IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

CRESCENT/MACH I PARTNERSHIP, L.P., et al.,	:	
Plaintiffs,	:	
v.	:	**C.A. No. 17455-VCN**
JIM L. TURNER, et al.,	:	
Defendants.	:	
CRESCENT/MACH I PARTNERSHIP, L.P., et al.,	:	
Petitioners,	:	
v.	:	**C.A. No. 17711-VCN**
DR PEPPER BOTTLING CO. OF TEXAS,	:	
Respondent.	:	

MEMORANDUM OPINION

Date Submitted: July 27, 2006
Date Decided: May 2, 2007

Michael A. Weidinger, Esquire of Morris James LLP, Wilmington, Delaware, and Michael Swartz, Esquire and Paul B. Derby, Esquire of Hennigan, Bennett & Dorman LLP, Los Angeles, California, Attorneys for Plaintiffs and Petitioners.

Elizabeth M. McGeever, Esquire and J. Clayton Athey, Esquire of Prickett, Jones & Elliott, P.A., Wilmington, Delaware, Attorneys for Defendant Jim L. Turner.

David J. Teklits, Esquire and Kevin M. Coen, Esquire of Morris, Nichols, Arsht & Tunnell LLP, Wilmington, Delaware, Attorneys for Respondent Dr Pepper Bottling Co. of Texas.

NOBLE, Vice Chancellor

These actions arose out of the acquisition of Dr. Pepper Bottling Holdings, Inc. ("Holdings"), a beverage packager and distributor, through a merger on October 8, 1999, with a wholly-owned subsidiary of the entity now known as Dr. Pepper/Seven-Up Bottling Group, Inc. ("Bottling Group"), an entity controlled by Cadbury Schweppes PLC ("Cadbury"), which was the franchisor for many of the beverages sold by Holdings, and the Carlyle Group LP ("Carlyle"), a private equity firm. The merger consideration was $25 per Holdings share. Former shareholders of Holdings claim that Defendant Jim L. Turner ("Turner"), the chief executive officer and majority shareholder of Holdings, as well as one of its three directors, breached his fiduciary duties by negotiating and encouraging them to accept inadequate merger consideration; they also seek appraisal, under 8 *Del. C.* § 262, of their shares in order to obtain fair value for them.[1] The two matters were tried together, and this Memorandum Opinion sets forth the Court's post-trial findings of fact and conclusions of law.

I. BACKGROUND

Turner started in the bottling industry after graduating from college in 1969. He became quite successful and was broadly recognized as one of the best

[1] The fiduciary duty action (C.A. No. 17455-VCN) has been pursued primarily because one shareholder, Petitioner Jefferies & Co., Inc. ("Jefferies"), tendered a portion of its shares for merger consideration. The Respondent in the appraisal action (C.A. No. 17711-VCN), as Holdings' successor, is Dr. Pepper Bottling Co. of Texas.

executives in the industry. By 1999, he owned, directly or indirectly, 61.5% of Holdings' Class A Common Stock.

In 1985, he established Dr. Pepper Bottling Company of Texas ("DPB"), a bottling company that would grow by the late 1990s, through sound management and value adding acquisitions, into Holdings, a company with annual sales in excess of one billion dollars. Holdings evolved primarily in Texas.[2] There, it held franchises for the distribution of such top-of-the-line soft drinks as Dr. Pepper and Seven-Up. Its product line also included A&W (root beer), Sunkist (orange), Welch's (grape), Canada Dry (primarily ginger ale), Schweppes, Hawaiian Punch, Sunny Delight, Big Red, and RC. It handled "new age" beverages such as Mystic, Snapple, and Arizona. It also distributed the waters of Evian, Perrier, and Deja Blue (a less expensive water product developed by Turner through a separate business entity).[3] In 1997, Holdings expanded to Southern California through the acquisition of Seven-Up/RC Bottling Company of Southern California, Inc. ("Seven-Up/RC").[4] Significantly, it did not acquire the rights to Dr. Pepper in that market.[5]

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[2] Its principal Texas markets were Dallas/Fort Worth, Houston, and Waco.

[3] JX 105 at 49.

[4] Holdings, at the time of the merger, served markets that reached 13% of the population of the United States. It also operated in parts of Central California, as well as Las Vegas, Nevada and Albuquerque, New Mexico.

[5] Seven-Up/RC came with problems. First, Coca-Cola and Pepsi-Cola began to discount prices aggressively in Southern California. Second, the El Niño weather system adversely affected soft drink consumption in that market in early 1998. Third, the management of Seven-Up/RC had

The soft drink industry has little technological risk and benefits from franchise distribution rights which virtually assure the absence of intra-brand competition.[6] The stability provided by these factors, however, is subject to the vagaries of consumer preference.[7]

Holdings' primary soft drink brands, Dr. Pepper and Seven-Up, were both franchised by Cadbury. Cadbury, looking to develop its United States soft drink distribution business along the lines of the separate bottling companies of Coca-Cola and Pepsi-Cola, had teamed with Carlyle to form ABC Holdings, Inc. ("ABC"), a bottling company serving the Midwest that was the largest independent (*i.e.*, affiliated with neither Coke nor Pepsi) soft drink bottling company in the United States. That acquisition had not worked out well, but Cadbury and Carlyle, nonetheless, sought to broaden their territorial coverage. They turned to Holdings because of its position in significant markets—Texas and Southern California—and for the management skill of Turner. In the summer of 1998, they approached him about a potential acquisition.

Turner had become increasingly concerned about Holdings' competitive position.[8] Growth in the sales of carbonated soft drink beverages was slowing as

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inaccurately reported expenses; accordingly, accounting and management adjustments resulted.

[6] JX 105 at 49.

[7] Except for cola products, the products marketed by Holdings were at or near the top of their respective categories.

[8] This was a perception which he did not share in any meaningful fashion with his fellow Holdings' shareholders.

consumers' preferences turned to water and other noncarbonated beverages. Also, the Coke and Pepsi affiliated bottlers, with the substantial financial support of the leading national companies sponsoring them, were providing increasing competition for Holdings.[9] Turner feared a price war in which Holdings would not have the same support and resources as its nationally-backed competition. In addition, the supermarket industry was consolidating, and supermarket chains preferred to deal on a national, instead of a regional, basis. That provided another significant advantage to Coke and Pepsi, to the detriment of Holdings.[10] Moreover, Texas, during the years of Holdings' growth, had enjoyed the lowest soft drink prices in the United States. Holdings was not able to lower its prices significantly to acquire any greater market share. Finally, Cadbury had provided greater support to Holdings than to any other bottler of Cadbury product and was in the process of restructuring its franchise relationship with Holdings to its greater advantage.

Turner had already started thinking about succession issues. No one in his family was involved with Holdings. His options for selling the business were limited. Coke and Pepsi would likely have run into insurmountable antitrust obstacles. No other participant in the soft drink industry appeared to be willing

[9] Both Coke and Pepsi had then recently spun-off their bottling operations, but each had retained a large, minority interest in those enterprises.

[10] Similarly, school districts and convenience stores had started to enter into exclusive agreements with Coke or Pepsi that precluded the sale of Holdings' products.

and able to acquire Holdings. Moreover, Cadbury, the franchisor, had the power to limit private equity purchasers, and it had made it clear to Turner that it would not likely consent to a private equity acquisition. Thus, Turner was confronted with a stark market reality: there was only one viable option for an acquisition: Cadbury (or Cadbury as part of a team). Turner, however, had other reasons for seeking a sale of Holdings. His view, one at which the Plaintiffs scoff but which the Court finds he genuinely held, was that the soft drink industry then faced troubling times ahead and that Holdings, in particular, because of the competitive challenges posed primarily by Coke and Pepsi, would encounter substantial market difficulties.

Cadbury initially proposed an acquisition price of approximately $19.50 per share. Turner rejected that, but conversations continued, sometimes on, but mostly off, until July 1999. Those talks involved not only the price for Holdings but also Cadbury's insistence that Turner (i) become the chief executive officer of the new enterprise that would combine the operations of Holdings with those of ABC and (ii) invest a significant portion of his merger proceeds in the new entity. Turner sought a price in the range of $28-$30 per share, but, after some bargaining, they agreed to a price of $25 per common share of Holdings.[11] Cadbury and Carlyle had wanted Turner to invest $50 million in the new venture; he was able to

[11] Turner, as the majority shareholder of Holdings, had a powerful incentive to maximize share price.

negotiate that down to $25 million.[12] He also agreed to take the CEO position at the new entity at the same salary as he received as the head of Holdings.[13]

Holdings' board approved the merger on August 30, 1999.[14] Donaldson, Lufkin & Jenrette ("DLJ") provided a fairness opinion supporting the merger.[15] It relied upon Turner's projection of 3% annual volume growth over the following five years, as well as the other assumptions—including pricing projections—necessary to model the anticipated 3% volume growth. DLJ established a fairness range by discounted cash flow analysis of between $19.32 and $31.05; by comparable transaction analysis of between $22.29 and $34.84; and by trading comparable analysis of between $19.75 and $28.53. Thus, the merger consideration of $25 per share fell comfortably within the various ranges established by the different and accepted methodologies.

Funding of the transaction required raising money. Carlyle needed financial data in order to sell the deal to its investors. A critical projection was the volume growth rate in case sales. Holdings' chief financial officer, Holly Lovvorn, ran two sets of numbers: one based on a 3% volume growth rate; the other based on a

[12] Following the merger, the Petitioners were given the opportunity to invest in the new enterprise on the same terms given to Turner. They declined that opportunity. Trial Transcript ("Tr.") 291-93.
[13] Turner also received stock options in the new venture. Turner would have been content even if continued employment had not resulted.
[14] The other members of the board—J. Kent Sweezey and William Hunt—were initially alleged to have violated their fiduciary duties in approving the merger. The Plaintiffs eventually abandoned those claims.
[15] JX 48 at 17.

4% growth rate. The 3% growth rate numbers were given to lenders and to Holdings' shareholders in the disclosures accompanying the merger proxy statement. Carlyle trumpeted the 4% growth rate as it sought to induce the participation of investors.[16]

Before the merger closed, the Plaintiffs expressed dissatisfaction with the price and filed their fiduciary duty action. The Plaintiffs, as Petitioners, also pursued an appraisal action. They properly dissented from the merger and perfected appraisal rights for 1,014,023 shares.[17] One Petitioner (Jefferies) also held 2,390 shares which were tendered for merger consideration and, thus, are not eligible for the appraisal process.

II. CONTENTIONS

The Plaintiffs, in their fiduciary duty action, contend that Turner breached his fiduciary duties by understating projections for Holdings and unreasonably denigrating its prospects. They argue that he had his personal reasons for selling

[16] This disparity forms the core of the Plaintiffs' fiduciary duty challenge. In short, they argue that Turner believed the 4% volume growth projection (or effective, corresponding 5.5% EBITDA growth rate) but reported a 3% projection to his shareholders because, according to the Plaintiffs, he desperately wanted the transaction to close and the 4% growth rate projections would show that the merger price was well below a reasonable value.

[17] The Plaintiffs in the fiduciary duty action, and the Petitioners holding shares of Holdings eligible for appraisal, are as follows: Brown University, 20,000 shares; Crescent/Mach I Partners L.P., 50,000 shares; Jefferies & Co., Inc., 193,410 shares; Richard Handler & Martha Handler, 50,000 shares; Shared Opportunity Fund II LLC, 30,000 shares; Shared Opportunity Fund IIB LP, 259,313 shares; TCW/Crescent Mezzanine Investments Partners, L.P., 513 shares; TCW/Crescent Mezzanine Partners, L.P., 18,773 shares; TCW/Crescent Mezzanine Trust, 5,714 shares; TCW Leveraged Income Trust, L.P., 236,300 shares; and TCW Leveraged Income Trust II, L.P., 150,000 shares. Pretrial Order ¶ 2.

cheaply and to the detriment of the minority shareholders. The Petitioners, in their appraisal action, rely not only on a revision of the unfairly pessimistic, in their view, projections sponsored by Turner but also on a thorough review of the various inputs—especially endorsing a discount rate of 9.41%—for the discounted cash flow analysis. They argue for a fair value of approximately $48.69 per share.[18]

Turner contends that his only purpose in selling the Company was to realize the greatest value and that his disclosures to his fellow shareholders represented his best understanding based on his lengthy service in the industry and with Holdings. The Respondent, invoking the opinion of its expert, asserts that a fair value of each share submitted for appraisal would be $25.10. Its valuation depends primarily upon Turner's projections and a discount rate of 10%.[19]

III. ANALYSIS OF THE FIDUCIARY DUTY CLAIMS

As a director of a Delaware corporation,[20] Turner, of course, owed fiduciary duties to the corporation and to his fellow stockholders,[21] and he is entitled to the presumption that he discharged those duties faithfully.[22] In general, in order to

[18] The Plaintiffs and Petitioners support their valuation contentions through the expert testimony of Robert J. Taylor of Taylor Consulting Group, Inc. Taylor has extensive experience in valuing entities participating in the soft drink distribution business. JX 537; JX 538.
[19] The Respondent relies upon the expert opinion of Kevin P. Collins of Houlihan Lokey Howard & Zukin. Collins, although, experienced in valuation efforts, had no prior experience with the soft drink industry. JX 535; JX 536.
[20] Holdings was incorporated under the laws of Delaware
[21] *See, e.g., Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971).
[22] *See, e.g., Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984). He also owed fiduciary duties as the controlling shareholder. *See, e.g., Superior Vision Servs., Inc. v. ReliaStar Life Ins. Co.,*

fulfill his duty of care, he was obligated to be reasonably informed about the business of Holdings, the industry in which it operated, and its prospects.[23] To satisfy his duty of loyalty, and its subsidiary requirement that he act in good faith, he needed to be candid with both his fellow board members and with his fellow stockholders and to act with their best interests in mind.[24]

The Plaintiffs do not contend that Turner was uninformed; indeed, they acknowledge his deserved position of respect within the industry. Instead, they argue that he was less than candid (indeed, that he knowingly provided misleading information) by understating key financial projections which he personally believed to be more optimistic than he reported and by generally disparaging Holdings' future even though he held a more favorable view. Not only was Turner not candid, according to the Plaintiffs, with his fellow directors and shareholders, but he also misled DLJ which provided the fairness opinion supporting the merger. In essence, the Plaintiffs argue that, without Turner's conscious efforts to understate the favorable prospects for Holdings, the fairness opinion would have demonstrated that the merger consideration was too light.[25]

2006 WL 2521426, at *4 (Del. Ch. Aug. 25, 2006).

[23] *See, e.g., In re Caremark Int'l, Inc. Deriv. Litig.*, 698 A.2d 959, 960 (Del. Ch. 1996).

[24] *See In re Digex Inc. S'holders Litig.*, 789 A.2d 1176, 1192-93 (Del. Ch. 2000).

[25] The Pretrial Order (Part III.A.) refers to Turner's "provision of certain five-year growth projections" and his "disparaging [of] Holdings."

Holdings' success—best measured by reference to EBITDA[26] growth—would depend on volume growth and pricing growth. Volume growth could result from population increases, increases in the public's appetite for soft drinks, and capturing market share from other soft drink suppliers. Consumer preference could be affected by increased advertising and, probably more significantly, aggressive pricing (*i.e.*, discounting). Population growth in the markets served by Holdings was projected to be approximately 3% annually. Turner and the Respondent contend that volume growth, as a practical matter, would be driven primarily by population growth. The Plaintiffs assert that, in addition to the population growth component, the favorable product mix marketed by Holdings, supported by a superior management, should have been able to achieve an additional one percent annual volume growth. As for pricing growth, Turner and the Respondent argue for 0.4% annually, an increase that would essentially offset anticipated cost increases. The Plaintiffs, in contrast, project an annual pricing increase of 1.8%. EBITDA growth based on the first set of projections (3% volume; 0.4% pricing) approximates 3% annually. By comparison, EBITDA growth based on the second set of projections (4% volume; 1.8% pricing) leads to an annual 5.5% increase.

[26] Earnings before interest, taxes, depreciation, and amortization.

The debate over volume growth, and, thus, derivatively EBITDA growth, starts with Exhibit 40, which contains two sets of projections prepared by Holly Lovvorn, Holdings' chief financial officer, who forwarded them to Cadbury/Carlyle on July 21, 1999. One set, of course, is based on a 3% volume growth and 0.4% pricing growth.[27] EBITDA, when driven by those parameters, grows at approximately 3% annually over the ensuing five years. The other set assumes 4% volume growth and uses a projected 1.8% annual pricing growth. With these projections, EBITDA growth of 5.5% annually is projected. The Plaintiffs generally endorse Lovvorn's second set.

Why the numbers were run in this fashion is not clear. Turner asserts that the 3% growth rate was his projection and assumes that 4% growth rate calculations were done at the request of Cadbury/Carlyle. Lovvorn's recall is similarly cloudy. The Plaintiffs contend that the 3% projections were necessarily the "conservative" projections routinely made to form the basis for covenants to lenders, and that the 4% projections were management's (*i.e.*, Holdings' and Turner's) actual projections.

Projections of the acquired company's management are frequently given substantial weight in the appraisal analysis, especially if the numbers have not been

[27] Thus, the two sets of projections about which the parties debate were both prepared (*i.e.*, in the sense of "running the numbers") by Holdings' management. Which set accurately reflected Holdings' management's (*i.e.*, Turner's) actual view is the primary topic of this Memorandum Opinion.

generated with a view toward the merger at issue.[28] Management is generally regarded as having the best information available and the best understanding of the company's prospects and, thus, unless there are reasons that would induce management to manipulate the projections, its projections are generally the most informed projections available to the Court. In this case, if Turner intentionally understated the prospects of Holdings in order to facilitate the merger, his fiduciary duties are implicated. That conclusion would also have consequences for the appraisal aspect of these proceedings because accurate future projections are critical to the appraisal process. Of course, it is at least possible that Turner, while acting in an informed fashion and with all good faith, simply held a view of Holdings' future that was too pessimistic. For that, there would be no liability for breach of fiduciary duty, but it could be significant for the appraisal process. Indeed, the outcome of the appraisal analysis would increase by perhaps as much as 15% if the 4% volume growth projections were adopted instead of the 3% projections.

The Plaintiffs seek to demonstrate that Turner believed in the 4% volume growth projections (akin to a 5.5% annual increase in EBITDA) and that he purposely understated Holdings' favorable future. In order to understand the

[28] *See, e.g.*, *Prescott Group Small Cap, L.P. v. Coleman Co.*, 2004 WL 2059515, at *21 (Del. Ch. Sept. 8, 2004).

Plaintiffs' claims, the Court first turns to the various projections. The debate focuses upon three sets of projections:

1. The 3% Volume Growth Projection

This projection is sponsored by both Turner and the Respondent. It anticipates a 3% volume growth and a 0.4% pricing growth, resulting in an effective 3% annual growth in EBITDA. This is one of the sets projected by Lovvorn. These projections were used in the proxy statement issued to Holdings' shareholders in the effort to gain support for the merger. Also, the acquirers used these numbers in their solicitation of lenders.

2. The 4% Volume Growth Projection

The projection of 4% annual volume growth accompanied by an annual pricing growth of 1.8% leads to a 5.5% annual growth in EBITDA. This is Lovvorn's other set of projections. The Petitioners rely primarily upon these projections. Carlyle used these numbers to solicit equity investors.

3. The Exhibit 80 Projections

This set of projections—sometimes referred to as the Exhibit 80 numbers—is the product of work performed by Cadbury and Carlyle's investment banker, Schroders. Its projection of annual growth in EBITDA is slightly less than the results from the 4% volume growth model. These numbers have been referred to as the "acquisition model."

EBITDA growth resulting from each of the three models can be summarized in the following table:[29]

	1999	2000	2001	2002	2003	2004
3% volume growth	90.0	92.7	95.5	98.4	101.3	104.3
4% volume growth	90.0	94.9	100.1	105.7	111.4	117.5
Exhibit 80 model	90.1	95.2	99.6	104.4	109.5	114.1

The Plaintiffs point to several facts which they contend support their view that Turner did not believe in the 3% volume growth projections.

First, the Exhibit 80 projections contain a footnote (flagged to 1999 EBITDA for the Southern California operations) that identifies the source as Jim Turner. The footnote states, "[e]stimated at $11.4-12 MM. (Source: Jim Turner)."[30] Through the footnote, the Plaintiffs seek to attach all of the other Exhibit 80 projections to Turner. That would be an unreasonable inference because the reference to Turner as the source is to one data point estimated for one part of Holdings' business. If Turner were the source for all of the numbers (the

[29] In millions of dollars. *See* JX 40 at DPH 182-83; JX 172 at CAR 98-99, 105, 111; JX 80 at C9483; JX 596 at C9773; JX 50 at TCW 2154.

[30] JX 80 at C9483. Text above the projections recites that "projections based on Turner comment that 1999 EBITDA is estimated at $90 MM."

table includes projections for many items, including volume, net sales, gross profit, EBITDA, capital expenditures, EBITDA from the Texas operations, and EBITDA from the Southern California operations), he would not have been identified as the source for them through a footnote clearly tied to just one entry.

Second, David A. Gerics, a vice president for corporate finance at Cadbury when the Holdings acquisition was negotiated, testified that the Exhibit 80 projections were based on Holdings' (*i.e.*, Turner's) projections.[31] Moreover, Gerics believed, at the time, that the Exhibit 80 projections were reasonable estimates for Holdings. This, however, does not demonstrate that Turner thought that the volume would increase by more than 3% annually because in the income statement,[32] the volume growth is shown as a series of percentages over the years, but all are less than 3% (except for the first year's growth of 3.1%). Thus, even if the volume growth estimates were provided by Turner (or on his behalf) they are not inconsistent with the 3% volume growth. Also, Gerics testified, although somewhat uncertainly, that "the numbers on [Exhibit 80 at C9483] were developed by Schroders."[33]

Third, on November 11, 1999 (after the merger), Gerics transmitted to John Wartig, Cadbury's chief financial officer for its beverage group, the following

[31] Tr. 606-08 ("That [as shown in Exhibit 80] would have been the growth based on the Holdings' projections.").
[32] JX 80 at C9513.
[33] Tr. 625.

EBITDA projections for the former operations of Holdings:[34]

	2000	2001	2002	2003
Bank Book	92.7	95.5	98.4	101.3
Equity Plan (JT's numbers)	94.9	100.1	105.7	111.4
Acquisition Model	95.0	100.0	104.0	N/A

The entries on the "bank book" line are the same as the 3% (or proxy statement) projections. The entries for the "equity plan" are the same as the 4% model. The "acquisition model" numbers are similar to these shown on Exhibit 80. In addition, the following note appears on the exhibit: "JT supplied the equity plan amounts to be used as a basis for compensation plans."[35]

This transmittal was between individuals involved in the acquisition of Holdings; there is no evidence that Turner ever saw it.[36] Yet it is troubling for a number of reasons. First, labeling the 4%/equity plan as "JT's numbers" may be construed to support the Plaintiffs' argument that Turner adopted the 4% volume growth projections as his own.[37] Second, Turner would be expected to seek a lower measure of goals against which his compensation plan would be measured. If he did not believe in the 4% numbers (*i.e.*, they were unrealistic because he

[34] JX 596 at C9773 ("EBITDA Analysis for Dr. Pepper Bottling Co. of Texas," print date of Nov. 11, 1999) (in $ millions).
[35] Also, another footnote recited that the EBITDA projections excluded contributions from Deja Blue (a water product marketed by Holdings) and from Snapple Beverages.
[36] Gerics testified that he did not send it to Turner. Tr. 627.
[37] Gerics, however, testified that the reference to "JT's numbers" "does not mean that they came from Turner." Cadbury and Carlyle "used JT to refer to the Holdings company . . . . It could have been Holdings or . . . it could have been Jim Turner." Tr. 619-20.

considered 3% to be the most likely volume growth to be achieved), it makes little sense for him to accept higher projections—and therefore be less likely to receive incentive compensation. Finally, the analysis is consistent with Plaintiffs' contention that there are typically three sets of projections for transactions of this nature: (i) a conservative one that would be used for establishing lending covenants (*i.e.*, the "bank book"); (ii) the number that those close to the deal actually believed (*i.e.*, the "acquisition model"); and (iii) the more optimistic numbers that would be used to "sell the deal." In this instance, there is little divergence between the equity plan and the acquisition model, but there is significant difference with respect to the bank book numbers (*i.e.*, the proxy statement projections).

One answer could be that the equity plan incorporates the benefits of the merger. As a general matter, however, the merger between Holdings and ABC came with few synergies. Perhaps purchasing in larger quantities could squeeze out a small discount in the cost of goods sold; duplicate management could be eliminated. There is virtually no evidence that, at the time of the merger, anyone anticipated these typical synergies to provide significant benefits from the business combination. Indeed, the benefits that might come from new management cannot be viewed as significant because Holdings (*i.e.*, Turner and his management team) was going to remain in charge of the combined entity.

Nonetheless, the acquirers expected to improve the net performance of the assets comprising Holdings. The risk of competition from Coke and Pepsi would be substantially less because of the resources that Cadbury and Carlyle could make available. The most significant benefit can be found in the franchise relationship. With the Coke and Pepsi bottling company models, a better relationship between the franchisor and the bottler/distributor is said to exist because the franchisor and the bottler both share the same economic incentives and the tension between them is significantly dissipated. With a reduction in tension, a more focused effort to expand the brands' presence can be expected to result. This consideration was particularly important for the Holdings' combination because it had become clear that Cadbury's support for Holdings (the highest of any bottler marketing its product) was about to end (or to be significantly reduced). That support had given Holdings a true advantage in its competition for the soft drink market in Texas. With the decline or reduction in that support, Holdings' ability to compete would be impaired.

The Court turns to, and relies upon, the testimony of Jerome H. Powell, whom the Court finds to be a highly credible witness with a solid command of the facts, especially in light of the passage of approximately six years. Powell was Carlyle's lead partner on the Holdings' acquisition, as managing director of its United States buyout unit. He makes clear that the "bank case, the management

case" was not the acquirer's case. Furthermore, Turner was not involved in soliciting equity investors and, thus, was not involved in preparing the relatively optimistic numbers for the acquirers. Finally, Powell articulated in some detail what Carlyle and Cadbury expected to achieve by implementing the Coke and Pepsi bottlers' model as the means of creating value through the transaction.

> [T]he idea was [Cadbury] would put more marketing dollars behind the company, more advertising dollars, that they would have a closer partnership with management. Just that the – we would all be pulling in the same direction; that, you know, the bane of the existence of the bottling industry is fighting with the brand owner. And so this was a way to get everybody pulling in the same direction.
>
> You think about it. The brand owner and the bottler have adverse interests in a lot of ways. The brand owner wants the profits to show up over here. The bottler wants the interest to show up on the bottler's income statement. This was a way to align the interests, and it was really that simple.[38]

Thus, there is documentation which can plausibly be read to support the Plaintiffs' claims; ultimately, the paper record is ambiguous as to what Turner actually anticipated. The Respondent's position is supported by the credible Powell, but it is not helped by the somewhat inconsistent—and more likely confused—Gerics. Thus, the Court must return to Turner.

Turner, of course, is, at least in theory, the best source of going-forward projections for Holdings. He was, by all accounts, a sophisticated, knowledgeable,

[38] Tr. 522-23.

experienced, and able bottling company manager. He understood Holdings' markets, especially Texas, and was in the best position to anticipate the challenges and successes that Holdings might experience. His projections—as the head of Holdings' management—are of the type of projections which this Court will frequently rely upon. On the other hand, the projections before the Court were not—as far as the record shows—Turner's projections on that proverbial clear day—before he was focused on and personally committed to the merger. With that background, it is necessary to turn to Turner's testimony. It may be somewhat unusual for a case of this nature, but the outcome here turns, in large part, on the Court's assessment of Turner's (and to a lesser extent, Powell's) credibility. Turner's testimony as to what he believed the future held for Holdings as of the time leading up to the merger was unequivocal.

Turner testified that the 3% volume growth projections were his; that he did not participate in the preparation of, or accept, the 4% volume growth projections. He considered a 0.4% annual pricing growth projection to be reasonable in the markets in which Holdings competed. He acknowledged that Carlyle and Cadbury eventually adopted both the 4% volume projections and the 1.8% pricing projections, but he viewed them as aggressive. He agreed to the $25 per share price with Cadbury and Carlyle on July 19, 1999.[39] The 4% projections, prepared

[39] The merger agreement was not finalized until the end of August 1999.

by Lovvorn and transmitted to Carlyle, were created after agreement as to price had been reached. He does not know the source of the 4% projections, but he has speculated that those numbers were run at Carlyle's request.[40]

Turner's projection of 3% volume growth was influenced by several factors. Holdings participated in the most competitive soft drink market in the United States. As an independent bottler, it was at a competitive disadvantage to Coke and Pepsi bottlers, which, among other advantages, had a lower cost of capital. Holdings' ability to drive prices was at the mercy of Coke and Pepsi bottlers which could respond to any pricing effort initiated by Holdings. For these reasons, it was especially difficult for Holdings to gain price increases.[41] Turner suggested that Coke and Pepsi, because they shared many markets between them, were likely to continue to be especially aggressive in competing with Holdings in Southern California because they would respond to the presence of a third major competitor. Also, Cadbury, Holdings' primary franchisor, was attempting "to shift more of the profitability" from the bottler to the franchisor by changing the fountain program and decreasing marketing support funds.

[40] When Turner first discussed the sale of Holdings with Carlyle and Cadbury in 1998, he submitted projections that are consistent with the 3% volume growth projection now challenged by the Plaintiffs. JX 377.

[41] His hope was to offset cost increases with pricing increases. This thought pattern led to the 0.4% pricing growth projection, pricing growth that roughly equaled the anticipated cost growth.

Turner believed that the soft drinks that Holdings sold had done very well during the preceding decade, but that further opportunities for market share acquisition were deteriorating. One particular problem was that Coke and Pepsi had started to enter into exclusive contracts for convenience store chains. Another problem was that supermarkets had been consolidating and the major supermarkets were "going from regional players to national players." They wanted to deal with soft drinks on a national basis and that was a major drawback for a regional bottler such as Holdings with no relationship with Coke or Pepsi.

In sum, the Court concludes that Turner believed in the 3% projections; the Court also concludes that the 4% projections were not Turner's (or adopted by Holdings' management). His projection of 3% was based on his knowledge of the market, his expertise in the bottling industry, and his experience. That estimate was his truthful estimate and a reasonable estimate.[42] Turner provided the projections to DLJ, for use in the preparation of its fairness opinion, and to his shareholders in, *inter alia*, the merger proxy statement, with loyalty and with due

[42] The competitive focus of Coke and Pepsi, particularly in Southern California, and the already low prices in the soft drink industry in Texas, made market share expansion difficult. To the extent that the Plaintiffs, and their expert espouse a more robust future for Holdings, those projections are rejected, not because they are inherently unreasonable or implausible, but because the Court is guided by Turner's testimony. The arguments advanced by the Plaintiffs are not without some force; the Court, however, concludes that by a preponderance of the evidence, the Respondent and Turner have demonstrated that Turner's projections are the best available for the Court to rely upon.

care. Thus, Turner exercised faithfully his fiduciary duties.[43] Furthermore, the Court finds, for purposes of the appraisal action, that for the period following the merger, a fair and reasonable projection of annual volume increases would be 3% and pricing growth would increase annually at 0.4%.[44]

IV. THE APPRAISAL DETERMINATION

A. *General Principles Guiding an Appraisal*

In an appraisal action, the Court is charged with determining the fair value of the entity in question as a going concern, excluding value arising from the merger itself, taking into account all relevant factors.[45] Factors which the Court may examine could include asset value, dividend record, earnings prospects, and any additional factors that relate to financial stability or prospects for growth.[46] In determining fair value, the Court may look to the opinions advanced by the parties' experts, select one party's expert opinion as a framework, fashion its own

[43] The Plaintiffs mention other fiduciary duty claims against Turner, including the forgiveness, shortly before the merger, of a $400,000 debt obligation; the conveyance of certain corporate real estate to him for only the appraised value of the land; and the business of JLT Enterprises, an entity created by Turner as a pass-through for certain products marketed by Holdings and viewed by the Plaintiffs as a conduit for siphoning funds from Holdings. The claims here were not proper for consideration at trial, in part because of their late development, in part because they may have been derivative, and not direct, claims. Also, at least to the extent presented at trial, they lack merit. The questioned transactions were all approved by the other two members of Holdings' board who, with the dismissal of claims against them, must be considered independent and accorded the presumptions of the business judgment rule.

[44] As a practical matter, this conclusion would be consistent with a view that volume growth would be primarily a function of population growth and that pricing growth would be sufficient to offset cost increases.

[45] 8 *Del. C.* § 262(h).

[46] *E.g.*, *Universal City Studios, Inc. v. Francis I. duPont & Co.*, 334 A.2d 216, 218 (Del. 1975).

framework or adopt, piecemeal, some portion of an expert's model methodology or mathematical calculations.[47] The Court, however, may not adopt an "either-or" approach and must use its judgment in an independent valuation exercise to reach its conclusion.[48] Once the Court has determined the fair value of the entity itself, the parties seeking appraisal are entitled to their pro rata share of that value.

In a statutory appraisal proceeding, unlike typical judicial proceedings, each side has the burden of proving its respective valuation position by a preponderance of the evidence.[49]

B. *The Competing Models and Inputs*

Although it is appropriate to consider all accepted methodologies, the Court tends to favor the discounted cash flow method ("DCF").[50] As a practical matter, appraisal cases frequently center around the credibility and weight to be accorded the various projections for the DCF analysis.[51]

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[47] *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996) (citing *Rapid-American Corp. v. Harris*, 603 A.2d 796, 804 (Del. 1992)).
[48] *See Gonsalves v. Straight Arrow Publishers*, 701 A.2d 357, 361-62 (Del. 1997).
[49] *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 520 (Del. 1999).
[50] "Put in very simple terms, the basic DCF method involves several discrete steps. First, one estimates the values of future cash flows for a discrete period, based, where possible, on contemporaneous management projections. Then, the value of the entity attributable to cash flows expected after the end of the discrete period must be estimated to produce a so-called terminal value, preferably using a perpetual growth model. Finally, the value of the cash flows for the discrete period and the terminal value must be discounted back using the capital asset pricing model or 'CAPM.'" *Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *9 (Del. Ch. Aug. 19, 2005); *but see Union Ill. 1995 Inv. L.P. v. Union Fin. Group, Ltd.*, 847 A.2d 340 (Del. Ch. 2004) (discounting the discounted cash flow methodology in the circumstances).
[51] *See, e.g., Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 314 (Del. Ch. 2006).

Collins, the Respondent's valuation expert, premised his opinion of value on a discounted cash flow analysis that used: (i) an EBITDA multiplier of 7.5 to determine the terminal value, (ii) a $4.5 million estimate for annual net operating loss carryover, (iii) $402 million in outstanding debt, (iv) a 40% tax rate, (v) a discount rate of 10%, (vi) a five-year projective period, (vii) 3% EBITDA growth, (viii) $25 million in annual capital expenditures, and (ix) estimates for depreciation and amortization drawn from Holding's proxy statements. Using these inputs, Collins came to a value of $25.10 per share, ten cents higher than the $25 offered as consideration in the merger.

Taylor, the Petitioners' valuation expert, also relied upon a discounted cash flow analysis as his primary methodology. Taylor, however, premised his opinion of value on a discounted cash flow analysis that used: (i) a perpetuity growth rate (after the discrete projection period) of 3.5% annually to determine the terminal value, (ii) a $6.125 million annual estimate for net operating loss carryover, (iii) $392.8 million in outstanding debt, (iv) a 38.11% tax rate, (v) a discount rate of 9.41%, (vi) discrete periods of five and ten years, (vii) 5.5% EBITDA growth, (viii) annual capital expenditures estimated as 3% of net revenues, and (ix) estimates for depreciation as 3% of revenue and amortization of $5.4 million. Using these inputs, Taylor came to a value of $48.69 per share.

In determining the appropriate inputs for the Court's DCF analysis, the Court will proceed as follows: it will examine the variables, weigh the facts about Holdings' past performance and its likely future within the context of the beverage industry in the markets in which it operated, consider the opinions and methodologies of each expert, and determine the appropriate value. The parties' task is to establish, by a preponderance of the evidence, probable and logical estimates for the inputs required for the DCF model. The Court then implements its DCF model using the established parameters. As a possible check on the outcome of the DCF model, the Court will then briefly consider the usefulness of other valuation methodologies.

C. *Appraisal Analysis*

1. Discrete Projection Period

In its projections before the merger, Holdings' management used a five-year projection period. Delaware courts frequently use a five-year period.[52] The Petitioners offer best practices guides that recommend using 7-10 year projection

[52] *See Grimes v. Vitalink Commc'ns Corp.*, 1997 WL 538676, at *1 (Del. Ch. 1997), *aff'd*, 708 A.2d 630 (Del. 1998) (TABLE); *see also In re Radiology Assocs., Inc., Litig.*, 611 A 2d 485, 491 (Del. Ch. 1991); *Kleinwort Benson Ltd. v. Silgan Corp.*, 1995 WL 376911, at *6 (Del. Ch. June 15, 1995) (using a six-year projection period). *Cf. Gonsalves v. Straight Arrow Publishers*, 1996 WL 696936, at *7 n.19 (Del. Ch. Nov. 27, 1996), *rev'd on other grounds*, 701 A.2d 357 (Del. 1997) (noting, in connection with an earnings capitalization model, that although the standard earnings base was five years, that time period is not necessarily the only period on which the method may be based).

periods.[53] Taylor offers evidence that some of the variables in the model (*e.g.*, capital expenditures, net operating losses, depreciation, and amortization) would benefit from a longer projection period in order to reach a steady state.[54] However, the Petitioners admit that the effect of these variables on the final outcome is of low magnitude.[55] More significant, however, is Turner's defense of five-year projections: regular changes in the soft drink market make longer projections unreliable.

The Petitioners also urge that, if a five-year period is to be used, the Court should use a growth rate during the perpetuity period that gradually declines to the steady state perpetual rate, citing *Prescott*.[56] In this instance, it is not necessary to apply this methodology. Care must be taken to distinguish between the growth modeled rate during the projection period—EBITDA growth—and the growth considered during the perpetuity period—debt free cash flow. More importantly, the growth rates (sales) projected in *Prescott* differ dramatically from projection period to the perpetuity period. Here, the debt free cash flow growth rate during the projection period trends toward the perpetuity growth rate.[57]

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[53] JX 716 at 213-14.
[54] Tr. 728, 914, 965.
[55] Consolidated Opening Post-Trial Brief of Petitioners and Plaintiffs at 20, 36-37.
[56] *Prescott Group Small Cap, L.P.*, 2004 WL 2059515, at *29-*30.
[57] In 2001, the increase in debt free cash flow is projected at 3.92%; in 2002, at 4.3%; in 2003, at 3.91%; and in 2004, at 3.79%. Thus, by the end of the projection period, the debt free cash flow growth rate (as it should in theory) is approaching the perpetuity debt free cash flow growth rate.

Accordingly, a discrete projection period of five years will be used.[58]

2. EBITDA Growth

With the Court's acceptance of annual volume growth and pricing growth of 3% and 0.4%, respectively,[59] EBITDA growth during the projection period could be expected to be approximately 3% annually.[60]

3. Tax Rate

Collins relied on a tax rate of 40% based on historical taxes and comparable companies; in contrast, Taylor calculated a rate of 38.11% on prospective earnings. When available and reliable, the historical tax rate will likely be appropriate.[61] The difficulty in this case is that, owing to its history of rapid expansion, an applicable historical tax rate for Holdings is not apparent. Although the Respondent correctly argues that Taylor's rate does not properly account for unitary taxation in California, Collins' model does not accommodate that nuance well either. Both estimates are rough, but only Taylor's model attempts to allocate between California and Texas. Collins admits that he is not a tax expert, failed to account

[58] Actually, the projection period is approximately 5.25 years. A partial year—the balance of 1999—and the next five calendar years—2000 through 2004—comprise the discrete period.
[59] *See* Part III, *supra*.
[60] Both Collins and Taylor generally agree that these volume and pricing growth rates lead to an EBITDA annual growth rate of 3%. In their models, the growth projections vary from year to year; the Court has assumed a constant rate of growth during the projection period. Although the same rate of growth from year to year is, of course, unlikely, the consequences (or perceived, enhanced accuracy benefits) are minimal.
[61] *See Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *10 (Del. Ch. Feb. 10, 2004) ("a company's historical tax rate . . . is more reliable than speculation").

for California's unitary tax system, and had no basis to contest Taylor allocation of income between the two states.[62] Collins concedes that his selection of 40% is an approximation based on comparison between the company's historical tax rate and comparable companies.[63]

In effect, neither side has proved an appropriate tax rate. The evidence supports an inference that the appropriate rate lies within a range of 38.11% to 40%. Therefore, the Court finds, based on a weighing of the reasonable inferences from the evidence produced at trial, that the appropriate tax rate projection is 39%.[64]

4. Discount Rate

Both experts calculated Holdings' Weighed Average Cost of Capital ("WACC") in their effort to determine an appropriate discount rate. Their

[62] Tr. 875, 883, 892. Also of note is the fact that, in preparing its NOL calculations, Collins used a prospective tax rate of 35%. *See* Tr. 333-38, JX 551 at 1710.
[63] Tr. 875.
[64] The making of equitable judgment calls within established ranges is one of the unavoidable attributes of an appraisal proceeding. *See Prescott Group Small Cap, L.P.*, 2004 WL 2059515, at *31 ("[I]t is one of the conceits of our law that we purport to declare something as elusive as *the* fair value of an entity on a given date. . . . Experience in the adversarial[] battle of the experts' appraisal process under Delaware law teaches one lesson very clearly: valuation decisions are impossible to make with anything approaching complete confidence. Valuing an entity is a difficult intellectual exercise, especially when business and financial experts are able to organize data in support of wildly divergent valuations for the same entity. For a judge who is not an expert in corporate finance, one can do little more than try to detect gross distortions in the experts' opinions. This effort should, therefore, 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 reasonable values, and the judge's task is to assign one particular value within this range as the most reasonable value . . . based on considerations of fairness.") (citation omitted) (emphasis in original).

calculations did not differ materially; the experts diverged with respect to the adjustments which may be necessary to obtain an appropriate measure.

Taylor made the following calculations to determine the appropriate WACC: [(Cost of Debt) * (Percentage of Capital Represented by Debt)] + [(Cost of Equity) * (Percentage of Capital Represented by Equity)].[65] A capital structure of 55% equity and 45% debt was based on Holdings' historical allocation. To determine the after tax cost of debt, he used a pre-tax cost of 8.75% and a tax rate of 38.11%, and established an after tax cost of debt of 5.42% with the following calculation: 8.75% * (1-38.11%). The Cost of Equity is a result of: Risk Free Rate[66] + (Beta of Security[67] * Market Premium) + Size Premium. Taylor selected the risk free rate of 6.19% using the contemporaneous Federal Reserve data for long term Treasuries. He chose a levered beta of 0.66 based on Holdings' capital allocation and comparable company levered betas.[68] Taylor estimated the market premium as 7.97% based on an S&P 500 benchmark as of 1999. He applied a size premium of 1.13%. The result is a calculated cost of equity of 12.58%. When all the

[65] JX 537 at 18.

[66] The cost of presumptively riskless capital, usually based on federal government bonds or the London Interbank Offering Rate.

[67] An estimate of the volatility of the security and a representation of the systematic risk of holding that security that cannot be diversified by holding other securities.

[68] Finding comparable companies has been difficult. The Pepsi and Coke bottling franchisees, for instance, have minority parent companies that may guarantee their debt, making their cost of capital lower than would otherwise be the case. *See* Tr. 201-03. Whether that includes all of the debt of the comparables, or only some of it, and the actual effect on the cost of capital are unclear. In the absence of a better alternative, the only option is to make reasonable assumptions about comparables.

calculations are completed, a WACC (and discount rate) of 9.36% is projected. Taylor later amended his calculations to increase his levered beta to 0.67, and the discount rate to 9.41%, to account for an error in the initial calculation.[69]

Collins shows a similar equation in his report to arrive at a WACC, with the one significant difference: the use of a decile adjusted beta (which the Petitioners' argue is improper because it adjusts the WACC calculation twice for the same company specific beta). Collins also uses somewhat different numbers to achieve the WACC in his report. However, the 10% discount rate that he presents as following from his WACC calculation does not, in fact, directly result from it. After four pages of analysis on the WACC calculation, he simply concludes that 10% is the result, without any notation that 10% diverges significantly from the result of his calculations. Initially, his calculations suggested a WACC of 9.63%; after being apprised of a mistake, he revised his work to yield a calculated WACC of 9.4%.

The selection of an appropriate discount rate has a profound effect on the share price in an appraisal action. The Petitioners offer a discount rate, subsequently amended for errors in the inputs, of 9.41%.[70] The Respondent's valuation expert tendered a report containing WACC calculations which produce

[69] JX 532 at 2.
[70] JX 532 at 1.

a 9.63% discount rate.[71] Collins admits that his WACC calculation, also subsequently amended for various errors in the inputs, actually leads to 9.4%.[72] Collins "rounds up" his estimate to 10%; he asserts that the proper range of rates is 9.5% to 10.5%, based on the erroneous 9.63% calculation and after failing to account for the amended calculation that, with the errors removed, produced a 9.4% rate. Collins simply invokes "professional judgment" for increasing his proposed discount rate from one calculated slightly above 9.4% to one of 10%.[73]

Collins fails to develop the basis for his "professional judgment." Merely "running the numbers" to calculate a WACC does not reliably or necessarily establish an exact discount rate. The generated number, itself the product of assumptions and projections, may require assessment and may be adjusted; those adjustments are sometimes (if not routinely) unavoidably subjective.[74] The goal of the discount rate is to capture the effects of the company's capital structure (and all that that encompasses) on its fair value. Although the WACC calculation attempts to adjust for Holdings' unique market position (especially in relationship to the Coke and Pepsi bottlers), the raw arithmetic yields but a number within a range and, in the Court's judgment, does not fairly accommodate the markets or capital

[71] JX 535 at 22-23.
[72] Tr. 980. Adjusting Taylor's WACC calculation to reflect the 39% tax rate would change the result to 9.36%. That small adjustment, given the estimated and approximate nature of the discount rate, requires no modification of the Court's analysis.
[73] Tr. 980-81.
[74] DLJ, in its fairness opinion, employed a range from 9% to 11%, but appears to have focused on 10%. JX 48 at 21.

structure of Holdings. Based on the record, the Court is satisfied that a fair range of a potential discount rate for Holdings has a low end of 9.25% and a high end of somewhat in excess of 10%, perhaps 10.25%. Use of a midpoint may be appropriate; that, of course, is not required. An adjustment of the calculated WACC by approximately 0.35% is a reasonable accommodation of the concerns related to Holdings' structure. Thus, the Court concludes that a discount rate of 9.75% should be used.

5. Capital Expense

Collins (as did DLJ) uses a static $25 million annual estimate for capital expenditures; Taylor urges a dynamic method measured as 3% of net revenues. A percentage of revenue estimate has been used to project capital expenditures.[75] The Petitioners observe that the 3% estimate was utilized by Carlyle at the suggestion of management as an accurate indicator of future capital expenses.[76] Taylor also points to historical capital expenditures that could be approximated as 3% of net revenue.[77] On the other hand, a constant projection of annual capital expenditures of $25 million over the projection period is roughly equivalent to Taylor's percentage of revenue methodology. Each projection approach is

[75] *See Cede & Co. v. Technicolor, Inc.*, 884 A.2d 26, 38 (Del. 2005); *In re U.S. Cellular Operating Co.*, 2005 WL 43994, at *14 (Del. Ch. Jan. 6, 2005). *Cf. Del. Open MRI Radiology Assocs., P.A.*, 898 A.2d at 336.
[76] *In re Radiology Assocs., Inc., Litig.*, 611 A.2d at 490 (approving use of projections prepared by corporation's bank with management's input to evaluate application for a loan).
[77] JX 537 at 16.

reasonable. Because of the relative brevity of the projection period, the Court elects to use the fixed projection of $25 million annually.

6. Net Operating Losses

At the time of the merger, Holdings had accumulated net operating losses ("NOLs") totaling $49.3 million.[78] As an offset to future taxes, the NOLs had substantial value. The treatment of the NOLs was the topic of some debate, although neither Taylor nor Collins had the accounting expertise or the stomach for vigorous engagement. There were two problems. The first was whether Holdings' acquisition of DLJ's interest in it triggered a change in control that would have limited or precluded their use on a going-forward basis.[79] The record before the Court does not support the conclusion that the NOLs would have been impaired for this reason. The second was an annual limitation—Collins argued for $4.5 million per year and Taylor sponsored $6.215 million per year.[80] The proper amount, perhaps explained too simplistically, depends upon the value of the entity's equity and the long-term tax rate. KPMG, Holdings' accountant, concluded that the NOLs could be used at an annual rate of $6.25 million per year. Arthur Andersen, on an after-the-fact basis, concluded that the $4.5 million amount would be

[78] *Id.* at 8.

[79] Of course, the question is the value that would be conferred by the NOLs assuming that the merger did not occur.

[80] The NOLs, as carried forward during the projection period, are used to reduce tax liability (and, thus, increase cash flow). After the projection period, the NOLs until they are fully consumed, reduce the tax liability. That tax savings must be reduced to a lump sum present value. Thus, the ultimate value of the NOLs depends upon the tax rate.

appropriate.[81] Ultimately, there is no reason to doubt the pre-merger projections of KPMG, as Holdings' accountant, and the Court, therefore, will employ its estimate of the availability of NOLs in its valuation analysis.

7. Debt

The Petitioners argue that the outstanding liabilities are properly estimated at $392.8 million, while Holdings relies on DLJ's estimate of $402.2 million. A report, dated September 30, 1999, to Holdings' board[82] shows debt of $386,576,000. Taylor starts with this number. He recognizes that this number excludes necessary items, such as an estimate for a pending appraisal action and accrued tax liability. He therefore adds $7,871,500 due under an August 1999 settlement agreement for an appraisal action involving Seven-Up/RC.[83] He subtracts income tax refunds and credits due of $1,597,049, which brings the debt to $392.85 million.[84]

Holdings contends that a more accurate estimate of Holdings' debt would be $402.2 million, approximately $9.4 million more than the Petitioners' estimate.

[81] Some specific criticisms of Arthur Andersen's analysis involved the improper valuation of the shares. This included adjustment for minority control discount, the relationship between the parties that might result in an implicit discount in share price, and the impact of a limited market for its shares. Also, there was debate as to whether Arthur Andersen's projections accounted for income from the Seven-Up/RC acquisition. The limitation that might have restricted the use of the NOLs carried forward by Holdings would not apply to income received through the Seven-Up/RC subsidiary.
[82] *See* JX 538 at 3.
[83] JX 538 at 4. Taylor observes that DLJ estimated the appraisal action liability as $8 million.
[84] JX 538 at 2-5. This is the net of a federal income tax credit of $1.614 million, a California tax credit of $248,048 and California tax liability of $265,380.

The explanation for the divergence that has emerged has centered around three considerations: tax effects of cashed-out options, accrued interest during the first week of October 1999, and differences in rounding other estimates.

Interest on the debt of $386.58 million should be accrued from September 30, 1999, to the date of the merger: $977,491.[85] Also, the Respondent made some rough approximations.[86] In weighing the evidence, and in the absence of a more precise explanation from Collins as to rounding of the tax estimates, the Court will accept Taylor's rounding conventions.

Finally, evidence for the treatment of the lost option deduction comes from Lovvorn's testimony; she testified that Holdings, as the result of the cash-out of various options, would lose an $18 million deduction.[87] Taylor estimates that, if one accepts Lovvorn's understanding, the consequences for Holdings' debt (*i.e.*, a corresponding additional tax obligation) would be an increase of $6.9 million.[88] However, because the debt increase is calculated as tax rate multiplied by the lost options deduction, the 38.11% tax rate used by Taylor must be adjusted. Using the Court's 39% tax rate, the effect of the options on Holdings' debt would be an increase of $7.02 million. The Court finds Lovvorn's testimony about the necessity for including an estimate for the effect of options credible, and accepts Taylor's

[85] JX 348.
[86] JX 48 at 4265; JX 528 at 3.
[87] Tr. 438-39, 446-47.
[88] Tr. 716.

means for estimating the magnitude of that effect. With addition of this debt and the accumulated interest on Holdings' debt, the debt estimate for the Court's valuation model is $400.85 million.

8. Depreciation and Amortization

Collins urges use of depreciation and amortization estimates from the proxy statement soliciting approval of the merger, while Taylor argues for amortization fixed at $5.4 million and depreciation at 3% of revenue.[89] This Court has traditionally given weight to unbiased management estimates. There is no reason not to accept management's projections; the integrity or accuracy of Holdings' management has not been challenged with respect to these projections. Thus, amortization and depreciation will be drawn from the proxy statement.[90]

9. Miscellaneous Inputs and Adjustments

Taylor assumed a $200,000 annual negative change in working capital. That projection is reasonable.[91]

[89] Thus, the Court will use a range between $26.5 million and $28.2 million annually. Taylor's model forecasts a range between $28.6 million and $34.0 million.

[90] *Del. Open MRI Radiology Assocs., P.A.*, 898 A.2d at 332 ("Traditionally, this court has given great weight to projections of this kind because they usually reflect the best judgment of management, unbiased by litigation incentives. That is especially so when management provides estimates to a financing source and is expected by that source (and sometimes by positive law) to provide a reasonable best estimate of future results.").

[91] Collins assumed that working capital would remain constant during the projection years.

Two employee option plans would generate approximately $1.8 million on exercise prompted by the merger.[92]

10. Terminal Value

The parties do not agree upon a proper method for determining terminal value. The terminal value is especially significant because it comprises, unfortunately,[93] roughly three-quarters of the final valuation under both parties' models. The Respondent proposes multiplying EBITDA by 7.5. The Petitioners propose using the Gordon Growth method, with a 3.5% annual perpetual growth assumption.

Appraisal actions have used the Gordon Growth method to determine the appropriate terminal value in a DCF calculation.[94] On the other hand, a good industry comparison is crucial if a multiplier methodology is employed, but the Respondent has not established that appropriate comparables are available. In addition, the Gordon Growth model is a more consistent fit for the DCF analysis[95]

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[92] For the fourth quarter of calendar year 1999, EBITDA is estimated by taking the 1999 estimate of $89.8 million and subtracting $70.6 million as actual EBITDA for the first three-quarters. *See* JX 345. Inputs for the balance of 1999 are prorated from the merger date to the end of the year.

[93] *See, e.g.*, *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549 (Del. Ch. Apr. 25, 2002).

[94] *See Prescott Group Small Cap, L.P.*, 2004 WL 2059515, at *14. *See also Cede & Co. v. MedPointe Healthcare, Inc.*, 2004 WL 2093967, at *9-*10 (Del. Ch. Sept. 10, 2004); *see also Cede & Co.*, 2004 WL 286963, at *4.

[95] "The Gordon Growth Model is equivalent to a discounted future cash flow analysis with certain simplifying assumptions, namely, (a) earnings grow at a constant rate into perpetuity and (b) all earnings are either distributed to shareholders or, if retained by the company, reinvested at the discount rate." Z. CHRISTOPHER MERCER, THE INTEGRATED THEORY OF BUSINESS VALUATION 22 (Peabody Publishing 2004).

than is the use of comparables to establish terminal value.[96] Although he eschews the use of a Gordon Growth model, Collins concedes that a perpetuity growth rate as high as 3.8% would be reasonable for perpetuity growth assumption if 3% volume growth is employed during the projection period.[97] More importantly, Collins asserts that a perpetual free cash flow growth rate of 3.5% annually and a 7.5 multiple of trailing EBITDA both yield substantially the same terminal value.[98] There may be some debate about that observation, but it does reduce the significance of the methodology debate and the Court will use the Gordon Growth methodology and the 3.5% perpetuity debt free cash growth rate, which it finds to be reasonable as applied to Holdings' steady state prospects following the projection period.[99]

11. Number of Shares

As of the merger, on a properly diluted basis, there were 10,777,589 shares of Holdings.[100]

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[96] That is not to say that there are no instances where an EBITDA multiplier is appropriate for a terminal value calculation in an appraisal action. This Court may use whatever method, or combination of methods, is appropriate in an appraisal proceeding. *See ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 907 (Del. Ch. 1999).

[97] Tr. 919-22.

[98] Tr. 920-25.

[99] The debt free cash flow from the Court's 2004 projection provides the starting point.

[100] The parties dispute the proper number. The divergence, 2,674 shares, appears to grow out of uncertainty over the number of shares issued as the result of options exercised just before the merger.

D. *The Valuation Process*

With the various inputs to the discounted cash flow analysis established, the Court has used those in its model and has establish the fair value of each share of Holdings' common stock, as of the date of the merger, to be $32.31.[101]

[101] A summary of the outputs of the Court's model appears in Schedule A, which accompanies this Memorandum Opinion.

The Court may use valuation methods other than DCF analysis. For example, a multiple of trailing EBITDA may provide a useful comparison. Taylor suggests an EBITDA multiple of 8.9 for such a comparison. *See* Tr. 1001. That is somewhat high due to the fact that the comparable companies will have an implicit value premium stemming from the liquidity advantage of a closer relationship with their "parent" companies. Using trailing EBITDA of $86.4 million and a multiplier of 8.9 yields an enterprise value of $769 million, or $35 per share. *See* Tr. 1001; JX. 345 at CAR 3461; JX 36 at CAR 1113. Turner's optimistic view, when discounted for the shortcomings in the multiple, is not inconsistent with the outcome. Because of Holdings' unique market position (and the lack of helpful comparables), other methodologies—all based on comparables of one form or another—are of limited value.

Before announcement of the merger, Holdings' stock was trading in the low-$30s. Although the result here is consistent with that market valuation, the Court has not considered the use of trading data because Holdings was thinly traded, with Jefferies, one of the Petitioners here, as apparently its only market maker. Jefferies was very optimistic about Holdings' prospects; indeed, it encouraged its investors to anticipate a rise in Holdings' price into the mid-$40s.

The conclusion here—that the merger consideration of $25 per share was slightly more than $7 per share less than fair value—may appear to be at odds with Turner's faithful performance as a fiduciary and his acknowledged competence and expertise in the soft drink bottling industry. Or, framed differently, why would Turner sell his stake in Holdings for roughly 25% less than its fair value? Part of the answer can be found through recognition that Cadbury/Carlyle was the only potential buyer. Turner obtained the best price that he could from Cadbury/Carlyle, but how often will the only buyer pay full price? The other part of the answer is derived from the nature of the statutory appraisal process with its primary reliance on DCF analysis. In particular, Collins' inability to justify persuasively his adjustment of the discount rate from roughly 9.4% to 10% contributed significantly to the difference. The answer provided by the DCF calculations, based on individually reasonable inputs, is within the range of reason. Indeed, it returns a result not far from the ranges of the initial DLJ fairness opinion. It is a prudent and credible result on its own, and there is no principled basis for subjectively reducing it. The Respondent, after all, implicitly concedes that the merger consideration was less than fair value by sponsoring an expert who concluded that the fair value was in excess of the merger price.

E. *Pre-Judgment Interest*

The parties have stipulated to a pre-judgment interest rate of 4.8%. The Respondent argues that the Petitioners' delay justifies an effective reduction in its interest obligation either through omitting interest for some period or by less frequent compounding. If pre-judgment interest were viewed as punitive (and that might be the practical consequences at a higher rate), then an adjustment might be worthy of consideration. The circumstances here do not support any such adjustment. Pre-judgment interest will be compounded monthly from the date of the merger through the date of the judgment. Post-judgment interest will be at the legal rate.

V. CONCLUSION

For the foregoing reasons, all fiduciary duty claims against Turner are dismissed and he is entitled to judgment to that effect with an award of costs. Furthermore, the Petitioners are entitled to an award in their appraisal action of $32.31 per share duly presented for appraisal, together with pre-judgment and post-judgment interest as set forth above and costs.

Counsel are requested to confer and to submit forms of order to implement this Memorandum Opinion.

	Schedule A / Dr. Pepper Bottling Holdings, Inc. / Appraisal Model							
	Balance of 1999	1999	2000	2001	2002	2003	2004	
EBITDA	17,682,628	89,800,000	92,494,000	95,268,820	98,126,885	101,070,691	104,102,812	
Depreciation and Amortization	(6,120,924)		(27,100,000)	(27,200,000)	(27,800,000)	(28,000,000)	(28,100,000)	
Operating income EBIT	11,561,704		65,394,000	68,068,820	70,326,885	73,070,691	76,002,812	
Net Operating Loss	(1,435,530)		(6,215,000)	(6,215,000)	(6,215,000)	(6,215,000)	(6,215,000)	
Taxable income	10,126,174		59,179,000	61,853,820	64,111,885	66,855,691	69,787,812	
Income Tax Expense	(3,949,208)		(23,079,810)	(24,122,990)	(25,003,635)	(26,073,720)	(27,217,247)	
After Tax Debt Free NI	6,176,966		42,314,190	43,945,830	45,323,250	46,996,972	48,785,565	
Depreciation Recapture	6,120,924		27,100,000	27,200,000	27,800,000	28,000,000	28,100,000	
After Tax Cash Flow	12,297,890		69,414,190	71,145,830	73,123,250	74,996,972	76,885,565	
Change in working capital	(46,196)		(200,000)	(200,000)	(200,000)	(200,000)	(200,000)	
Capital Expenditures	(5,774,457)		(25,000,000)	(25,000,000)	(25,000,000)	(25,000,000)	(25,000,000)	1.035 X 2004 free cash flow=
Free Cash Flow	6,477,238		44,214,190	45,945,830	47,923,250	49,796,972	51,685,565	53,494,560
To Enterprise								terminal
								896,668,405
Present Value	6,405,327		$41,311,063	$39,115,264	$37,174,223	$35,196,059	$33,285,558	$551,208,849
NPV of future cash flows	743,696,343							
NPV of Unused NOLs	3,570,559							
Stock Option Plan	1,800,000							
Interest Bearing Debt	(400,847,492)							
Total Equity Value	$348,219,410							
Number of shares	10,777,589							
Value Per share	$32.31							

Schedule A