sell engineering assistance, then the Court would have to include this portion of the purchase price in its DCF analysis, separate and apart from its relation to the sale of nonoperating assets. Because there is no evidence that such a sale of engineering assistance was known or knowable as of the Merger Date, the Court will not include it in its DCF analysis.

as of the Merger Date was $352,537.09, which includes $74,391.55 for inventory, $72,000 for intellectual property, $6,145.54 for equipment and $200,000 for a noncompetition covenant.[128]

Adding $352,537.09 to the total enterprise value yields a total value of Trilithic of $651,062.16.

D. Valuation Conclusion

The Court's DCF analysis produces a per share value of Trilithic's common equity of $217.02. Thus, Petitioner's 750 shares or 25% stake is worth $162,765.54.

III. INTEREST

In addition to determining the fair value of Petitioner's shares, the Court must determine a fair rate of interest to be paid upon the amount determined to be the fair value.[129] An award of interest serves two purposes. It compensates the Petitioner for the loss of use of his capital during the pendency of the appraisal process and causes the disgorgement of the benefit the Company has enjoyed during the same period.[130] Normally, these twin purposes are furthered by applying a rate of interest derived from

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[128] *Id*. The Court has included the price of the noncompetition agreement in the value of the refrigeration monitor assets because the value of a line of business is more than the sum of its individual parts and includes the right to operate such business. *See Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 694–95 (Del. Ch. 1996) (implying that value of noncompetition agreement should have been paid to the company, not individuals, as part of a sale of a going concern); *see also Fulk v. Wash. Serv. Assocs., Inc.*, 2002 WL 1402273, at 12 n.35 (Del. Ch. June 21, 2002) (recognizing that "the sale of a going concern business necessarily includes the goodwill or going concern value of the business").

[129] 8 *Del. C.* § 262(h).

[130] *Gonsalves v. Straight Arrow Publishers, Inc.*, 793 A.2d 312, 327 (Del. Ch. 1998).

equal weightings of the prudent investor rate and the Company's cost of debt.[131] The weighting of these rates is complicated in this case by both the long delay in bringing this case to trial and the dearth of evidence concerning the Company's cost of borrowing.

A. Rate of Interest

It is well established that "[e]ach party bears the burden of proving an appropriate rate under the circumstances."[132] Petitioners appear to argue that the prudent investor rate for the period beginning with the Merger Date and ending December 31, 2004 is 8.8%.[133] This rate is "based upon analysis of the S&P 500 index as well as the NYSE composite index."[134] In other words, Petitioner's expert assumed that the prudent investor would invest only in equities. Such an assumption "ignores this Court's precedent that '[t]he prudent investor takes both a long term and short term investment strategy . . . [and] employ[s] a mix of . . . conservative investments . . . and . . . riskier investments.'"[135] Petitioner has thus failed to satisfy its burden with respect to the prudent investor rate.

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131 *Gholl*, 2004 WL 2847865, at *18.

132 *Grimes v. Vitalink Commc'ns Corp.*, 1997 WL 538676, at *9 (Del. Ch. Aug. 26, 1997).

133 *See* Trial Ex. 172.

134 *Id.*

135 *Cancer Treatment Cts. of Am.*, 2004 WL 1752847, at *37 (quoting *Chang's Holdings, S.A. v. Universal Chems. & Coatings*, 1994 WL 681091, at *4 (Del. Ch. Nov. 22, 1994)).

In contrast to Petitioner's expert, Respondent's expert used a mix of short and long term investments to determine that the prudent investor rate for the period beginning with the Merger Date and ending December 31, 2004 is 6.14%, assuming monthly compounding of the prudent investor's returns.[136] Margolin explicitly relied on the mix of assets used by this Court in *Chang's Holdings, S.A. v. Universal Chemicals & Coatings*.[137] Respondent thus has carried its burden of proving an appropriate prudent investor rate.

In his report, Petitioner's expert opined that Trilithic's cost of borrowing during the relevant period was 6.5%.[138] Haas purportedly based his opinion on the average annual bank loan interest rate charged to Trilithic. Respondent did not contest Petitioner's expert's opinion because the rate is favorable to it.[139]

At trial, Petitioner's expert attempted to discredit his own opinion on Trilithic's cost of borrowing by claiming that he had not had the documents necessary to render an opinion.[140] Then, in post-trial briefing, Petitioner argued that the record was insufficient

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[136] Trial Ex. 176.

[137] *Compare* Trial Ex. 176 (using a portfolio comprised of six month CDs (10%), ninety day Treasury bills (15%), ninety day commercial paper (15%), twenty year Treasury bonds (20%), Moody's AAA corporate bonds (20%) and S&P 500 equities (20%)) *with Chang's Holdings*, 1994 WL 681091, at *5 (using a portfolio comprised of one year CDs (10%), ninety day Treasury bills (15%), ninety day commercial paper (15%), ten year Treasury bonds (20%), Moody's AAA corporate bonds (20%) and average risk mutual funds (20%)).

[138] Trial Ex. 172.

[139] ROB at 48.

[140] Tr. at 159 (Haas).

in terms of Trilithic's cost of borrowing to determine a specific pre-judgment interest rate. Therefore, Petitioner urged this Court to award interest at the legal rate of 8%.[141] The Court addressed Petitioner's attempt to distance itself from its expert's opinion at the pretrial conference and explicitly rejected it.[142] Petitioner engaged Haas in 1995 and delivered his report in 2004. Haas thus had nearly ten years in which to obtain the documents he needed to calculate Trilithic's cost of borrowing. If Petitioner and his expert did not have the necessary documents, they should have sought them in discovery and timely moved to compel their production if Trilithic failed to produce them. At this very late date, the Court will not allow the Petitioner to walk away from his own expert's opinion and argue for an award of interest at a rate 150 basis points higher based on his own failure of proof.

When neither party has carried its burden with respect to a component of the rate of interest, this Court normally uses the legal rate of interest.[143] To do so here, however, would encourage action similar to Petitioner's: delay and then an attempt to change course on the eve of trial. Such action is inequitable and will not be rewarded with an

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141 POB at 45; Joint Pretrial Order ¶ 2.5 (stipulating that "[t]he legal rate of interest as of June 1, 1993 was eight percent (8%).).

142 *See* Pretrial Conference Tr. at 12–13.

143 *See Gonsalves*, 793 A.2d at 327 (using legal rate for company's cost of borrowing where petitioner failed to provide any evidence of the cost of debt and respondent failed to provide a credible explanation of its calculations); *Gonsalves*, 2002 WL 31057465, at *10.

award of interest at the legal rate, especially in light of Petitioner's torpor in prosecuting this litigation.

In *Chang's Holdings*, this Court employed "a sliding scale that alters the relevance of the prudent investor rate and the cost of borrowing rate according to the relative fault of the parties in causing the delay."[144] The long delay in this case, like in *Chang's Holdings*, is not the product of a "war[] of attrition in which the plaintiff's mounting legal expenses hinder her efforts to pursue a just valuation."[145] In such a case, courts have ordered the respondent company to disgorge the benefit of months and years of interest-free borrowing consistent with the dual compensatory and restitutionary purposes of an award of pre-judgment interest. Where, as here, the delay is primarily attributable to the Petitioner's failure to diligently prosecute this action,[146] the Company should be made to pay only what has been taken from Petitioner: the return a prudent investor would have

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[144] 1994 WL 681091, at *2.

[145] *Id.* at *2.

[146] The record and the briefs are replete with accusations of delay by Petitioner and acquiescence in the delay by Respondent. *See, e.g.*, ROB at 1-2; POB at 46. The Court finds some acquiescence in the delay by Respondent, who never filed a motion to dismiss for failure to prosecute, but concludes that Petitioner could have and should have prosecuted this case more diligently. Significant lapses by Petitioner include the failure to serve discovery requests until nearly nine months after the filing of this action, the gap between Respondent's production in September 1994 and Petitioner's Motion to Compel in February 1997 and the subsequent failure to pursue that motion until January 1998. From 1999 through mid-2003, the docket contains little more than status letters from both sides indicating that discovery was continuing.

realized during the relevant period. Therefore, the Court will use the prudent investor rate of 6.14% as the rate of pre-judgment interest.

B. Simple or Compound Interest

Having determined the rate of interest, the Court must decide whether to award simple or compound interest. The trend in this Court has been to award compound interest "because it better comports with 'fundamental economic reality.'"[147] "'It is simply not credible in today's financial markets that a person sophisticated enough to perfect his or her appraisal rights would be unsophisticated enough to make an investment at simple interest.'"[148] Similarly, companies neither borrow nor lend at simple interest rates.[149] An award of compound interest thus furthers the compensatory and restitutionary purposes of an award of pre-judgment interest.[150] For these reasons and because Trilithic bears some of the fault for the long delay in bringing this action to a conclusion, the Court awards compound interest.

As to the frequency of compounding, this Court has held that "the dual purposes of compensation and restitution may only be served by compounding at least as frequent

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147 *Finkelstein v. Liberty Digital, Inc.*, 2005 WL 1074364, at *26 (Del. Ch. Apr. 25, 2005) (quoting *Onti, Inc. v. Integra Bank*, 751 A.2d 904, 921 (Del. Ch. 1999)).

148 *Id.* (quoting *Onti*, 751 A.2d at 926).

149 *Id.*; *Onti*, 751 A.2d at 926.

150 *Id.* Although the Court did not consider Trilithic's cost of borrowing in determining the appropriate rate of interest, it is still relevant that companies do not borrow or lend at simple interest rates because Trilithic had use of Petitioner's capital during the pendency of this litigation. Presumably, Trilithic effectively earned at least the return a prudent investor would have earned on the capital during this period.

as once a month."[151] Here, neither party has provided evidence of the appropriate frequency of compounding. Consequently, the Court defaults to compounding monthly.[152]

IV. CONCLUSION

For the reasons stated in this Memorandum Opinion, the Court concludes that the per share fair value of Trilithic's common equity as of the Merger Date is $217.02. As such, Petitioner's 750 shares are worth $162,765.54. With interest, Petitioner is entitled to $339,413.57.

Petitioner's counsel should submit an implementing order, on notice, within 10 days.

IT IS SO ORDERED.

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151 *Grimes*, 1997 WL 538676, at *13; *accord In re Emerging Commc'ns, Inc. S'holders Litig.*, 2004 WL 1305745, at *27 (Del. Ch. May 3, 2004).

152 *See Cede & Co.*, 2004 WL 286963, at *15 (awarding compound interest compounded monthly where neither party provided evidence as to the appropriate interval because the dual purpose of an award of interest is only served by (at least) monthly compounding).