IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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MICHAEL W. HINTMANN, et al.,	)	
	)	
Petitioners,	)	
	)	
v.	)	C.A. No. 12839
	)	
FRED WEBER, INC., a Delaware corporation,	)	
	)	
Respondent.	)	

Submitted: February 24, 2000
Decided: April 4, 2000

MEMORANDUM OPINION

Donald E. Reid of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware. OF COUNSEL: Russell M. Pelton of Oppenheimer Wolff & Donnelly, Chicago, Illinois. Attorneys for Petitioners.

Daniel A. Dreisbach of Richards, Layton & Finger, Wilmington, Delaware. OF COUNSEL: Lawrence C. Friedman and Kevin A. Sullivan of Thompson Cobum LLP, St. Louis, Missouri. Attorneys for Respondent.

STEELE, V.C.

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When asked to vote for a 1992 merger, petitioners voted against it and elected appraisal of their shares. In 1998, I issued a post-trial opinion resolving many of the then-outstanding issues. In 1999, I issued another opinion that resolved some other issues and instructed the parties to select jointly a Special Master who would recommend resolution of the remaining questions.

The Special Master recently released his final report containing his recommendations. The parties submitted exceptions to the Special Master's Final Report. I have reviewed the Special Master's Final Report and the parties' exceptions to that report. For reasons explained later in this opinion, I accept the Special Master's recommendations with the following exceptions: I find that (1) .052% should be added to the prudent investor rate because upon examination of the properly admissible evidence it seems petitioners' accounts were not subject to custodial fees; (2) FWI's cost of debt should be 7.23%; and (3) the unvested shares purportedly voted by Petitioner Medic are not properly subject to appraisal. I also find that the prudent investor rate should be updated through the fourth quarter of 1999.

I. BACKGROUND

FWI is engaged in the construction, construction materials and landfill businesses in Missouri. FWI has a construction division that specializes in highway construction, and a materials division that specializes in construction

aggregate mining and processing. Weber Industries, Inc. ("Industries") originated in 1986 for the purpose of holding FWI Class A common stock. Industries ceased to exist on September 15, 1992, when it merged into FWI.

On the date of the merger, FWI had two classes of common stock, Class A and Class B. Industries itself owned 100% of the Class A shares, and 129 FWI employees owned 100% of the Class B shares. Industries had one class of common stock. The Fred Weber, Inc. Employee Stock Ownership Plan owned 95% of Industries' common shares for the benefit of FWI employees. The ESOP participants who voted in favor of the merger received $127.50 in cash plus one share of newly-issued FWI non-voting preferred stock with a stated value of $132.50' for each share of Industries common stock-for a total consideration of $260 per share.

Before the merger, Industries' board requested fairness opinions from two companies, A.G. Edwards & Sons, Inc. ("A.G. Edwards") and Rubin, Brown, Gomstein & Co. A.G. Edwards had valued Industries' shares annually, in accordance with ERISA requirements,[2] for six years preceding the merger. In its

[1] Dividends accumulate daily on the stated value of the preferred shares at the rate of 10% per annum, payable quarterly. The preferred stock participates in any increase in the value of FWI's Class A common up to a maximum value of $180 per share. Shareholders have the option of converting their preferred shares to FWI Class A common.

[2] The Employee Retirement Income Security Act of 1974 ("ERISA') governs 'qualified retirement plans such as FWI's ESOP. FWI structured the merger to allow ESOP participants to seek appraisal. Therefore, I encounter no federal preemption issues.

most recent annual valuation before the merger, completed January 31, 1992, A.G. Edwards had calculated a value of $260 per share. Both companies concluded that the merger provided fair consideration to the ESOP participants.

Notwithstanding the fairness opinions, petitioners voted their shares against the merger[3] and instituted this appraisal action.[4] Petitioner Devine also seeks appraisal of his FWI Class B common shares. I conducted a trial on these issues in June 1997.

The parties' appraisal experts noted that, because Industries was a holding company whose primary asset was 100% of FWI's Class A common stock, the value of petitioners' shares depended upon the value of FWI's Class A common stock, which required the valuation of FWI as a whole. Thus, the experts expressed their opinions concerning the value of petitioners' shares in terms of the value of FWI's Class A common shares.

Petitioners' expert, Ben Buettell, of Houlihan, Lokey, Howard & Zukin, Inc., valued FWI's Class A common stock at $391 per share on the date of the

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[3] The shares were actually voted by a trustee at the direction of an ESOP Advisory Committee, which made most decisions involving the shares. Employees could direct the ESOP trustee's vote in only limited circumstances, which included a merger involving FWI.

[4] The appraisal remedy is generally available to shareholders of both surviving and acquired corporations. The "market-out" exception, however, elimates appraisal rights for shareholders whose securities are listed on a national exchange, are designated as a national market system security by the NASD, or are held by 2,000 or more recordholders. 8 ***Del. C.*** § 262(b)(l). But, the market out exception does apply if the shareholders are forced to take cash, bonds, or other property rights in return for whole shares of their stock. 8 Del. ***C.*** § 262(b)(2).

merger. Respondent's expert, Richard Braun, of Williamette Management Associates ("WMA"), valued FWI's Class A common stock at $271 per share on the date of the merger. Both experts computed the value of FWI by calculating the simple average of the results of discounted cash flow and market capitalization[5] analyses. Both testified that their approaches were substantially similar and that the discounted cash flow and market capitalization valuation methods were generally accepted in the field. The experts averaged the results of the two approaches and subtracted the value of FWI's Class B common shares to determine the value of the Class A common shares. They divided that value by the number of outstanding Class A shares to arrive at the per share value.

II. 1998 OPINION

I issued the post-trial opinion in February 1998.[6] That opinion contains the following post-trial rulings:

(1) FWI's cost of equity was 16.8%;

(2) FWI's cost of debt should be calculated using FWI's actual cost of debt;

(3) FWI's weight adjusted cost of capital ("WACC") was 98% its, cost of equity and 2% its cost of debt;

[5] Although the two experts testified that they used the same valuation methods, Braun called his market approach valuation by a different name, the Guideline Publicly Traded Companies Method.

[6] ***See Hintmann v. Fred Weber, Inc.,*** Del. Ch., C.A. No. 12839, 1998 WL 83052, Steele, V.C. (Feb. 17, 1998).

(4) I rejected a 3% company-specific risk premium;

(5) I adopted FWI's position that its cash and cash equivalents should be treated as operating assets;

(6) I added a 20% premium to the value of the FWI shares to reflect the ESOP's 90% control;

(7) I ordered the parties to appraise the Class B stock according to § 262 methods, not the certificate's redemption provision;

(8) I directed the parties to rely on the most recent July 21, 1992 financial data when preparing the final judgment;

(9) I ordered FWI to pay monthly compounded interest on their shares from the merger date to the payment date as a simple average of FWI's cost of debt and the prudent investor rate;

(10) I set the prudent investor rate equal to the actual interest rate: earned by petitioners from their funds invested in the Money Market Fund, the Bond Fund, the Index Fund, and the Value Equity Fund after deducting applicable fees;

(11) I ordered the parties to recalculate FWI's cost of debt by compiling its actual interest rates for loans from banks and other third parties;

(12) I directed the parties to calculate a prudent investor rate for the Common B shares using the same cost of debt, but without relying on the actual rate earned on the four funds; and

(13) I held that FWI did not engage in bad faith for which I might award attorneys' fees, although I allowed the parties to stipulate to an award that I would put into my final order.

III. 1999 OPINION AND SPECIAL MASTER'S APPOINTMENT

I expected the parties to work out their remaining differences and complete the tasks specified in my 1998 Opinion. Unfortunately, they were unable to do so. As a result, I issued a second opinion in March 1999 resolving some of the still-disputed issues and leaving others for the Special Master, who was to be selected

by the parties.[7] The following paragraphs outline my 1999 rulings and describe the issues that I left for the Special Master.

A. Discount Cash Flow Recalculation

The parties disagree over how to recalculate the fair value of FWI under discount cash flow analysis ("DCF"). FWI also argues that since Devine and Medic received partial distributions the number should be adjusted downward to reflect those distributions. I left the issues relating to DCF for the Special h/laster.

B. Cost of debt

Cost of debt is only 2% of FWI's WACC, nonetheless, the parties argue over its calculation. FWI seeks to avoid interest rates used in certain leases and use low interest rates awarded by manufactures in calculating its cost of debt. Petitioners object to both.

In my 1999 Opinion, I held that if FWI wishes to use the interest rate charged by the manufacturer, FWI must obtain the market price of the product (at the time of purchase) for an immediate cash sale, determine the total amount of FWI's stream of principal and interest payments, and calculate the actual interest rate being charged for the product. I left it to the Special Master to examine the evidence FWI produced supporting its position and petitioners' rebutting evidence

[7] ***See Hintmann v. Weber,*** Del. Ch., C.A. No. 12839, 1999 WL 182577, Steele, V.C. (March 26, 1999).

opposing that position. I held that the Special Master should then choose the more accurate market price and calculate the real interest rate for the loan. That actual interest rate would then be added into FWI's cost of debt calculation. I also noted that FWI could choose simply to delete any manufacturer's loan from its pool of loan data in order avoid the cumbersome process associated with determining the actual interest rate. This election seemed plausible in light of the actual interest rate's minor role in the overall fair value calculation.

C. Prudent investor rate based on the four funds – Industries stock

The parties disagree over how to calculate the prudent investor rate based on the performance of petitioners' investments in the four ESOP funds (-i.e., the Money Market, Bond, Index and Value Equity Funds). For one thing; the: parties disagreed as to whether fractional results should be rounded. I resolved that matter by ordering that the parties calculate all figures to one hundredths of the relevant unit.

In my 1999 Opinion, I confessed to "misapprehending a fact" when I directed the parties in my 1998 Opinion to use petitioners' actual distribution of capital between the four funds. In reality, the Value Equity Fund was not one of the four funds originally available to the ESOP participants. Accordingly, I

instructed the parties to submit their positions on the effect of my mistake to the Special Master.

I also permitted the Special Master to supplement the trial record on this issue and recommend a fund distribution to be used to calculate the prudent investor rate. In so doing, I instructed the Special Master to retain the spirit of my original reasoning in the 1998 Opinion while making the necessary adjustments to correct the error regarding the Value Equity Fund.

Petitioners also dispute the assessment of management fees against the funds when calculating the prudent investor rate. I considered it impossible for me to evaluate that argument's merits after trial since the parties did not present evidence on the fee issue to me at trial. Therefore, I requested that the Special Master attempt to resolve the issue.

D. Class B Common stock – prudent investor rate

At the time of my 1999 Opinion, the parties seemingly agreed that the Class B Common stock's fair price was $202.83 per share. FWI calculated Mr. Devine's 1,886 shares to be worth $382,537.38. Petitioners calculated the total of the Class B shares to be $3,995,000. I instructed the Special Master to correct any discrepancy if these figures mm out to be irreconcilable. I also held that the

prudent investor rate for Devine’s Class B shares is to be calculated independently from the rate for the Class A shares.

E. Attorneys’ fees

Petitioners asked that I order the Trustee to reimburse the petitioners for their costs and fees. I denied that request, just as I had in my 1998 Opinion,

F. Appointment of Special Master

I appointed a Special Master, but left it to the parties to determine the Special Master’s identity. I stated that the Special Master’s final report was to include resolution of the above matters, and an opinion on the fair value of FWI’s Class A and Class B shares and each petitioners’ award. The Special Master was to submit a draft report to the parties, to which the parties could take exceptions. The Special Master was to consider those exceptions, if any, and then submit a final report to me. The parties could also file exceptions to the final report and/or request that I conduct a hearing. Consistent with recent Supreme Court direction, I retained the ultimate decision-making power on the matter and planned to ‘conduct a meaningful review of the final report and exceptions.*

[8] ***See DiGiacobbe*** v. ***Sestak***, Del. Supr., 743 A.2d 180, 183 (1999) (stating “the master’s rulings, findings of fact, conclusions of law, and recommended disposition have no effect until they are adopted by a judge after a “meaningful review.“‘) (citations omitted).

IV. SPECIAL MASTER'S REPORT AND PARTIES' EXCEPTIONS

By order dated April 29, 1999, I appointed Lawrence C. Ashby as Special Master. The parties had earlier agreed on Mr. Ashby. Before discussing the specifics of the Special Master's final report, I note that Mr. Ashby performed admirably in his role. I am confident his involvement greatly enhances the likelihood of an acceptable resolution.

As envisioned by my 1999 Opinion, the Special Master reviewed pertinent portions of the record and information submitted by the parties, requested supplemental briefing, held a number of oral arguments with respect to all remaining issues necessary to appraise the Industries Stock and the Class B Common stock, and considered the parties' preliminary exceptions to a draft report. He filed his final report on January 14, 2000. At the beginning of his final report, the Special Master outlined his findings. I will list those findings first and then discuss the Special Master's rationale in reaching each of his findings. The Special Master found:

- The fair value of the Industries stock (Class A) to be $335.47 per share based upon 225,282 shares.
- FWI's pre-tax cost of debt is 7.43%.
- The prudent investor rate for Industries stock is 10.93%, and the resulting pre-judgment interest rate is 9.18%.

- The prudent investor rate for the Class B common stock is 7.73%, and the resulting pre-judgment interest rate is 7.58%.

- Petitioner Medic perfected his appraisal rights with respect to all shares previously in his Plan account, and FWI's motion to withdraw a portion of the non-vested shares subject to this appraisal proceeding should be denied.

A. Special Master's rationale for his DCF calculations

The Special Master reached his decision regarding the DCF calculations by relying on expert testimony, and in so doing, assessing the legal viability of competing economic theories. He noted two material differences in the parties' approaches to FWI's fair value under a discounted cash flow ("DCF") analysis.

The Special Master traced the first material difference to the methods used by Mr. Braun, FWI's expert. He found that Braun failed to make an adjustment required by my 1998 finding that FWI's cost of capital was 16.8%. In response to rulings in my 1998 Opinion, FWI asserted that its cost of debt was 7.21% and submitted a revised DCF calculation based upon a WACC of 16.556%. The Special Master notes, however, that Braun inconsistently applied the new WACC when doing his calculations. That inconsistency demonstrated that Braun was not following the Court's direction and, accordingly, that the integrity of his results were questionable.

The second material difference related directly to the two primary components of the DCF calculation. Interim Flow is the present value of identified

cash flows for the interim periods, and is one of the primary components of a DCF calculation. The competing Interim Flow analyses both came to precisely tlhe same value, with both experts using the “mid-year convention.” The mid-year convention projects the cash flow for each period as being received in the middle of the year rather than at the end of the year.

In addition to Interim Flows, the other essential component of DCF is the present value of the average cash flow (“Terminal Value”).” The Special Master found significant divergence here among the parties’ respective estimates. The Special Master notes that the Petitioners’ expert applied the same present value factor to his “Average Terminal Value” that he used to calculate the present value of the 1998 Interim Flow. Petitioner’s expert erred because the present value factor for the 1998 Interim Flow is based upon the mid-year convention, and its use therefore overstates the present value of the **average** terminal value at the end of 1998. The Special Master logically opted instead to use FWI’s (expert’s calculations, which adjusted for the six-month period from mid- 1998 to year-end.”

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[9] The sum of the present value of the Identified Flows and the Terminal Value less debt provides the indicated present value of FWI’s equity.

[10] In reaching this conclusion, the Special Master cited to PRATT, ET AL., VALUING A BUSINESS (3d ed. 1996).

B. Cost of debt

The 1998 Opinion instructed FWI to adjust its cost of debt to account for a missing period (the period between the merger date and January 1993) and to reflect the actual rates FWI paid to banks, commercial lenders and other pe-rsons or entities, in arm's length transactions, since the merger date. Accordingly, FWI submitted revised calculations that included the missing period to the Special Master. FWI also attempted to revise its calculation in accordance with the 1998 Opinion by eliminating stockholder redemption rates based on bylaw provisions rather than arm's-length bargaining. FWI's revised calculations, however, contained other changes to which petitioners objected. Specifically, petitioners objected to the continued inclusion of the low-interest equipment transactions, to the deletion of the cement pig leases presented as loans at trial, and to FWI's inclusion of previously overlooked transactions.

The 1998 Opinion extended to FWI the option of including low-interest equipment loans if FWI obtained and submitted the market prices of the equipment (at the time of purchase) for an immediate cash sale as well as other information necessary to calculate the "real interest rate." FWI did indeed collect and submit information regarding low-interest equipment transactions in the cost of debt calculation to the Special Master. Most notably, FWI presented an affidavit to the

Special Master that described the low-interest equipment loans. Letters from various equipment dealers purportedly supporting the affidavit were attached to the affidavit. FWI's affidavit and the letters supporting it state that in most cases no subsidy was paid to secure the financing, and that in those cases where a subsidy was paid, the affidavit takes into account the previously undisclosed subsidies and offers a recalculation of the higher effective interest rate included in FWI's revised calculation.

The Special Master found that FWI's evidence was not what I envisioned when I wrote the 1999 Opinion permitting FWI to present evidence of equipment market prices in a cash sale. The Special Master wrote, "while F'WI has documented the prices it paid, which the dealers say were unaffected by the financing in most instances, FWI has not submitted any evidence of the prevailing market prices paid by others for the equipment involved. In response to the Special Master's draft report, FWI asserted that FWI is the largest purchaser in its area and that, in effect, evidence of the prices paid by FWI is evidence of the market price or lower."[11] The Special Master was not convinced this was the kind of evidence I had in mind when I granted FWI the opportunity to argue for including the low-interest equipment loans in the cost of debt calculation!;. As a

[11] Special Master's Final Report, at 10.

result, he recommended that the low-interest equipment loans be deleted from the calculation of FWI's cost of debt.

FWI wished to delete the cement pig transactions despite a ruling in the 1999 Opinion that closed the trial record. The Special Master found that he did not have the authority to review the decision closing the record. He therefore could not permit FWI to delete the cement pig transactions. Further, he stated that he would not recommend opening the record even if he were so permitted because "[h]olding FWI to the evidence submitted at trial except to the limited extent necessary to correct the defects noted by the 1998 Opinion and to update the calculation for the additional lapse of time is most appropriate and fair to the litigants."[12]

The Special Master also examined two competing methods of calculating interest rates. Petitioners averaged the interest rates of various FWI borrowings without accounting for the dollar size of the borrowings. Conversely, FWI used a weighted average that averaged out the cost per dollar of its loans. The Special Master found FWI's weighted average method to be fairer and more appropriate.

[12] *Id.* at 12.

C. Prudent investor rate – Industries stock

Any proceeds from the merger would have been paid into Petitioners' ESOP accounts. Accordingly, the petitioners are entitled to a prudent investor rate equal to the actual returns that would have been earned if the proceeds had been invested in their ESOP accounts. Since I could never know how the petitioners would have actually allocated those proceeds had they been given the chance, I decided to "assume an allocation of petitioners' assets among the four original funds in the precise manner they were allocated on the date of the merger."[13] The Special Master heeded these instructions and reached what he considered a prudent investor rate.[14]

After some initial wrangling, both parties' methodologies became closely aligned. Both sides advocated the use of the original Money Market, Bond, Index, and Balanced Funds throughout the relevant time period. Nonetheless, the parties calculations yielded different results. This difference can be traced to two causes: (1) FWI used a calculation that reallocated the capital on a quarterly basis -in order to maintain the original ratios, while petitioners did not; and (2) the parties did not

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[13] ***Hintmann v. Fred Weber, Inc.,*** Del. Ch., C.A. No. 12839, mem. op. at 34, 1998 WL 83052, Steele, V.C. (Feb. 17, 1998).

[14] In so doing, the Special Master made allowances for the fact that the Balanced Fund, not the Value Equity Fund, was the fourth fund.

agree on the application of the management fees and expenses in calculating the prudent investor rate.

The Special Master recommended that the capital not be reallocated in determining the prudent investor rate. He stated, "[u]sing the initial averages and only the four original funds already assumes that a prudent investor would have started in 1993 with only 15% of his or her assets in an all equity fund and would not have invested more fully into equities during the seven-year period of sustained growth in the market. Thus, FWI's asset reallocation approach would compound the effect of an already conservative starting point."[15] In other words, he thought that a prudent investor would not rebalance to maintain the original ratios.

Regarding the management fees, the Special Master recognized that the ESOP Trustee regularly charged fees for investment management, record keeping, and custodial services. It is not possible to verify the exact nature of these charges because they were already deducted from the fund balances shown on the participant's account statements. Accordingly, petitioners argued that FWI failed to present satisfactory evidence concerning the fees chargeable against an account where no custodial fees would have been appropriate (since no securities would have been held in a dissenter's account). Petitioners suggested using the overall

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[15] Special Master's Final Report, at 18

gross returns and then allow a reduction of approximately .24%, which according to petitioners represents average fees.

Despite petitioners' arguments, the Special Master found FWI's calculation based on changing account balances more logical. He considered it to be more precise. FWI's comprehensive data gathering regarding the fees clearly proved persuasive.

Finally, the Special Master found that FWI's proposed prudent investor rate should be adjusted upward because FWI committed a minor error in calculating that rate. FWI's proposed rate was based on a ratio that used 85 months as the denominator. According to the Special Master, this was wrong because there were really only 84.5 months in the period.[16] A recalculation using 84.5 yields a small upward adjustment favoring the petitioners.

D. Prudent investor rate – Class B common

The parties used 6 different investments in their calculations to determine a prudent investor rate for the Class B common: (1) Ten-year Treasury Bonds, (2) Moody AAA Corporate Bonds, (3) 90-Day Treasury Bills, (4) 90 Day Commercial Paper, (5) One-year Certificate of Deposit, and (6) Average Risk Mutual Fund. In

[16] The Master found that the period begins in the middle of September 1992. Therefore September 1992 should only count as half a month. Hence, there are only 84.5 months in the period ending September 1999.

accordance with ***Chang's Holdings v. Universal Chemicals and Coatings, Inc.***,[17] the parties allocated only 20% of the capital to the average risk mutual funds. The remaining 80% was allocated to the remaining five investments. The respective calculations contained noteworthy differences only in respect to the 20% allocated to equities.

Petitioners suggested that 21% was the appropriate rate for an average risk mutual fund because 21% was the rate that the S & P Index returned over the period in question. FWI argued that the Stern Brothers Valuation Advisors report ("Stern Report") done by Stern Brothers at FWI's request sets forth a more accurate rate. The Stern Report uses the Morningstar risk and volatility tools to select a group of large, medium, and small capitalization equity mutual funds that Stern claims represent average risk mutual funds. The Stern Report suggested an equity component return of 13.77%.

The Special Master found neither suggested rate to be entirely fair. He first noted that relying entirely on the S & P 500 rate of return would be overly aggressive given its narrow focus on select large cap stocks. It also seemed unfair given the greater-than-average growth of large cap stocks during the relevant period. On the other hand, the Special Master found the Stern Report rate too

[17] Del. Ch., C.A. No. 10856, mem. op. at 9, Chandler, C. (November 22, 1994).

conservative, especially "during a period of extraordinary growth."[18] He found the ***Chang*** formula to be conservative enough in its requirement that only 20% of the investment be allocated to equities. The Special Master also rejected. FWI's argument that the prudent investor rate should be more conservative when applied to petitioners because of their relatively advanced age than when applied to younger investors. He considered this argument inappropriate given Delaware case law.[19] Eventually, the Special Master settled on an equity component rate of about 15.5%, which led to a prudent investor rate of 7.73%. The 7.73% rate compared quite favorably to the legal rate to which courts can resort as the: default rate.

E. Number of shares subject to appraisal

When Petitioner Medic voted against the merger only 20% of his ESOP was fully vested. Medic took early retirement in 1988 subjecting 80% of his plan account to forfeiture and reallocation to other ESOP participants upon a 5-year break in Medic's service. Indeed, Medic did not return to FWI's employ within the 5-year period, which ended in January 1994. Accordingly, 80% of his plan was reallocated to other participants. The Special Master examined whether Medic's

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[18] Special Master's Final Report, at 24.

[19] In support, he cited ***Chang,*** at 8-9, and ***Gonslaves v. Straight Arrow Publishers, Inc.,*** Del. Ch., C.A. No. 8474, mem. op. at 31, Chandler, C., (Mar. 26, 1998).

election to seek appraisal would even apply to the 80% of the plan that Medic ultimately forfeited.

The Special Master recommended that I find that the entirety of Medic's former plan is covered by Medic's appraisal election. That finding would mean those participants who "inherited" part of Medic's forfeited portion of his plan would receive a pro rata share of Medic's interest in the proceeds of this litigation. The Special Master reasoned that since the shares were already converted into a "purely monetary claim," Medic's election could not fairly be undone.[20] Also, he noted that FWI admitted that Medic had the right to demand appraisal with respect to all shares and that Medic's shares were no longer "outstanding" on FWI's books. The Special Master further states that FWI permitted Medic to perfect his appraisal rights as to all his shares, and is now, seven years later, trying to reverse its prior decision.

V. PARTIES' EXCEPTIONS TO FINAL REPORT

Both parties tiled final exceptions to the Special Master's Final Report, but neither party requested a hearing at which they would have the opportunity to question the Special Master. I will now summarize and discuss each of those exceptions, beginning with the petitioners' exceptions.

[20] Special Master's Final Report, at 28.

A. Petitioners' exception to rounding up cost of debt percentage

Petitioners argue that cost of debt should be rounded from 7.43% to 7.5%, as the Special Master had done in his draft report. I disagree with petitioners and find that the Special Master was correct in recommending that this Court use the more precise number. Like the Special Master, I see no need to round up to guard against uncertainty. I find that 7.43% is adequately supported and not overly speculative.

B. Petitioners' request that prudent investor rate be updated

Petitioners ask that the prudent investor rate be updated to take into account the results for the fourth quarter of 1999. Petitioners note that a few months ago FWI asked the Special Master to update its calculations to September 30, 1999 in order to replicate accurately the returns experienced by ESOP participants. The fourth quarter results are available and have been produced by FWI. The same rationale for updating to September 30, 1999 applies to updating to the most reasonable recent date. I find that the prudent investor rate should be updated to recognize the fourth quarter of 1999.

C. Petitioners' request that .052% be added to prudent investor rate

Petitioners object to the Special Master's refusal to add .052% to the prudent investor rate despite petitioners argument that their accounts were not subject to

custodial fees thereby warranting the .052% addition. The Special Master agreed with petitioners regarding this issue in his draft report, but did not recommend the addition in his final report. Petitioners claim that FWI swayed the Special Master by a letter that FWI did not introduce until after the Special Master released the draft report. This unsworn, untimely letter is not persuasive, according to the petitioners. Further, petitioners object because they did not have the opportunity to cross-examine the letter writer, Ryan Easley of Bankers Trust (the ESOP investment management company).

I examined the letter in question. It explains that all fees incurred by the ESOP are charged pro-rata based on the market value of each of the investment accounts, including even those invested in the funds that are not invested in FWI common stock. Whether the letter is persuasive on the inference sought to be drawn or is inaccurate as a matter of fact should be subject to the tests inherent in our adversary system. The record must be closed at some point and can not be re-opened for fact finding without some opportunity for testing the credibility and reliability of the evidence proffered. While this letter appears, at first blush, to be relatively straight forward and matter of fact, petitioners should, in the absence of a stipulation to its accuracy and authenticity, be given an opportunity to put its writer under oath and subject him to the scrutiny of cross-examination before either the Special Master or I can rely upon that evidence. If FWI had put the letter's (content

in issue before the Master and, therefore, before the draft report, petitioners could have elected to examine the author. Since FWI offers the letter as substantive evidence after the draft report for the first time, I refuse to consider the letter and accept the Special Master's recommendation made in his draft report – that .052% be added to the prudent investor rate because the accounts were not subject to custodial fees.

D. FWI's objection to 7.43% cost of debt

FWI argues that the cost of debt should be 7.23%, not 7.43%, because interest rates for certain equipment purchases should have been included. The 1999 Opinion allows FWI to introduce evidence of these rates if FWI also obtained the market price of the product, determined the total amount of FWI's stream of principal and interest payments, and calculated the actual interest being charged for the product.

Arguing that their evidence tit within those parameters, FWI submitted letters from equipment dealers stating that the rates they gave FWI were not conditioned on "side-payments" or any other premiums. The Special Master refused to accept these rates because he felt that lower prices may still have been had in a cash sale. FWI contends that the Special Master reached this conclusion despite the fact that petitioners offered no independent evidence of their own and resorted simply to criticizing the reliability of FWI's affidavit.

FWI's affidavit states the finance programs applicable to FWI's lower rate equipment loans originated with the manufacturers, not the local dealers. Further, FWI's affiant swears that the purchase prices of the equipment were negotiated prior to purchase and prior to any financing arrangements. He therefore implies that FWI always received the lowest possible cash price, regardless of whether it ultimately opted to finance that particular equipment purchase. Yet, the Special Master rejected this evidence because FWI "simply failed to come forward with appropriate evidence of the market prices of equipment in a cash sale as required by the 1999 Opinion."[21]

I disagree with the Special Master, and find that the uncontroverted affidavit addresses the question that I posed in the 1999 Opinion. Perhaps, I could have been clearer in the 1999 Opinion, but all I sought was some credible evidence of arms-length market prices and interest rates, not necessarily cash sales to third parties or FWI. I find FWI's letters and affidavit persuasive and therefore accept FWI's argument that cost of debt should be 7.23%.

F. FWI's contention that a prudent investor would maintain ratios

FWI argues that the funds should have been reallocated on a quarterly basis in order to maintain the original ratios throughout the seven year period.

[21] Special Master's Final Report, at 10.

Reallocation is especially reasonable given the petitioners' relatively advanced ages, FWI contends.

FWI alleges that the beginning equities ratio was approximately 48% and that the ending equities ratio (seven years later was 58%). FWI argues that a 58% ending equities component is too risky to be "prudent."

I, however, agree with the Special Master's recommendation not to require reallocation. The Special Master is correct in stating that the original ratio was quite conservative given the steady bull market of the last seven years. Investor attitudes have changed remarkably over the last decade. Today's prudent investor considers investment in equities to be much less risky than did any 1992 counterpart.[22] In fact, the ratios achieved without reallocation may even be considered slightly conservative given the mindset of today's prudent investor - even if that prudent investor is in his early sixties.[23] Accordingly, I accept the Special Master's recommendation, and will not require reallocation.

FWI alleges that the Special Master disregarded ***Chang*** and its progeny that suggest no more than 20% in equities to be prudent. If this holding seemingly

[22] "The average investor measured by the American Association of Individual Investors has boosted stocks to 75% of his or her portfolio from about 60% in 1994." WALL ST. J., March 27, 2000, at Cl.

[23] Petitioners' average age is sixty-one.

contradicts ***Chang***, it should be read to recognize today's more risk-tolerant prudent investor.

G. FWI's contention that the forfeited shares should not be subject to appraisal

FWI argues that the Special Master's recommendation that the forfeited shares be considered subject to appraisal contradicts both ERISA and Delaware law, and should therefore be rejected. Specifically, FWI claims it was obligated under ERISA to follow the wishes of the plan participants who took Medic's forfeited shares. Undeniably, those people wanted the merger consideration, not appraisal. A refusal to honor this wish would be a breach of fiduciary duty under ERISA, FWI claims.[24] FWI acknowledges that it permitted Medic to vote shares that he did not beneficially own, but it adds it did so in good faith before Medic's forfeiture became final. FWI argues it only permitted Medic to vote those shares because it was unclear at the time whether they would indeed be forfeited; therefore, FWI claims, it did not admit that Medic had permanently binding authority of his unvested shares.

FWI also states it would be "administratively impossible" for the ESOP to subject the forfeited shares to appraisal. The cash portion of the exchange has been invested for over five years. Dividends were paid, and cash has been distributed to

[24] See ERISA § 404(a)(l)@), 29 U.S.C. § 1104(a)(l)(D).

some former employees. Participants have retired and received distributions. FWI also argues that a court order forcing FWI to subject the forfeited shares to appraisal would unlawfully involve the Court in the administration of the ESOP. FWI alleges that only the federal courts may sanction that type of involvement with an ESOP pursuant to ERISA.[25]

FWI cites Delaware law as well. FWI relies on 8 ***Del. C.*** § 262(k), which permits dismissal of appraisal rights "upon such terms as the Court deems just." In his Final Report, the Special Master acknowledged that statute, but stated the facts of this case did not justify this Court unperfecting Medic's appraisal rights,

FWI disagrees, and argues that the worth of Medic's forfeited shares should be measured by the preference of the ESOP participants who ultimately took control of those shares. Those participants made their preferences clear when they voted for the merger and elected not to pursue their appraisal rights, states FWI.

I agree with FWI. I can think of no good reason why the participants who eventually ended up with Medic's forfeited shares should bear the consequences or obtain the benefit of his election to seek appraisal. I also recognize the difficulties associated with converting those shares at this late date, if it is possible to do so at all. Equity dictates that the preference of the ESOP participants now holding those shares should prevail over Medic's decision to vote shares in which he had only an

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[25] See ERISA § 502, 29 U.S.C. § 1132.

inchoate right. Medic, who had retired by the time of the merger, undoubtedly knew his rights would not vest in 80% of the shares he had been allowed to vote. To rule otherwise would create a windfall for shareholders who voted for the merger and who, therefore, elected not to seek the benefit they would now receive.

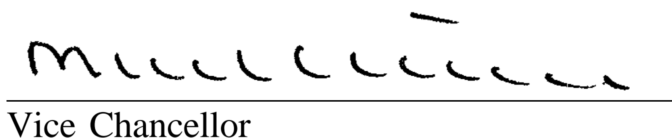
H. Petitioners took exception and requested that litigation costs be deducted from total proceeds if persons who voted for the merger benefited from Medic's forfeited shares

My decision to limit appraisal to Medic's vested shares obviates the need to consider this exception.

VI. CONCLUSION

I accept the Special Master's recommendations on all but the following issues: (1) I find that .052% should be added to the prudent investor rate because upon examination of the properly admissible evidence it seems petitioners' accounts were not subject to custodial fees; (2) I find that FWI's cost of debt should be 7.23%; and (3) I find that the unvested shares purportedly voted by Medic are not properly subject to appraisal. I also find that the prudent investor rate should be updated through the fourth quarter of 1999.

Petitioner's counsel shall prepare an Order consistent with these findings, to be approved as to form by respondent.



Vice Chancellor