COURT OF CHANCERY
OF THE
STATE OF DELAWARE

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Re: *In re Hanover Direct, Inc. S'holders Litig.*
Consol. C.A. No. 1969-CC
*Fackelmayer, et al. & Cede & Co. v. Hanover Direct, Inc.*
Civil Action No. 3047-CC
*Fackelmayer, et al. v. Feldman, et al.*
Civil Action No. 3291-CC

Dear Counsel:

This is my post-trial decision in this combined entire fairness and statutory appraisal action arising out of a going-private merger consummated on April 12, 2007, in which the public stockholders of Hanover Direct, Inc. were cashed out of the company for $0.25 per share. It is a typical case involving the recapitalization of a troubled company. Hanover was a distressed company that had been heading toward insolvency—its debt commitments combined with its contractual obligations to its preferred stockholders together exceeded the value of its common stock—at the time of the merger and for many years before the merger. After numerous failed reorganization and recapitalization attempts, Hanover found itself still in debt, its business deteriorating, without an end in sight. Hanover's board engaged an independent financial advisor to value the company and, in reliance on that valuation analysis, approved a merger proposal in November 2006 to pay the public stockholders $0.25 per share for their shares of common stock—an amount which the board determined was actually in excess of the fair value of the company's common stock. If anything, the common stock was worth even less at the time the deal was consummated in April 2007. Several stockholders filed suit alleging that the $0.25 per share price they received was unfair. They contend that the intrinsic value of the common stock at the time of the merger was $4.75 per share. At trial, as is typical in litigation of this sort, both sides presented valuation experts in an effort to show that the price of $0.25 per share was either entirely fair, or grossly unfair.

I have thoroughly reviewed the parties' post-trial briefs, and during trial I carefully assessed the strength and credibility of the testimony offered by the various witnesses. Like many of these cases, the valuation issue became a battle of the experts. Unlike most of these cases, however, this decision turns entirely on the fact that one expert's proffered opinion, for a host of reasons, was totally, completely unreliable. For the reasons briefly described below, I find in favor of respondent and defendants (jointly, "respondent"). This decision (to repeat) is driven by the fact that I assign full weight to the trial testimony of respondent's expert witness and no weight to the testimony of the expert witness for petitioners and plaintiffs (jointly, "petitioners"). Accordingly, I conclude that the merger price of $0.25 per share was entirely fair.

Respondent offered the testimony of an experienced valuation professional who has previously appeared as a valuation expert in this Court. Petitioners introduced their competing expert to determine the "fair value" for Hanover. Respondent's expert used three different approaches in his valuation analysis: (1) a DCF analysis; (2) a comparable companies analysis; and (3) a comparable transactions analysis. Petitioners' expert, on the other hand, based her valuation on a single methodology: a comparable public companies analysis.[1]

This post-trial decision will be mercifully (but atypically) brief for two reasons: 1) the relative simplicity of the legal and factual questions presented at trial and in the parties' post-trial briefs; and 2) the overwhelming persuasiveness of

[1] Petitioners' expert also performed a DCF analysis and a comparable transactions analysis but determined that neither of those approaches generated reliable indicators of value, and ultimately rejected her own DCF and comparable transactions analyses essentially because management's "projections were unreliable." Petitioners' Joint Post-Trial Br. 43.

respondent's evidence and arguments relative to those of petitioners. In short, respondent's evidence of fair value was so convincing, and petitioners' evidence was so comparatively weak, that the outcome of this case is not in doubt. And so, given the simplicity of the issues and the strength of respondent's case, I neither wish to burden the parties with a lengthy and fact-intensive post-trial opinion, nor rehash the facts and expert opinions merely to inflict on the readers of this decision the straightforward outcome this case requires.

There is, of course, nothing novel about this type of hybrid action (consisting of an entire fairness action and an appraisal action) in the Court of Chancery. At its heart, the action turns upon one question: was the merger price entirely fair? The issue of fair process is secondary to the ultimate import of fair price; and fair value under a statutory appraisal is tantamount to fair price in an entire fairness action. As is always the case in this type of hybrid action (or any valuation proceeding), the key evidence comes to me by way of each party presenting its own valuation expert in an attempt to convince me that its valuation of the company is the most accurate or appropriate one. Usually, the dueling experts in cases like this rely on similar methodologies and the fight is over the proper inputs (betas, discount rates, revenue projections, cost of capital calculations, etc.) to the valuation models. Here, as noted above, the contest was entirely one-sided. Petitioners' expert witness employed a valuation methodology not only fraught with error, but one also based upon a single valuation technique (comparable companies analysis) rather than a more robust approach (involving multiple techniques, such as a discounted cash flow analysis and a comparable transactions analysis).

Although there is no single preferred or accepted valuation methodology under Delaware law that establishes beyond question a company's value, there are commonly accepted methodologies that a prudent expert should use in coordination with one another to demonstrate the reliability of its valuation. If a discounted cash flow analysis reveals a valuation similar to a comparable companies or comparable transactions analysis, I have more confidence that both analyses are accurately valuing a company. If an expert witness clearly and persuasively explains why he or she has included or omitted an outlier from his or her data set, I have more confidence that the expert witness's data set is less likely to lead to a biased or skewed valuation. Here, petitioners' expert witness employed a methodology that leaves me with no confidence in her valuation. There are many reasons for my lack of confidence. Rather than prolong this decision, I note briefly a few of my most serious concerns: (1) the real-time change (literally) in petitioners' expert's valuation while she testified from the witness stand, as well as several changes in the expert's valuation report in the lead-up to trial; (2) the expert's demeanor in attempting to explain to me why her valuation methodology and its unique approaches were reliable and worthy of confidence, however different those approaches were from more common, clear, and convincing methodologies; (3) the unprecedented attempt by petitioners' counsel to submit a new valuation in their *post-trial answering brief* (which for obvious reasons cannot be accepted as new "evidence" on the valuation question or given any weight in my analysis); (4) the expert's inclusion of data points that seemed to be at worst outliers and at best a failure by the expert to adjust appropriately even for the *possibility* that these data points were outliers; (5) the expert's seeming disregard for earlier data points; and (6) most importantly, the fact that the expert's valuation was based entirely on one valuation technique—a comparable companies analysis—rather than on a blend of techniques. In the presence of data whose reliability is heavily questionable, and in the absence of multiple valuation techniques that serve to cross-check one another's results, I cannot place any confidence in her calculation of $4.75 per share. I hasten to add that there may well be circumstances where a single valuation methodology is valid and reliable, and is perhaps the best and only method by which to value a particular company. This, however, is not such a case or such a company.

I can, however, have confidence in the testimony and valuation methodologies employed by respondent's expert witness. From using a data set that raises no issues of reliability, to applying multiple valuation techniques that support one another's conclusions, respondent's expert witness has convinced me that his valuation of the company is accurate, reliable, and reflective of a per-share value of the company below $0.00. Thus, on the basis of evidence presented at trial and in respondent's expert report, I conclude that the company was in fact "under water" at the time of the merger. Accordingly, a merger price above $0.00 (in this case, $0.25 per share) was entirely fair.

Although fair price is of paramount concern and what stockholders seek to verify they have received, I will note my finding of secondary import: no evidence presented at trial raised any doubt in my mind regarding the process surrounding this transaction. That is, no credible evidence was offered at trial that would suggest the transactional process was manipulated, timed, or tainted by an improper motive so as to cause the company's common stockholders to be offered an unfair price in the merger. The company had long been struggling financially—no one seriously disputes that it was a distressed company. The company retained independent legal and financial advisors who guided it through this process and, based on the evidence at trial, that process resulted in a transaction at a fair price.

For the foregoing reasons, and based on the evidence presented at trial, I conclude that a merger price of $0.25 for a company already below sea level is entirely fair. Counsel shall confer and submit a proposed form of Order consistent with this letter decision.

Very truly yours,

William B. Chandler III

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