COURT OF CHANCERY
OF THE
STATE OF DELAWARE

JOHN W. NOBLE
VICE CHANCELLOR

417 SOUTH STATE STREET
DOVER, DELAWARE 19901
TELEPHONE: (302) 739-4397
FACSIMILE: (302) 739-6179

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Stuart M. Grant, Esquire
Grant & Eisenhofer, P.A.
1201 North Market Street, #2100
Wilmington, DE 19801

Thomas J. Allingham II, Esquire
Skadden, Arps, Slate, Meagher & Flom LLP
One Rodney Square
P.O. Box 636
Wilmington, DE 19899-0636

Re: *Cede & Co., Inc. v. MedPointe Healthcare, Inc.*
C.A. No. 19354-NC
Date Submitted: January 20, 2004

Dear Counsel:

This is an appraisal action to determine the fair value of approximately 2.3 million shares of stock of Carter-Wallace, Inc. ("Carter-Wallace" or the "Company") which were held by Petitioners Cede & Co., Inc. and GAMCO Investors, Inc. (collectively, the "Petitioners"). On September 28, 2001 (the "Merger Date"), a transfer of Carter-Wallace was accomplished. This transfer had two components: an asset sale of the Company's Consumer Products Division (the "Asset Sale") and the merger of the Company's

Healthcare Division with MedPointe Capital Partners, Inc (the "Merger").[1] Under the terms of the agreement governing the Merger, the shareholders would receive $20.44 per share.[2] Objecting that the merger consideration was inadequate, the Petitioners made, as the Company concedes, a timely demand for appraisal for 2,143,567 shares and satisfied all requirements of the appraisal statute, 8 *Del. C.* § 262.[3] For the reasons discussed below, I find that Carter-Wallace had a fair value of $24.45 per share as of the Merger Date and that the appropriate annual interest rate thereon from the Merger Date is 7.50%, compounded quarterly.

I. FACTUAL BACKGROUND

Many of the facts relevant to this appraisal action are undisputed.[4]

A. *Carter-Wallace*

Carter-Wallace was a publicly-traded company with 33,487,623 outstanding shares of Class A common stock and 12,216,883 outstanding shares of Class B common stock. It manufactured, produced, marketed, and sold consumer and pharmaceutical products through two separate business segments – the Consumer Products Division and the Healthcare Division – a fact which would prove critical in the decision to sell the Company. The Consumer Products Division included the Carter Products division which

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[1] Carter-Wallace was the surviving corporation which then changed its name to MedPointe Healthcare, Inc. For convenience, Respondent, MedPointe Healthcare, Inc. will sometimes be referred to as "Carter-Wallace" or the "Company."

[2] The merger consideration at the time of the Merger was $20.30 per share, subject to certain post-closing adjustments. Those adjustments added $0.14 per share.

[3] Whether timely demand was made with respect to approximately 200,000 other shares is a question that must be resolved.

[4] There are significant disputes regarding fiduciary duty claims, asserted elsewhere, that are not for decision in this matter.

sold such products as Nair, Pearl Drops, Arid, First Response home pregnancy tests, and Trojan Condoms, and the Lambert Kay pet products division. The Healthcare Division included Wallace Laboratories and Wampole Laboratories and produced antihistamines, muscle relaxants, cough and cold medications, and drugs for the treatment of cancer and epilepsy.

Carter-Wallace was formed in 1880 by the great grandfather of Henry Hoyt ("Hoyt"), who was the chief executive officer of the Company for most of the time period relevant to this proceeding. The majority shareholder of Carter-Wallace was CPI Development Corporation ("CPI"), and substantially all of CPI's shares were owned by members of the Hoyt family. As of June 2001, CPI owned 11,754,000 shares of Carter-Wallace Class A common stock, which represented 35.12% of the outstanding shares of common stock, and 11,754,000 shares of Class B common stock of Carter-Wallace, representing 96.17% of that class of stock. As a result, CPI held approximately 83% of the voting power of all outstanding stock of Carter-Wallace.

While in the years leading up to the Merger, the Company had experienced significant income and earnings growth, there was some evidence that this was soon likely to end. For example, from 1997 to 2001, the Company's revenues grew from $167 million per year to more than $222 million per year, and its per share earnings nearly doubled from $0.58 to $1.04 per share. However, the Company's market share of the muscle relaxant, Soma, was under increasingly sharp attack from generic versions of the drug. Furthermore, patent protection on two of its leading drugs, Astelin and Felbatol, was set to expire in the near future. Perhaps as the result of Carter-Wallace's decision in

1994 to reduce dramatically research and development expenditures, there were no significant new drugs in the product pipeline. While the Company did have a new cancer treatment drug, Taurolin, available to it, it had not yet begun to market it significantly, and its possible benefits for the Company were unknown.

B. *Efforts to Sell the Company as a Whole*

In November 1998, Carter-Wallace retained J.P. Morgan Securities Inc. ("JP Morgan") for the purposes of arranging a sale of the Company.[5] The ensuing sale and auction process would not be an easy one. In fact, Willard "Sandy" Boothby ("Boothby"), Vice Chairman of Investment Banking at JP Morgan, testified that the process lasted "longer than virtually any other transaction that [he had] worked on."[6]

On June 24, 1999, Hoyt and the Board approved and adopted a series of "golden parachutes" which provided generous payments to certain employees of the Company in the event of a change-in-control. Less than a month later, the Company and Hoyt entered into a "consulting agreement" under which the Company would pay Hoyt $69,300 monthly during the five years beginning at his retirement, which was slated for, and did occur on, December 31, 2000. This agreement also provided that the Company's obligations would be accelerated in the event of a change-in-control.

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[5] The parties dispute how this occurred. The Petitioners claim that Hoyt decided to retire and, having no successor in the Company, decided to sell the Company before doing so. Carter-Wallace, however, insists that it hired JP Morgan "to evaluate strategic alternatives available for enhancing shareholder value to the Company" and it recommended that the Board explore the possibility of a sale or merger. Resp't's Post-Tr. Br. at 5.
[6] Tr. at 150.

After initially putting the sale process on hold in October 1999 to allow the Board to evaluate the potential value of Taurolin, the process resumed from March through August 2000. During this time, JP Morgan contacted and provided information to more than forty potential purchasers. Neither the Board nor CPI placed any limits on which potential purchasers could be contacted and the universe from which these potential purchasers were solicited was broad. As part of the sale process, JP Morgan developed a descriptive memorandum to inform potential purchasers about Carter-Wallace. This memorandum, as one would expect of a document advertising the sale of a company, was very optimistic about the Company's prospects:

> Carter-Wallace is recognized as a diversified worldwide manufacturer and marketer of leading consumer and healthcare products. Through new product introductions, strategic acquisitions, and targeted marketing and advertising, the Company has built a profitable and diverse portfolio of trusted brands in growing niche product categories. Opportunities to accelerate top-line growth in the United States through increased advertising and marketing of leading brands and products in categories with the greatest growth prospects, and through new product introductions and product extensions. In addition, expanding distribution of existing products into new countries provides a significant, incremental source of growth.[7]

Boothby testified that, while initially the Descriptive Memorandum was released to potential customers only upon the signing of a confidentiality agreement, at some point the search for an acquirer became "desperate" and they "were sending that material out to prospective purchasers without a confidentiality agreement."[8]

By August 2000, this solicitation had resulted in the receipt of eight preliminary indications of interest. Most indicated an interest in purchasing only a specific portion of

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[7] PX 1 at HLHZ10194 (the "Descriptive Memorandum").
[8] Tr. at 167.

the Company – the Healthcare Division, the Consumer Products Division, or certain products or brands – as contrasted with acquiring the Company in its entirety. On November 10, 2000, an additional indication of interest was submitted by the eventual acquirer, MedPointe Capital Partners, LLC, for the Healthcare Division.[9] Only one company, IVAX, showed any serious interest in purchasing the Company as a whole. JP Morgan prepared preliminary analyses of an acquisition of the Company for IVAX and encouraged it to be more specific in its indication of interest; however, no bid was received from it by the due date.

C. *The Decision to Sell the Company in Two Parts*

By December 5, 2000, Carter-Wallace and JP Morgan were considering selling the two business divisions to different purchasers. JP Morgan advised the Board that any sale of a division as an asset would have negative tax implications and also informed the Board of ways to minimize these effects. JP Morgan's plan to minimize tax liabilities was to have two purchasers, each interested in a different division of the Company, form a joint venture and purchase the Company as a going concern.

Ultimately, this plan was not pursued, either because JP Morgan was "unsuccessful in convincing parties to participate" in such a plan[10] or because the Carter-Wallace Board rejected this proposal.[11] Instead, following receipt of preliminary indications of interest, discussions with potential purchasers focused on an asset sale of

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[9] RX 62-36.
[10] Tr. at 156.
[11] The parties dispute why this plan was not implemented. Because it is not relevant for the purposes of this action, I need not resolve the issue.

the consumer products business, followed by a merger involving the remaining healthcare business. This plan would carry with it a substantial tax liability that would have to be borne by the Carter-Wallace shareholders.

From mid-December 2000 until February 2001, JP Morgan received at least eight preliminary indications of interest in the Consumer Products Division and at least three indications of interest in the Healthcare Division. After requesting final bids from the interested parties in March 2001, the Company received: (i) three offers for the Consumer Products Division from Armkel, Playtex, and JW Childs with DB Capital Partners and the Shansby Group; (ii) two offers for the Healthcare Division from MedPointe and Andrx; and (iii) a letter from Biovail indicating an interest in discussing an offer for the Healthcare Division. With respect to the Consumer Products Division sale, the Board decided to implement an auction process to improve the price since Playtex and Armkel had submitted similar bids. With regard to the Healthcare Division, only MedPointe submitted a fully marked-up merger agreement and substantially completed its due diligence. As this bid was higher than any other bid or indication of interest, a decision was made to begin contract negotiations with MedPointe, while still encouraging the other potential purchasers to complete their due diligence. Each of the interested parties was asked to re-bid its final offer by March 27, 2001.

D. *The Board Considers and Rejects Alternative Transaction Structures*

During the next few months, the Board would receive alternative proposals and would reject them for various reasons. For instance, the JW Childs Group expressed an interest in paring with Schwarz Pharma to present a bid for the entire Company. This

offer was declined by the Company in late April because the offer price was less than the value of the transactions being negotiated with MedPointe and Armkel and was subject to an extended due diligence period of approximately 45 days, and the group demanded the reimbursement of approximately three million dollars incurred in due diligence expenses.[12] Similarly, on March 14, 2001, the Company received a letter from Galen Associates expressing an interest in a tender offer for 51% of the stock or a private purchase of the Hoyt family's stock. When the Board informed Galen that it was not interested in pursuing such a transaction, it then expressed an interest in pairing with the Leschly Group to tender for all equity at the same price. The Board was then informed by Leschly that it was unable to present a detailed proposal but had an interest in conducting due diligence.

On April 26, 2001, an investor proposed an alternative transaction under which the Company would be sold in two parts but would avoid the tax liability. This proposal called for the Company to spin the two divisions into subsidiaries and then divest each subsidiary to a different purchaser in a non-taxable merger. This proposal would have required the Company to hold to the subsidiaries for two years before divesting them. JP Morgan informed the Board that it concluded that any potential tax advantages of this proposal were outweighed by its risk – the Company would be separated into two smaller public companies that were relatively illiquid and that would then have to survive in the

[12] Furthermore, the Board was advised on April 4, 2001, that Schwarz Pharma was pulling out of the JW Childs Group.

same difficult competitive environment for two years and then be sold at a premium. Based on this assessment, the Board rejected the investor's proposal.[13]

E. *The Structure of the Final Deal*

After a fairness opinion authored by Houlihan Lokey was given to the Board on May 7, 2001,[14] (the "Houlihan Lokey Fairness Opinion") the Board approved the final terms of the arrangement under which Carter-Wallace was to be sold. It was structured as a two-step transaction: (1) Armkel LLC, a joint venture between Church & Dwight Co., Inc. and Kelso & Company created specifically for this purpose, would acquire all assets and liabilities relating to the Consumer Products Division for a cash payment of $739 million, less certain outstanding debt; (2) MedPointe Capital Partners would acquire the Healthcare Division for $408 million in a merger in which Carter-Wallace would remain the surviving entity and would change its name to MedPointe Healthcare, Inc. After paying transaction costs, the outstanding Carter-Wallace stock would be cancelled and the proceeds would be distributed among the shareholders in the amount of $20.30 per share, subject to certain post-closing adjustments.

That the Asset Sale of the Consumer Products Division and the Merger of the Healthcare Division were dependent on each other is not in dispute. The Company's proxy statement seeking shareholder approval of the transaction was unambiguous: "The

[13] At a suggestion of one of the directors, the Board also asked JP Morgan and Houlihan Lokey Howard & Zurkin ("Houlihan Lokey") to analyze the value of the Company's individual brands in the context of a possible sale of each brand on a per brand basis. Both concluded that the estimated after-tax value of these brands was less than the value that would be realized from the transactions being negotiated with Armkel and MedPointe.

[14] RX 62-125.

asset sale and the merger are conditioned on each other. Therefore, the conditions to both of the transactions must be satisfied or waived in order for the asset sale and the merger to be completed."[15]

As a result of the adjustments, the shareholders actually received $20.44 for each share they owned on the Merger Date. While this was approximately the same as the market price of the stock after May 2001 when the transaction was successfully negotiated, in the year prior to the merger, shares of Carter-Wallace had been trading higher. For instance, from January 2001 to April 2001, its average market price was approximately $24 per share, reaching a high of slightly over $26 in March. Between August 2000 and January 2001, its stock was generally trading at an even higher price. Its average price was over $26.00 dollars a share and reached almost $34 per share at its highest point. Before then its stock price was more volatile, trading any where between $18 and almost $24 from April 2000 to August 2000. The first rumor of a possible sale surfaced on May 3, 2000, in the *New York Post*. Before then, from at least January 1998 until April 2000, the trading range of Carter-Wallace stock was generally between $15 and $19 per share.[16]

F. *Transaction Costs Related to the Merger*

As result of the structure of the transaction, the total price paid for Carter-Wallace of $1.3 billion was reduced by more than $320 million in tax liability and severance and closing fees before the net proceeds were distributed to the shareholders. The end result

[15] PX 99 at 8.
[16] RX 62-124 at 17-18; Pet'rs' Post-Tr. Br. at app. 2.

was that these transaction costs reduced the equity value of the Company by more than $6 per share. These transaction costs took primarily two forms.

First, because the sale of the Consumer Products Division was structured as an asset sale, Carter-Wallace incurred capital gains tax liability of approximately $160.7 million. The Company does not dispute that these tax payments diverted $3.18 per share from its shareholders.

Second, the sale of Carter-Wallace resulted in the Company's incurring at least $159.7 million in transaction-related costs in addition to taxes. These costs included advisory fees paid to JP Morgan as a result of the sale and change-in-control payments made to Hoyt and other Carter-Wallace employees. Hoyt was paid the balance of his consulting agreement which was accelerated due to the change-in-control. It is undisputed that none of these payments would have been made if the Company had not been sold. The Petitioners claim, as will be addressed more fully later, that these costs reduced the value of Carter-Wallace by an additional $3.16 per share.

G. *Disputes Occur as to Whether Appraisal Rights for Certain Shares were Perfected*

The shareholder vote on the transaction took place on September 20, 2001, at 1:00 p.m.[17] It is undisputed that the Petitioners perfected appraisal rights for 2,143,567 shares. There remains a dispute, however, with regard to an additional 184,600 shares for which the Petitioners seek appraisal. As to 82,000 of these shares of the Company held for State Street Bank, the Company claims that it never received any notice that appraisal

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[17] The shareholders were called upon to, and did, approve both the Asset Sale and the Merger.

was being sought on these shares until after the shareholder vote. At trial, the Petitioners introduced as their exhibit 54 ("PX 54") a letter, dated September 18, 2001, from Cede & Co., as record holder for shares held by its participant State Street Bank, to Carter-Wallace, demanding appraisal rights on the identified shares of stock. The letter bears two facsimile legends indicating that it was faxed by State Street Bank and by the Depository Trust Company on Wednesday, September 19, 2001. The letter also bears a third fax legend indicating that it was faxed at 1:22 p.m. on September 19, 2001. In addition, the parties stipulated in the pretrial order that if the Petitioners called a live witness, that witness would testify that the demand contained in PX 54 was sent to the Company before 1:00 p.m. on September 20, 2001, the deadline for a timely demand. The Company's only real argument to the contrary is that the Company did not find a timely demand in its files. This argument is not enough to contradict the reasonable inference to be drawn from the evidence. Thus, I find that appraisal rights were perfected with respect to these 82,000 shares.[18] The status of the shares that are subject to a timeliness dispute is discussed below.

II. CONTENTIONS

The Petitioners' brief in this case, and to an extent the Company's brief by way of reply, at times reads as though it were submitted for a breach of fiduciary duty action and devotes substantial effort questioning the timing and logic behind the decision to sell, as

[18] The Company's argument that PX 54 is the same as RX 48, which was received after the vote, must be rejected. While PX 54 is not a model of legibility, there is enough of it that can be read which shows that it refers to a different block of stock than RX 48.

well as the structure of the transaction that was approved. However, when the arguments beyond the scope of this appraisal action are excluded, four relatively narrow questions remain: (1) What was the nature of the Company at the time of the Merger, (*i.e.*, should the Company at the time of the Merger be considered as the two historical divisions or as a healthcare business plus the proceeds of the sale of the Consumer Products Division)? (2) What is the value of the Company as a going concern as of the Merger Date? (3) What rate of interest should be awarded? (4) For which of the remaining disputed shares were appraisal rights properly perfected?

It is not unusual in an appraisal action for the Court to be confronted with two experts expressing wildly divergent views on the fair value of the Company.[19] In this case, the views of the two experts are generally reasonable, and they disagree primarily on a few key inputs and variables.[20] The Petitioners and the Company, and their experts, have a significant disagreement over the nature of the company being valued. The Petitioners would have this Court view the Asset Sale and the Merger as part of a unitary transaction, with the value determined as if the Company at the time of Merger consisted of both the Consumer Products Division and the Healthcare Division. The Company would have this Court value only the company which was actually merged – a company comprised of the Healthcare Division, a pile of cash, and transaction-related and

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[19] *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2004 WL 1752847, at *9 (Del. Ch. July 30, 2004); *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003).

[20] These few differences, however, do lead to a $17.76 per share difference in the final calculation of fair value.

historical liabilities. Resolution of this issue will turn on the appraisal statute's command that this "Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."[21]

Once that issue has been determined, the Court must then seek to ascertain the "fair value" of the Company.[22] Both the Petitioners' and the Company's experts have agreed that the discounted cash flow method (or "DCF") is appropriate to use in the circumstances. The two experts have few differences in their methodologies: whether the Petitioners' expert included sufficient research and development ("R&D") expenditures in his cash flow forecasts; what is the proper long-term growth rate used to determine terminal value; what are the "risk-free rate," "risk premium," and capital structure used to determine the appropriate "discount rate."

Next, with respect to interest, both sides agree that an award of interest, is necessary, but disagree as to how to calculate the annual rate. The Petitioners ask the Court to look solely at the Company's adjusted borrowing rate of 9.49%. The Company, instead, calculates a prudent investor rate of 2.24%, and calculates the interest rate, at a two-to-one blend of the prudent investor and borrowing rates, to find an annual simple interest rate of 4.81%.

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[21] 8 *Del. C.* § 262(h).

[22] For insight into whether there is one true intrinsic fair value, or if this is a value within a range of reasonableness, see *Cede & Co.*, 2003 WL 23700218, at *2 & n.5.

Finally, it must be determined whether appraisal rights with respect to certain shares were timely perfected. The Company has objected to 184,600 shares for which the Petitioners seek appraisal because it claims that the demand letters for these shares were not received by Carter-Wallace until after the vote at 1:00 p.m. on September 20, 2001. With regard to 82,000 of these shares belonging to State Street, I have already found as a matter of fact that they were timely received. The rest of the demands, however, were received late, but the Petitioners request that this Court use its equitable powers to excuse this late performance because the date of the vote was so close to the attacks of September 11, 2001, and they were tardy by less than one week. The Company objects to this "global 9/11" argument, largely because there is no evidence in the record that the attacks had anything to do with the late performance of these shareholders.[23]

III. THE NATURE OF THE CARTER-WALLACE TO BE VALUED

The goal of the appraisal statute is to assure investors that, if they do not approve of the merger consideration, they can obtain a judicially-determined fair value for their stock, a value premised on the assumption that the company continued as a going concern.[24] The most important debate between the parties is over the nature of that going concern. The Petitioners contend that the Court must view Carter-Wallace as it existed before the Asset Sale of the Consumer Products Division. On the other side of the debate, the Company contends that the appraisal statute addresses the fair value of the

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[23] Resp't's Post-Tr. Br. at 46.

[24] 8 *Del. C.* § 262(h) ("After determining the stockholders entitled to an appraisal, the Court shall appraise the shares, determining their fair value exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation.").

entity that, in fact, merged – in this case, Carter-Wallace without its Consumer Products Division, but with the proceeds (and liabilities) resulting from the Asset Sale. This is a question of significance because the Asset Sale's transaction costs, including tax liability, are in excess of $6.00 per share.

The starting point, of course, is the structure of the transaction. The Merger was conditioned on the Asset Sale; the Asset Sale was conditioned on the Merger; one could not (and, as a matter of contract, would not) occur without the other.[25] Indeed, Carter-Wallace never operated without its Consumer Products Division.

The Petitioners point out that "[t]he underlying assumption in an appraisal valuation is that the dissenting shareholders would be willing to maintain their investment position had the merger not occurred."[26] Because the Merger and the Asset Sale were cross-conditioned, the Asset Sale, the Petitioners note, would not have happened if the "merger had not occurred." Moreover, the same decision-making process and marketing efforts led to the single transaction, with its two discrete components, which resulted in the loss of their investment in Carter-Wallace as it had existed before the day of the Merger.

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[25] In fact, the proxy statement which sought shareholder approval for the Asset Sale and the Merger admitted as much. It stated:

> **Q: CAN ONE TRANSACTION OCCUR WITHOUT THE OTHER?**
>
> A. No the asset sale and the merger are conditioned on each other. Therefore, the conditions to both of the transactions must be satisfied or waived in order for the asset sale and the merger to be completed.

PX 99 at 80.

[26] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 553 (Del. 2000) (citing *Cavalier Oil v. Harnett*, 564 A.2d 1137, 1145 (Del. 1989)).

The Petitioners also invoke another fundamental premise of fair value analysis: in general, those elements of value (which may be either positive or negative) that arise out of the Merger – as contrasted with those elements of value associated with the ongoing business venture – may not be considered. The mutually dependent relationship between the Asset Sale and the Merger, it is argued, precludes consideration of the negative effects of the Asset Sale in determining the fair value of Petitioners' Carter-Wallace shares. Those costs – taxes and transaction costs – result from the transaction agreement by which the Merger was accomplished and would not have existed in the absence of the Merger.[27] Thus, for these reasons, the Petitioners contend, relying upon an accurate factual premise: because the taxes and transaction costs would not have been incurred without the Merger, they cannot be considered in determining fair value.

Although Petitioners' argument is appealing, the Court, in applying the appraisal statute, is constrained by it to value the Carter-Wallace entity that was merged.[28] The challenge for the Court is to determine the fair value of the going concern at the time of

[27] *See*, *e.g.*, *Allenson v. Midway Airlines Corp.*, 789 A.2d 572 (Del. Ch. 2001).

[28] Part of the appeal of the Petitioners' argument arises from the context, as they describe it, of the decision to sell Carter-Wallace. These allegations, in the nature of breach of fiduciary duty, are set forth, in summary form, not as factual findings, but to provide the necessary backdrop for appreciation of the Petitioners' arguments. The Petitioners assert that the decision to sell Carter-Wallace was the product of Hoyt's personal decision that the time had come to sell the Company for his benefit (and for the benefit of his family) and not for Carter-Wallace's business reasons. They assert that the timing was bad and that, as a result, other transactional opportunities and better tax strategies were precluded. Thus, a question from the Petitioners' perspective is: why should they have to suffer, for example, the tax burdens that resulted from the effort to meet Hoyt's personal wishes? For appraisal purposes, however, the question must also be asked: assuming the wisdom of a similar and hypothetical two-part transaction, with respect to which there are no claims of breach of fiduciary duty, should the dissenting shareholders be able, in effect, to impose the tax burdens from the asset sale on the other shareholders?

the Merger.[29] By the time of the Merger, Carter-Wallace had sold the Consumer Products Division; it had incurred the capital gains tax liabilities and it had incurred the transaction costs. In short, the Court in an appraisal action values the stock that is merged with regard to its "operative reality" as of the Merger. That principle, of course, does not prevent the Court, in the appropriate circumstances, from looking beyond the Merger for assistance in discerning the fair value of the entity that was merged. For example, in *Technicolor IV*, plans developed before the merger for corporate actions after the merger were properly considered in the valuation effort as long as they were "susceptible of proof" and "nonspeculative."[30]

Two other related considerations merit mention. First, the sale of assets of a Delaware corporation does not trigger a right to appraisal.[31] Second, "the right to an appraisal is a narrow statutory right that seeks to redress the loss of the stockholder's ability under the common law to stop a merger."[32] Even though it was accomplished as

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[29] There is, of course, language in our cases as to valuing the merged company as of the "date of the Merger," suggesting, one supposes, that events on the day of the Merger should not be considered. There is no principled distinction between an asset sale occurring a few hours before the merger and a sale on the day before the merger. The inquiry here is not one of hours, but of whether one two-step transaction, with all components occurring in a certain order and substantially simultaneously, may (or must) be divided for valuation purposes.

[30] Value added or subtracted in the period before the merger accrues for the benefit or detriment of the shareholders. *See Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 298-300 (Del. 1996) ("*Technicolor IV*"); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983).

[31] *See Tanzer v. Int'l Gen. Indus., Inc.*, 402 A.2d 382, 390 (Del. Ch. 1979); 8 *Del. C.* § 271.

[32] *Applebaum v. Avaya, Inc.*, 812 A.2d 880, 893 (Del. 2002); *cf. Glassman v. Unocal Exploration Corp.*, 777 A.2d 242, 248 (Del. 2001); *Technicolor IV*, 684 A.2d at 296 ("An appraisal proceeding is a limited statutory remedy.").

part of a two-step transaction, if the Merger had been stopped by the dissenting shareholders at the time of the Merger, they would have been left with stock in a company that had already disposed of the assets of the Consumer Product Division.[33] In short, when the Merger, which triggered the right to appraisal,[34] occurred, Carter-Wallace, the "constituent corporation" in the Merger, no longer had a consumer products business. Accordingly, the Court will seek to determine the fair value of Carter-Wallace at the time of the Merger, that is, after the Asset Sale.[35]

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[33] *Paskill Corp.*, relied upon extensively by the Petitioners, ultimately provides comfort to the Company. There, the Supreme Court concluded that it was erroneous to deduct "speculative future tax liabilities" because "a sale of its appreciated investment assets was not part of [the company's] operative reality on the date of the merger. Therefore, the Court of Chancery should have excluded any deduction for the speculative future tax liabilities that were attributed . . . to those uncontemplated sales." *Paskill Corp.*, 747 A.2d at 552. The Asset Sale, by the time of the Merger, was more than "contemplated": it had been consummated and, thus, was part of the "operative reality" of the company that was in fact subject to the merger process.

[34] "Appraisal rights shall be available for the shares of any class or series of stock of a constituent corporation in a merger . . . to be effected pursuant to § 251 . . . of [Title 8 of the *Delaware Code*]." 8 *Del. C.* § 262(b).

[35] Furthermore, a comment regarding the import of *Allenson* in this context is appropriate. In *Allenson*, Midway Airlines Corporation was near bankruptcy when it entered into a merger with a third party which gave it a badly needed capital infusion. By the terms of the agreement, the public shareholders would be cashed out and the corporation would be merged into a new entity. Furthermore, the corporation's key creditors were required to give certain operational cost concessions to the outside investor. While these concessions were in place before the effective date of the merger, they were expressly contingent on the merger, and only operative when it became effective. *Allenson*, 789 A.2d at 573. This Court rejected the petitioner's argument that the concessions should be included when valuing the company for appraisal purposes because *Technicolor IV* required "any element of value that is known and susceptible of proof at the time of the merger – even if it would not exist but for the merger – [to] be included in determining fair value – so long as it is not speculative." *Id*. at 582. While this Court agreed that the concessions were not speculative and were susceptible to proof, it held that they were not to be taken into account in the appraisal proceeding because they were not actually being implemented at the time of the merger and could not have

IV. THE EXPERTS' VALUATION OF CARTER-WALLACE

The Petitioners sponsored Professor Michael van Biema ("van Biema") as their valuation expert. The Company relied upon Professor Richard Ruback ("Ruback").

van Biema, on behalf of the Petitioners, concluded that the fair value of Carter-Wallace, as of the Merger Date, was $37.16 per share. Ruback opined that the fair value was instead $19.40 per share. However, van Biema valued Carter-Wallace as if the Asset Sale of the Consumer Products Division had not occurred.

When the experts' unadjusted values of the Healthcare Division – the value of the Healthcare Division by itself as of the Merger Date – are compared, van Biema's value is almost twice Ruback's value. van Biema suggests, based on a constant growth methodology, that the unadjusted fair value of the Healthcare Division was $13.60;[36] Ruback proposes $7.61 per share.[37] The difference stems from different assumptions or projections for a few key criteria – primarily choice of discount rate and long-term growth rate. Nevertheless, both parties are critical of each of other's experts and the

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been because the concessions were expressly contracted to not become legally operative until after the merger. *Id*. at 585. The Court found that this distinguished *Allenson* from *Technicolor IV*, because in *Technicolor IV* "the new value was contributed by *premerger* by the acquiror" and in *Allenson* "the new value was contributed *post-merger*." *Id*. at 586. Here, the burdens of the Asset Sale had been incurred by the time of the Merger.

[36] van Biema determined the fair value of the Healthcare Division under four methods: constant growth, EBITDA multiple, sales multiple, and EBIT multiple, and then used the average value of the four, $16.39 per share. For the reasons discussed later in this letter opinion, I do not rely on the values obtained using the EBITDA, Sales, and EBIT Multiple methods. *See* notes 102, 107, *infra*.

[37] If Ruback had used van Biema's unadjusted value for the Healthcare Division and then made the adjustments that he proposes, a fair value of $25.38 per share of Carter-Wallace would have been obtained.

differences between them; the Company even characterizes van Biema's work as "sloppy."[38] Thus, in order to determine the fair value of Carter-Wallace as of the Merger Date, the opinions of both experts must be reviewed.

A. *van Biema*

van Biema is a Professor in the Columbia Business School's Department of Finance. He valued Carter-Wallace primarily using a DCF methodology. This is a method by which revenues and expenses are projected for a *pro forma* period, and then, using those revenues and expenses, free cash flows are determined. Next, a terminal value is calculated which represents the projected cash flows from the end of the *pro forma* period forward in time. The value of the company is then determined as the sum of the present values of the obtained cash flows and terminal value, after applying an appropriate discount rate, and by making any necessary additions or subtractions to firm value.

van Biema also valued the Company using publicly-traded and transaction comparables; however, he assigned substantially less weight to the comparable companies analysis and no weight to the comparable transaction analysis as he felt that they "represent techniques that are less in keeping with the definition of fair value under Delaware law which strives for an intrinsic as opposed to a market valuation."[39]

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[38] Resp't's Post-Tr. Br. at 2, 32.
[39] PX 149 at 2.

van Biema valued Carter-Wallace as whole – consisting of both the Consumer Products Division and the Healthcare Division[40] – and as the sum of its parts – by valuing each division separately and then adding the two together.[41] The starting point for his inputs in the valuation effort was the Company's historical financial statements as well as management projections prepared by JP Morgan, dated May 29, 2001 (the "Management Projections"), for the years 2002 through 2009.[42] He also noted that he was more conservative than management where appropriate in an attempt to choose the number "that would result in the most conservative outcome."[43] The areas of his analysis that he found "require[d] considerable judgment in determining the appropriate projections and final equity valuation"[44] were as follows: growth rate both short and long-term, unallocated corporate overhead, amortization of intangibles, additional value from non-operating, or redundant, assets (additions), liabilities in addition to conventional debt (subtraction), and adjustments for outstanding options (dilution).

1. <u>Calculation of Free Cash Flows</u>

van Biema started his analysis by projecting the future cash flows of Carter-Wallace. For the Healthcare Division, he chose to utilize a 5-year *pro forma* period and

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[40] While I have already decided that the appropriate way to value the Company is as consisting of the Healthcare Division after the Asset Sale, it is necessary to look at van Biema's analysis to understand the values that follow.
[41] van Biema, however, acknowledged that Carter-Wallace as an ongoing entity operating both of its divisions as it had done historically (his valuation construct) was worth less than the sums of the value of the two divisions separately. Tr. at 94 ("The whole is, in fact, less than the sum of the parts.").
[42] PX 50.
[43] PX 149 at 3.
[44] *Id.*

started his cash flow projections with net sales data for 2001 and then projected that data at a 7% short-term growth rate through 2006. This 7% rate was derived from the Houlihan Lokey Fairness Opinion and the Management Projections which showed 5.7% growth for the Healthcare Division between 1997-2000 and projected 12.9% growth in 2002.

van Biema's next step was to determine EBIT based upon a constant percentage of net sales. For the Healthcare Division, he used 22%, which was 2.7% lower than the EBIT percentage in the Management Projections. van Biema included in this analysis an R&D cost amount that was 5.5% of sales. While this amount was less than what was projected by MedPointe and its consultants, van Biema testified that his 2.7% EBIT adjustment to their forecasts could be used to bring R&D expense up to the same level as in their forecasts.[45]

He then adjusted EBIT for taxes and changes in net working capital and net fixed assets, and corporate level unallocated overheads, providing him with a free cash flow number. In tabular form, the numbers he calculated were as follows:

	2002	2003	2004	2005	2006
Sales	$258.5	$276.6	$296	$316.7	$338.9
EBIT	$56.9	$60.9	$65.1	$69.7	$74.6
Cash Flow	$30.1	$30.9	$34.9	$37.4	$40.1

2. Choice of Long-Term Growth Rate

van Biema's choice of a 4% long-term growth rate is of considerable importance to the overall calculation of the fair value of Carter-Wallace and is the subject of

[45] Tr. at 54.

considerable dispute. Even van Biema's report notes that this growth rate differs significantly from that used by Houlihan Lokey and JP Morgan, which used a 2% value – a value van Biema characterizes as "unrealistically low."[46] In justifying his choice, van Biema testified as follows:

> I developed a terminal growth rate again looking at the historicals of the healthcare products, as well as looking at management's projections. And their projections basically, grew the healthcare division at approximately an average rate of 6 percent between 2002 and 2009, dropping to, I believe, 4.7 percent in the 2009 year. They then suggested that the terminal growth rate should drop from 4.7 percent directly to 2 percent.
>
> I thought that that drop was not justified. In fact, I don't understand how they justified that drop, if they did. I dropped my growth rate to 4 percent as the terminal growth rate, from 4.7%. I think this is for – in keeping with what one could expect from a healthcare company. And I rationalized that, again, by looking at the economy as a whole. If one looks at growth in GDP, historically it's been over 5 percent. We all know that one of our major problems in the U.S. today is that healthcare is growing at a significantly increased rate over the GDP. So it seems to me that a 4 percent growth rate is just – is, if anything, quite conservative here.[47]

The Petitioners also support van Biema's choice by noting that in a presentation to potential purchasers in February 2001, Carter-Wallace touted that the largest component of the Healthcare Division "[would] achieve double-digit top-line growth."[48] It further recited that the 4-year compound annual growth rate from 1997 to 2000 was 8.3% and anticipated a rate of 12.5% from 2000 to 2002. This presentation also claimed that "substantial opportunities exist for top-line growth" for one of its major drugs, Astelin.[49]

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[46] PX 149 at 4.
[47] Tr. 57–58.
[48] PX 67 at HLHZ 10814.
[49] *Id.* at HLHZ 10821.

The Petitioners further support this 4% terminal growth rate by observing that it is only 1.5% above projected inflation. van Biema testified that, based on his experience, historical inflation rates are approximately 2.5%.[50] He also relied upon a survey of anticipated inflation of the next 10 years prepared by the Federal Reserve Bank of Philadelphia, which projected 10-year inflation rates at 2.5%. Along with this, van Biema took into account long-term population growth rates of approximately 1%, and concluded that if "[y]ou put those two numbers together, and you are getting growth of at least 3-and-a-half percent. As we said, healthcare has to be growing faster than that."[51]

While van Biema was aware that certain Carter-Wallace drugs would lose patent protection in 2009 and 2010, he did not see this as having much of an impact on long-term growth. As he testified:

> My analysis was that it is very difficult to predict the drug pipeline. Obviously some drugs will go over – go off of patent over time. Some new drugs will be added. The best way one can estimate what is going to go on in the future is by understanding the past and other than that, what one has to rely on are more general estimates as to what will happen in the economy.[52]

3. <u>Calculation of the Discount Rate</u>

The next step in van Biema's analysis was to calculate the weighted average cost of capital ("WACC") used to discount future cash flows and terminal value to present value. WACC is the rate of return received by investors in a corporation, both shareholders and debt holders, and is calculated as follows:

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[50] Tr. at 59.
[51] *Id.*
[52] *Id*. 126.

$$\text{WACC} = (\text{Weight} * \text{Cost of Equity}) + (\text{Weight} * \text{Cost of Debt})$$

Cost of equity is then calculated using the capital asset pricing model, or CAPM.[53] Under CAPM:

$$\text{Cost of Equity} = \text{Risk-Free Rate} + (\text{Beta} * \text{Risk Premium})$$

The cost of debt is Carter-Wallace's actual cost of debt, and the weight is the portion of the company's capital structure that is debt and the portion that is equity. Using this model, van Biema calculated a WACC of 9.4 % for the Healthcare Division.

For the cost of debt, van Biema used 7%. He also determined the Beta for the Healthcare Division as having a value of 1.13. He determined this from an analysis of comparable companies with comparable risk profiles. For the risk-free rate of return, van Biema used a value of 4.78%, which is the 30-year Treasury rate of 5.78% minus 1%.

Because van Biema's chosen value for the market risk premium is heavily disputed by the Company, a more detailed discussion is warranted. The market risk premium is the premium received by investors who invest in a market basket of equities, as opposed to investors who invest in risk-free investments. van Biema chose to rely on the recent academic research of Professors Fama and French[54] who claim that the time period from 1950 onward is the relevant time frame from which this value should be

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[53] Under CAPM, the goal is to determine the cost of equity by determining the return on a riskless investment (risk-free rate) and then increasing the return to account for the overall risk experienced in stocks as a whole (market risk premium), modified by Beta, the "measure of total return volatility of common stocks of public companies." 1 JAY E. FISHMAN, SHANNON P. PRATT, ET AL., GUIDE TO BUSINESS VALUATIONS 5-27 (12th ed. 2002).

[54] PX 156.

chosen.[55] This is in contrast to the older, more widely utilized, research of Ibbotson Associates, which is based on the period from 1926 onward. Fama and French contend that fundamental economic changes have occurred since 1950, such as globalization, creation of enormous mutual funds, investment of pensions and retirement funds in the market, and an increase in labor mobility, justify utilizing a shorter time frame.[56] Thus, van Biema chose a market risk premium of 4.5%.

At trial, van Biema supported his decision as follows:

> I based my market risk premium on the current academic research in this area, which puts the market risk premium at somewhere between 2.5 percent and 5 percent. And the market risk premium that I chose was 4.5 percent. Specifically, the article that I happen to think is the best article in this area is an article by Fama and French. And they estimate the premium, based on two other models, at being between 2 – 2 percent, I believe, and 4.3 percent.
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> . . . .
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> I used a slightly higher number [than Fama and French], to be conservative. There are some other articles that indicate that the market risk premium may currently be as high as 5 percent. In addition, JP Morgan was using 4 percent in its estimates, as best I could determine. I felt my 4.5 percent was a good, conservative estimation.[57]

Turning next to the capital structure, or weight accorded to the cost of equity and the cost of debt components, van Biema used a capital structure for the Healthcare Division of 80 percent equity and 20 percent debt. While he noted that Carter-Wallace as a whole ran at a very low level of debt, he claimed that his structure was reasonable because the Healthcare Division had never operated as a stand-alone company, and thus he could not assume that it would be run the same way as Carter-Wallace as whole.

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[55] Tr. at 39-42.
[56] *Id.* at 41-42.
[57] *Id*. at 39-40.

Furthermore, he testified that he selected this ratio of debt-to-equity based on an analysis of EBIT and interest coverage.[58]

4. Terminal Value and Fair Value

The next step in van Biema's analysis was to determine the terminal value for the Healthcare Division. He used four methods to calculate terminal value and each was weighted equally. In the first three methods, terminal value was calculated as a multiple of sales, EBIT, and EBITDA. The multiples were obtained from companies van Biema deemed comparable to Carter-Wallace.[59] This resulted in a range of terminal values for the Healthcare Division, discounted to the Merger Date, of between $617 million and $977 million. When he applied the constant growth methodology with a long-term growth rate of 4% and a discount rate of 9.4%, to the cash flow of the final year of the *pro forma* period, the determination of the terminal value was $559 million.

van Biema added the Healthcare Division's cash flows, discounted at 9.4%, during the *pro forma* period, to determine the present value of its projected cash flows. That yielded $128 million. The sum of the present values of both the cash flows and the terminal value under the constant growth methodology was $688 million, or $13.60 per share. Using the terminal value determined through valuation multiples, van Biema found a range for the Healthcare Division's fair value of between $15.35 and $21.87 per share.

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[58] *Id*. at 231.

[59] His comparable companies for the Healthcare Division were Pfizer, American Home, Bristol-Meyers, Del Labs, King Pharmaceuticals, Medicis Pharmaceuticals Corp., ICN Pharmaceuticals, Watson Pharmaceuticals, and Biovail Corp.

5. Adjustments

The final step in van Biema's DCF analysis was to adjust his valuations to account for nonrevenue-producing assets and liabilities not captured in the cash flows of Carter-Wallace and its divisions. After reviewing the information produced by JP Morgan regarding additions and subtractions to value, van Biema concluded that $269.9 million of cash, over-funded pensions, and unused real estate needed to be added to obtain the value of Carter-Wallace. This was $5 million less than the amount of additions determined by JP Morgan. van Biema also added in $68 million in proceeds from the exercise of certain options and then subtracted liabilities in the amount of $85.2 million. This number for subtraction was $159.7 million less than the amount of subtraction used by JP Morgan, a difference primarily attributable to van Biema's view that the Carter-Wallace had to be valued as still consisting of both the Consumer Products and Healthcare Divisions. The net of the additions and subtractions was $252.2 million, or $4.98 per share. The end result was a value of between $17.58 to $25.85 per share for the Healthcare Division, depending on how the terminal value was calculated, with an average value of $21.37.

6. DCF Fair Value of Carter-Wallace

van Biema added to the value of the Healthcare Division his value for the Consumer Products Division, for which he performed a similar analysis.[60]

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[60] Because I have concluded that the value of the Consumer Products Division must be considered in the context of the Asset Sale, I do not assess the correctness of his separate valuation of the Consumer Products Division (or the Company as a pre-Asset Sale entity). His constant growth model for the Consumer Products Division yielded a value

7. Comparable Companies Analysis

van Biema also performed a comparable companies analysis of Carter-Wallace. As this Court has explained:

> The comparable company approach entails the review of publicly traded competitors in the same industry, then the generation of relevant multiples from public pricing data of the comparable companies and finally the application of those multiples to the subject company to arrive at a value.[61]

van Biema's analysis consisted of valuing the Healthcare Division as multiples of its sales, EBIT, and EBITDA where the multiples were obtained from comparable companies he selected.[62] The multiples he calculated for the Healthcare Division were as follows:

	High	Low	Average
EBITDA	15.0x	9.8x	12.4x
Sales	4.0x	1.7x	2.9x
EBIT	29.0x	20.5x	20.5x

From these multiples, the pre-adjusted values of the Healthcare Division which van Biema obtained were:

	EBITDA	Sales	EBIT
($MM)	613,239	736,820	854,932
(per share)	$12.12	$14.57	$16.90

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of $800 million, or $15.81 per share. The range for his other methodologies was $16.21 to $20.98 per share. Thus, his unadjusted value for Carter-Wallace as the sum of his constant growth projections was $1,488 million, or $29.41 per share. His other methodology, *i.e.*, those using comparables to determine terminal value yielded a range of $1,586 million to $1,927 million.

[61] *Doft & Co. v. Travelocity.com, Inc.*, 2004 WL 1152338, at *8 (Del. Ch. May 20, 2004); *see also Agranoff v. Miller*, 791 A.2d 880, 892 (Del. Ch. 2001).

[62] He relied upon the same comparable companies as he chose for terminal value comparison purposes. *See* note 59, *supra*.

van Biema also calculated a range of adjusted values for the entirety of Carter-Wallace as between $37.59 to $39.37 per share using this methodology.

van Biema did not rely on this methodology other than as a check on the reasonableness of the values obtained from his DCF valuations. He noted that the values obtained from the comparable companies methodology fell within the range of values suggested by his DCF method for both divisions of Carter-Wallace – $35.03 to $39.28.

8. van Biema's Conclusion

van Biema, thus, concluded that the fair value of Carter-Wallace was between $35.03 and $39.28.[63] He settled on $1,880 million, or $37.16 per share, as the fair value of Carter-Wallace.[64]

B. *Ruback*

Ruback is the Willard Prescott Smith Professor of Corporate Finance at the Harvard Graduate School of Business Administration. He is also a senior consultant for Charles River Associates, an economics and business consulting firm.

Ruback valued Carter-Wallace stock solely by performing a DCF analysis of the Healthcare Division, adding the proceeds and subtracting the associated costs from the sale of the Consumer Products Division and making a few further adjustments. His DCF calculations were as much a critique of van Biema's as they were an independent analysis. He noted in his report that while he "rel[ied] on management forecasts as

[63] van Biema also performed a comparable transactions valuation; however, he noted the range of values obtained fell well above the range suggested by the DCF calculations and that he did "not rely upon" those values. PX 149 at 11.
[64] *Id*.

presented by Carter-Wallace's investment banker, JP Morgan" he also "adopt[ed] the assumptions of plaintiff's expert, Dr. van Biema, where [he] consider[ed] them appropriate."[65] The end result was that he calculated the value of the Healthcare Division to be $385 million (or $7.61 per share) plus adjustments, including the proceeds of the Asset Sale, leading to a total value for the Company of $981 million or $19.40 per share. Ruback opined that the reason his value for the Healthcare Division was so much lower than van Biema's was that van Biema made "two assumptions that result[ed] in the substantial over-estimate of the value of the Healthcare Division."[66] The first related to van Biema's choice of 4% as a long-term growth rate and the second was van Biema's calculation of the discount rate.

1. Long-Term Growth Rate

With respect to the long-term growth rate, Ruback found that van Biema's choice of 4% was too high because of the limited expenditures allotted to R&D and, instead, proposed 2%. Ruback noted that "[c]ompanies generally invest in research and development to enhance their product pipelines that lead to long-term growth. Substantial decreases in research and development, therefore, are generally associated with a decline in long-term growth."[67] Ruback also noted that Carter-Wallace had been decreasing its R&D expenditures related to the Healthcare Division over the last decade, from about 8% of sales from 1990 through 1994 to about 4% of sales from 1996 through 2001. The result of this, as set forth in Carter-Wallace's August 16, 2001, proxy

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[65] RX 63 at 6, ¶ 11.
[66] *Id.* at 7, ¶ 15.
[67] *Id.* at 13, ¶ 25.

statement, was a reduced product pipeline. This reduction in R&D expenditures, Ruback found, meant that it would be unlikely that Carter-Wallace would have new drugs to replace the two important drugs that were losing patent protection in 2009 and 2010.

Attacking van Biema's choice of growth rate more directly, Ruback contended that van Biema's figures indicate R&D healthcare expenditures that are only 5.5% of sales which is well below the historical average of 6.3% of sales, the 8.6% to 9.2% that MedPointe was advised by its consulting firm, McKinsey, would be required after the Merger, and the 7.5% to 8.4% of the Management Projections for 2002 to 2009. In spite of having lower R&D figures than both McKinsey and JP Morgan, which Ruback argues should imply a lower growth rate, van Biema's growth rate was higher – 4% compared to the 2% mid-range of JP Morgan and 3% suggested by McKinsey. Thus, Ruback saw two ways to correct this perceived error: increase R&D expenditures to a level that could generate a product pipeline capable of achieving 4% growth, or reducing the growth rate to a level consistent with the R&D expenditures suggested by van Biema. He chose the latter option, and set the growth rate at 2% because he had "no basis to reasonably forecast the required expenditures necessary to generate 4% growth" and "according to the Proxy Statement the management of Carter-Wallace considered that strategy but rejected it."[68]

2. Discount Rate

While Ruback differed with van Biema in how the WACC was calculated, this was mainly with respect to the capital structure, risk-free rate, and market risk premium.

[68] *Id.* at 18, ¶ 33.

For example, Ruback expressly adopted van Biema's assumption that the proper cost of debt was 7%.[69] In addition, he used van Biema's comparable companies to estimate the riskiness of the Healthcare Division. While his Beta was somewhat less than the one van Biema employed, 1.00 versus 1.13, Ruback acknowledged at trial that as van Biema's chosen Beta was more conservative than his, as a lower Beta reduces WACC and increases firm value, the differences in this case could be put aside.[70]

For the risk-free rate, Ruback used the rate of yield-to-maturity of a 20-year government bond, which equaled 5.45% on September 28, 2001.[71] This is somewhat different from the 30-year bond rate minus 1% used by van Biema which was 4.78%. Ruback testified that one reason for the difference was that van Biema made an error in calculating this value which should have led to a risk premium which was being approximately 1.5% higher.[72]

The first main point of disagreement involves the choice of the risk premium. Ruback found a value of 7.3% compared to that of 4.5% used by van Biema. Ruback's number came from using the Ibbotson Associates data. Using the historical information from 1926 to 2000, the historical risk premium is estimated by subtracting the average holding period bond return of 5.7% from the average holding period stock return of 13.0%. Ruback relied on the Ibbotson numbers instead of the more recent Fama and French research because it was the more accepted method in the academic community

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[69] *Id.* at 14, ¶ 26.
[70] Tr. at 399.
[71] RX 63 at 21-22, ¶ 39.
[72] Tr. at 306-09.

and the Fama and French analysis was still under debate. Furthermore, Fama and French have realized that their analysis is subject to a slight "downward bias"[73] which is not present in the Ibbotson approach.

The second area of dispute involved van Biema's choice of capital structure. As opposed to van Biema's use of an 80% equity, 20% debt structure, Ruback used an all-equity structure which he felt was more in keeping with "Carter-Wallace's historical funding strategy that was entirely equity financed."[74]

Thus, using these assumptions, Ruback found that the proper value of the discount rate was 12.85%.

3. Cash Flows and Terminal Value

There is also considerable difference in how Ruback calculated his cash flows. Ruback adopted the Management Projections without any modification. The end result is an 8-year *pro forma* period with the eighth year used for calculating the terminal value. These cash flows are shown as follows:

Projected Year	2002	2003	2004	2005	2006	2007	2008	2009
Cash Flow (millions of dollars)	$19.2	$21.3	$34.6	$39.9	$43.1	$45.3	$47.5	$49.9

When these cash flows are discounted back to present value at Ruback's discount rate of $12.85%, and the terminal value is capitalized at Ruback's long-term growth rate and

[73] Tr. at 247.
[74] RX 63 at 23, ¶ 42. For his calculations, Ruback used a capital structure of 103% equity and -3% debt. *Id*. at ex. 6.

then discounted back to present value, the value of the Healthcare Division is found to be $385 million, or $7.61 per share.

4. Adjustments

The last area of substantial difference between Ruback's and van Biema's analyses involved the adjustments made after the DCF calculation was completed. Ruback first added the after-tax proceeds from the sale of the Consumer Products Division of $553 million, along with $196 million in other assets, then subtracted liabilities of $219 million, and added option proceeds of $66 million to his valuation of the Healthcare Division of $385 million. The resulting value of Carter-Wallace was $981 million, or $19.40 per share which is less than the $20.30 per share the shareholders were offered in the Merger.

V. THE FAIR VALUE OF CARTER-WALLACE AS OF THE MERGER DATE

For those shares for which the Petitioners have satisfied the requirements of Section 262 of the Delaware General Corporation Law, they are entitled to the *pro rata* share of the fair value of the common stock of Carter-Wallace, as the corporation existed as of the Merger Date.[75] "The underlying assumption in an appraisal valuation is that the dissenting shareholders would be willing to maintain their investment position had the

[75] 8 *Del. C.* § 262.

merger not occurred."[76] Thus, as is often recited, Section 262's concept of "fair value" denotes a '"proportionate interest in a going concern.'"[77]

In determining the fair value to which the Petitioners are entitled, "the Court shall take into account all relevant factors."[78] Moreover, "the parties to an appraisal action must be afforded the opportunity to present evidence of fair value consisting of 'any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court.'"[79] But the broad scope granted to the Court in determining fair value is constrained by the theoretical underpinnings of the appraisal action, for the determination of fair value is to be "exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation."[80] It is this narrow statutory exclusion, and its subsequent interpretation, which delineates the limits imposed upon the Court's quest at divining fair value.[81]

In this case, a DCF analysis is the preferred methodology for valuing Carter-Wallace. As described above, this was the primary method relied upon by both experts.

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[76] *Paskill Corp.*, 747 A.2d at 553.
[77] *Cavalier Oil*, 564 A.2d at 1144 (citing *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950)); *see also Paskill Corp.*, 747 A.2d at 553; *Gray v. Cytokine Pharmasciences, Inc.*, 2002 WL 853549, at *6 (Del. Ch. Apr. 25, 2002); *Nagy v. Bistricer*, 770 A.2d 43, 55 n.23 (Del. Ch. 2000) ("[T]he purpose of an appraisal is to provide stockholders who are no longer owners of the previous entity with their fair share of its value as a going concern as of the date of the merger.").
[78] 8 *Del. C.* § 262(h).
[79] *In re Shell Oil Co.*, 607 A.2d 1213, 1219 (Del. 1992) (quoting *Weinberger*, 457 A.2d at 713 (Del. 1983)). The Court, in addition to accepting the methodologies proposed by the parties, may create its own model. *See Technicolor IV*, 684 A.2d at 299.
[80] 8 *Del. C.* § 262(h).
[81] *In re Shell Oil Co.*, 607 A.2d at 1219.

Importantly, Carter-Wallace had enjoyed a long and relatively stable financial history, making the projections necessary for a cash flow analysis reasonably reliable.

A. *The Free Cash Flows*

First, the free cash flows must be determined. As noted above, Ruback utilized the Management Projections in deriving his cash flows. van Biema, on the other hand, derived his free cash flows by starting with the net sales data for 2001, assuming sales would grow at 7% through 2006, determining EBIT as a constant percentage of net sales, and then adjusting EBIT to determine the free cash flows. The results are shown below:

	2002	2003	2004	2005	2006	2007	2008	2009
van Biema	$30.1	$30.9	$34.9	$37.4	$40.1	n/a	n/a	n/a
Ruback	$19.2	$21.3	$34.6	$38.9	$43.1	$45.3	$47.5	$49.9

In spite of the fact that van Biema's terminal value projection – the value for year 2006 – is lower than Ruback's value – either in 2006 or 2009 – and, hence, more conservative, the Company still objects to van Biema's projections as unfounded because the 7% growth rate departs from management forecasts without any significant reason.

This Court has a preference for the use of management forecasts because management is typically deemed most knowledgeable about the Company's prospects.[82] However, because "*post* hoc litigation driven forecasts have an 'untenably high'

[82] *See, e.g.*, *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *14-*15 (Del. Ch. May 3, 2004); *Gray*, 2002 WL 853549, at *8; *In re Radiology Assocs., Inc. Litig.*, 611 A.2d 485, 490 (Del. Ch. 1991).

probability of containing 'hindsight bias and other cognitive distortions,'"[83] this Court is "skeptical of *ex post* adjustments to such predictions."[84] In this case, these management forecasts were prepared on May 29, 2001, after the merger agreement had been finalized. Thus, these forecasts were made in consideration and in anticipation of the Merger, and one may question as to how accurate they are for the purpose of valuing the Company as a "going concern." On the other hand, in light of how close both experts' projections of free cash flow actually are, especially in the later years, and the fact that van Biema relied upon the same Management Projections along with the Houlihan Lokey Fairness Opinion, without any further basis in the record, there seems to be no compelling reason to depart from the Management Projections with respect to the free cash flows. Thus, the Court adopts the management forecasted values for free cash flows that were utilized by Ruback in their entirety, as they are reasonable under the circumstances. Therefore, the Court will use an 8-year *pro forma* period to calculate the fair value of Carter-Wallace.[85]

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[83] *Cede & Co.*, 2003 WL 23700218, at *7 (Del. Ch. Dec. 31, 2003) (quoting *Agranoff*, 791 A.2d at 892).

[84] *In re Emerging Communications, Inc., S'holders Litig.*, 2004 WL 1305745, at *14. *See also Cede & Co. v. JRC Acquisition Corp.*, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004) ("[T]his Court prefers valuations based on management projections available as of the date of the merger and holds a healthy skepticism for post-merger adjustments to management projections or the creation of new projections entirely.").

[85] The use of the Management Projections for the DCF analysis is hardly prejudicial to the Petitioners. If one uses the long-term growth rate and the discount rate which the Court finds, *infra*, and applies them to van Biema's 5-year *pro forma* cash flows or to (i) the first five years of Ruback's *pro forma* cash flows, or (ii) the 8-year *pro forma* cash flows that Ruback uses (and employs Ruback's partial year adjustment for all calculations), the results using Ruback's *pro forma* cash flows are more favor able to the Petitioners than if van Biema's projected cash flows had been employed.

B. *The Long-Term Growth Rate*

The next input that must be determined is the proper long-term growth rate of Carter-Wallace. Ruback adjusted van Biema's 4% long-term growth rate to a 2% long-term growth rate, largely because he concluded that van Biema had not accounted for sufficient R&D expenditures to justify the increase in the growth rate from the Management Projections of 1% to 3%. The Company also criticizes van Biema's growth rate because Carter-Wallace would lose patent protection over the drugs Astelin and Felbatol shortly after the end of the projected periods and there were no new drugs in the pipeline to help Carter-Wallace retain its market share.

I am satisfied that the Company places too much weight on R&D expenditures.[86] Although the Company's reduction in its commitment to research and the approaching loss of patent protection for two major products would affect growth projections adversely, Ruback's choice of a 2% long-term growth rate is too conservative. First, it depends on the very sharp reduction in growth, projected by JP Morgan, from an average of almost 5% growth from 2006 to 2009 to 2% in 2009. Second, while the patent protection over Astelin and Felbatol would be lost in 2009 and 2010, Carter-Wallace's experience with the muscle relaxant Soma – which lost its patent protection in 1990 – showed that the decline in market share would be gradual, not sudden as suggested by the

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[86] Resp't's Post-Tr. Br. at 27 ("[v]an Biema sought to salvage [the conflict between assuming increased growth while reducing R&D expenditures] by reference to a generic 'fudge factor' in his model, from which management 'could' have decided to allocate additional funds to R&D. Of course, if [v]an Biema really believed that management would have allocated additional funds to R&D, it would have been easy to adjust the R&D figure in his analysis – explicitly – to reflect that belief." (citations omitted)).

Company. For instance, an analysis of Soma prepared by MedPointe projected that, even though sales volume would decline by 7 percent per year, its price would increase by at least 10 percent or more, resulting in real revenue growth for a drug ten years beyond patent protection,[87] even in spite of the competition it was experiencing from generic drugs.

Thus, I find that a 3.35% long-term growth rate is reasonable under the circumstances.[88] This value fully takes into account the effects of the loss of patent protection over the two drugs shortly after the end of the *pro forma* period, while recognizing that the actual loss of market share will likely be gradual over time and not sudden. It also is more in keeping with the Management Projections which saw an almost 5% growth rate up until 2009, but which could not reasonably be expected to drop off precipitously. Furthermore, Carter-Wallace could be expected to grow at a rate at least equal to the projected inflation rate of 2.5%, plus an upward adjustment to accommodate the increased demand for healthcare of a growing populace. Finally, the Court's projection is not inconsistent with McKinsey's projection of 3% for long-term growth. The Company's projected growth rate had Carter-Wallace actually declining

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[87] P70 at MEDCAP 04083.

[88] The Petitioners also attempt to support van Biema's growth rate by noting that in a presentation to potential purchases the Company claimed that the largest portion of the Healthcare Division "[would] achieve double-digit top-line growth." P67 at HLHZ 10814. It also points to a similar statement in the Descriptive Memorandum that there were "[o]pportunities to accelerate top-line growth in the United States." P1 at HLHZ 10194. Statements, such as these, made in an attempt to attract buyers are of questionable evidence of fair value of any company. Accordingly, I give them no weight.

since it was not even growing at the rate of inflation – something unsupported by the record.

C. *The Capital Structure*

van Biema used a capital structure of 80% equity and 20% debt in contrast to the 100% equity structure used by Ruback. Historically, Carter-Wallace had an all equity structure and therefore, it must be assumed that this would have continued into the future had the entity continued as a going concern. While it is true, as the Petitioners contend, that Carter-Wallace had never existed solely as the Healthcare Division, this one fact alone does not provide a solid basis for projection of the future capital structure of the Company. While van Biema may well be correct than an 80/20 capital structure would be typical for a company of this nature, Carter-Wallace's traditional aversion to debt could be expected to continue.[89]

D. *The Discount Rate*

It is now necessary to calculate the WACC in order to discount future cash flows to present value. This in turn means that the disputes regarding the appropriate Beta, risk-free rate, and risk premium now be resolved.

1. Beta

van Biema proposed a Beta 1.13 and Ruback proposed 1.0. The parties do not quarrel significantly, perhaps because the other side's expert had chosen a more favorable

[89] The Petitioners also argue for van Biema's projection by pointing to the fact that MedPointe's advisors, McKinsey, had concluded in its valuation that a 40/60 debt/equity ratio would be appropriate, P2 at CARL 03913, and that MedPointe actually established a capital structure of 55% equity 45% debt. However, these structures were proposed by outsiders, not the management of Carter-Wallace. *See Allenson*, 789 A.2d at 582-86.

number.[90] Ruback even noted that this was an issue that could be put aside.[91] I will utilize Ruback's choice of Beta because it is consistent with the Court's perception of Carter-Wallace's lack of risk.

2. The Risk-Free Rate

Despite the fact that the two values utilized by the experts for the risk-free rate are comparable – van Biema uses a value of 4.78%, while Ruback uses a value of 5.45% – this is contested rather fiercely by both parties. There is some question as to whether the method used by van Biema was correct in this instance. At trial, Ruback claimed that when using long-term bonds to calculate the risk-free rate, as van Biema did, the risk premium should be increased by approximately 1.5%. The Petitioners respond by claiming – quite correctly – that this testimony says very little about the correctness of subtracting 1% from the 30-year bond rate to calculate the proper risk-free rate. Regardless, I will use Ruback's calculation here as well, because the differences are slight and using the 20-year Treasury rate is more reasonable under the circumstances and in keeping with the accepted practice.

3. The Risk Premium and the Discount Rate

In calculating the risk premium, van Biema used the relatively new research by Fama and French to find a value of 4.5%. In contrast, Ruback employed the older and more widely accepted practice of using the Ibbotson Associates data and used a value of 7.3%. The Company's main argument against the use of the Fama and French research is

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[90] Tr. at 399.
[91] *Id.*

that because it is "brand-new" and "still under significant academic debate" it cannot satisfy the standard that a valuation methodology be 'generally considered acceptable in the financial community,'" as required by *Weinberger v. UOP*.[92]

The mere fact that it is new does not make this research unreliable or outside of the *Weinberger* standard. A valuation such as this is built on assumptions that will always be under debate or attack in the academic community. Ruback even testified that the Ibbotson data is not perfect as he noted that "we're all working very hard on trying to figure out how to estimate that number better."[93] Indeed, this Court has recently recognized that "[a]lthough the Fama-French three-factor CAPM model is not wholly accepted, neither is the original CAPM itself. By better factoring in the real risks of leverage, the Fama-French model captures useful data that contributes to a more reliable and real-world cost of capital."[94]

Furthermore, the Company's concern that the Fama and French number is subject to a downward bias may be assuaged. First, the Fama and French article itself notes this downward bias but explains that it is small.[95] Second, van Biema used a slightly higher number than Fama and French to be conservative – 4.5 in contrast to the 4.3 suggested in their research – which would have the effect of compensating for any bias.

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[92] Resp't's Post-Tr. Br. at 31 (quoting *Weinberger*, 457 A.2d at 713).
[93] Tr. at 410.
[94] *Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Group, Ltd.*, 2004 847 A.2d 340, 362 (Del. Ch. Jan. 5, 2004).
[95] PX 156 at 655.

More importantly, using Ruback's numbers would put the discount rate outside of the range used for most of the valuations of the Company.[96] For instance, the Management Projections used a WACC of 11.00%[97] and McKinsey & Co., valuing the Company on behalf of MedPointe on November 7, 2000, used a value of 9.48%.[98] By contrast, Ruback's value of 12.84% was substantially higher than both of them.[99]

Thus, I am persuaded that using a risk premium of 4.5% is reasonable under the circumstances. This leads to a WACC of 9.95%[100] which will be used to discount the cash flows below.

E. *The Value of the Healthcare Division*

Now that the long-term growth rate has been found to be 3.35% and the WACC has been determined to be 9.95%, the fair value of the Healthcare Division can be determined. This is found by adding the sum of (1) discounted free cash flows, and (2) the present value of the terminal value taken to perpetuity.

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[96] Interestingly, for all of the chiding that the Company gives to van Biema for departing from the management forecasts without reason, the Company has no real argument as to why Ruback's departure here was reasonable, other than to point out that JP Morgan calculated the discount rate in a different way, using a "hard-wired cost of capital," so that the equity risk premium was not used. *See* Resp't's Post-Tr. Br. at 31–32.

[97] P50 at 5951.

[98] The Company points to the rate used in the Houlihan Lokey Fairness Opinion of 15% as instructive in this matter as well. However, this forecast was not only made after the terms of the sale and merger were known, but also, in an attempt to demonstrate that the terms of the deal were fair. The potential for this document to contain the kind of hindsight bias and other cognitive distortions that makes this Court skeptical of *post hoc* litigation driven forecasts, is too great to afford this value of 15% any weight in making this determination. *See Cede & Co.*, 2003 WL 23700218, at *7.

[99] To be fair, van Biema's final number of 9.40% was the lowest of the discount rates.

[100] This is the sum of the risk-free rate of 5.45% and the risk premium of 4.5% multiplied by the Beta of 1.0.

First, discounting of the free cash flows back to present value, according to the relevant time periods, yields the following:

2002[101]	2003	2004	2005	2006	2007	2008	2009
$9.38	$19.37	$28.62	$30.02	$29.49	$28.19	$26.89	$25.69

When added together, the present value of the discounted cash flows of the Healthcare Division of Carter-Wallace is found to be $197.64 million.

For terminal value, I have used the constant growth methodology as applied to project year eight cash flow of $49.9 million from the end of the *pro forma* period. When this value is extended into perpetuity using the previously determined long-term growth rate of 3.35% it leads to a value of $756.06 million.[102] When discounted back to present

[101] In accordance with Ruback's analysis, this year was subject to a partial year adjustment of 0.5 years.

[102] I have briefly considered van Biema's other three methods of calculating terminal value – of calculating multiples of sales, EBIT, and EBITDA where the multiples are obtained from a study of comparable companies. They have been given no material weight. *See* note 107, *infra*. The reason for this is that van Biema's report concerning the comparable companies is not sufficiently developed to determine if the companies are truly comparable. With respect to the underlying premise of any comparable companies analysis, *i.e.*, the companies compared are reasonably comparable, van Biema offers little factual support, particularly with respect to the comparable companies' product pipeline.
Furthermore, the "constant growth methodology" appears to lead to a reasonable and supportable value without the need to compare the value to other similar companies, especially for a company with Carter-Wallace's long history. Also, I note that while "[s]everal methods can be used to estimate the value of a company during the terminal year, including methods based on price/earnings and other value multiples . . . the one most often used by valuation consultants, is the capitalization of the terminal year operations [under the Constant Growth Methodology]." 1 FISHMAN & PRATT, *supra* note 53, at 5-57. That said, the discounted terminal values found for the EBITDA, sales and EBIT multiples under van Biema's model with the Court's determined discount rate of $630.29, $601.1 and $951.21 million are all substantially higher than the Court's projection of $389 million.

value using a discount rate of 9.95%, this yields $389.22 million. After adding the present value of the free cash flows, the value of the Healthcare Division, absent any adjustments for the sale of the Consumer Products Division, is found to be $586.86 million, or $11.60 per share.

F. *Adjustments*

The final step in determining the fair value of Carter-Wallace is to adjust the value of the Healthcare Division to account for the Asset Sale of the Consumer Products Division that took place shortly before the Merger and to make other corporate adjustments. As previously determined, all necessary costs attributable to the Asset Sale – including the tax liability and change-of-control costs – must be spread equally among all shareholders; those costs will be accounted for here. Ruback was the only expert to calculate adjustments in this manner.[103] He first started by adding to firm value the net proceeds from the Consumer Products Division sale of $553.[104] He then added the value of other net assets including cash and equivalents, the tax benefit of the option proceeds, and "usable portion of pension surplus,"[105] all of which totaled $196.2 million. He then subtracted from firm value other liabilities including notes payable, the Hoyt consulting contract, accrued vacation and bonuses, golden parachute payments, severance benefits for terminated employees, and advisory fees. The total of these liabilities was

[103] van Biema excluded those costs that would not have happened "but for" the Merger, such as tax liability and change-in-control payments.
[104] The gross proceeds were $714 million and were subject to $160.7 million in taxes.
[105] RX 63 at ex. 8.

$219.0 million. Lastly, he added option proceeds of $66.0 million for a total adjustment of $596.2 million.

The Petitioners argue that two changes should be made to these figures. First, they claim that Ruback incorrectly included subtractions related to pension enhancements, severance payments, deferred compensation, and transaction advisory fees because they were costs that related to the merger transaction. I must reject the Petitioners' argument. Ruback correctly included these fees because they were incurred by the Company as a result of the Asset Sale and, therefore, were part of the Company's "operative reality" as of the Merger.

The Petitioners' other argument is that Ruback should have added an additional $54.2 million because he only added in the portions of the pension amounts that were immediately "useable" and failed to include over-funded pension amounts in his calculation of assets. The Company provided no evidence or explanation as to why only the immediately usable portions of the pension payment should be added. Therefore, I will add this amount to the adjustments as well, bringing the total amount of adjustments to $650.4 million.

When these adjustments are added to the calculated value of the Healthcare Division, the fair value of Carter-Wallace as a going concern becomes $1.237 million or, with 50.6 million shares outstanding on a fully diluted basis,[106] $24.45 per share.[107]

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[106] The increase in the number of shares from that set forth in Part I.A. of this letter opinion is largely attributable to the exercise of options.

[107] A number of "checks" on this number are available.

1. Both the Asset Sale and the Merger were the product of "arms length" negotiations. Carter-Wallace was aided by experienced and sophisticated investment bankers who devoted several years to the effort. Except possibly for JP Morgan's relationship with Armkel, there is no suggestion that the sales effort was not professionally handled. As a general matter, an arms length transaction may be a good indication of value. *See Union Ill. 1995 Inv. Ltd. P'ship*, 847 A.2d at 357 & n.37. In addition, van Biema concedes that the value of Carter-Wallace as a pre-transaction whole was less than the sum of the values of its two divisions. This all suggests that the Court's conclusion may be high. Yet, it must be remembered that, to use JP Morgan's Boothby's telling choice of words, the sales effort was "desperate." The result of a "desperate" sales effort is not a compelling indicator of value.

2. Another check is the comparable companies analysis. In many instances, a comparable companies analysis should be factored directly into the Court's determination of fair value. Here, there is an insufficient showing that the comparable companies are truly "comparable," an essential element of any such analysis. *See Travelocity.com, Inc.*, 2004 WL 1152338, at *8; *Lane*, 2004 WL 1752847, at *32. The Healthcare Division's product pipeline was lacking; nothing in the record enables the Court to assess accurately whether the "comparables" suffered similarly. van Biema's comparable companies analysis suggests that the Court's determination of fair value may be low. However, as noted, the efficacy of a comparable companies analysis, on this record, is limited. Moreover, van Biema relied on comparable companies only as a check to his principal valuation efforts. Similarly, the lack of any comparable transactions precludes helpful input from this methodology.

3. Finally, another check may be the stock's trading history. *See Union Ill. 1995 Inv. Ltd. P'ship*, 847 A.2d 15, 357 & n.38; *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *23. Carter-Wallace, for a significant period before rumors that it was for sale became public in May 2000, had been trading in the range of $15 and $19. After the market learned that Hoyt was interested in selling the Company, the shares traded sharply upward. The upward movement ended in December 2000, with a price in the mid to upper $30s per share and then started to drop back to a range of $23-$26 which it reached in January 2001 and remained there until these transactions were announced. The trading range of Carter-Wallace before rumors started circulating would support a view that the Court's fair value determination is on the high side. That trading range ended, however, a full year before the Merger was announced. It should also be noted that Carter-Wallace's financial data during this period were encouraging. Thus, the trading range's usefulness as a reliable indicator of fair value in this instance is limited. Indeed, "Delaware law recognizes that, although market price should be considered in an appraisal, the market price of shares is not always indicative of fair value [and] [o]ur appraisal cases so confirm." *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1305745, at *23. That Carter-Wallace stock in the months before announcement of the Merger settled into a trading range not inconsistent with the Court's fair value determination affords some, but not significant, support for the Court's conclusion. In

VI. INTEREST

Next I turn to the rate of interest which should accompany the award. The Petitioners argue that the proper interest rate should be 9.949% compounded monthly; this rate is the Company's stipulated adjusted borrowing rate. The Company, on the other hand, claims the proper rate of interest should reflect not only the borrowing rate, but also the "prudent investor rate" which it claims is 2.24%. It then argues that the prudent investor rate and the borrowing rate should be blended together at a two-to-one ratio to find an interest rate, which it claims should be awarded as simple interest. I find that the proper interest rate is the legal rate of 7.5%, compounded quarterly.

A. *The Rate of Interest*

8 *Del. C.* § 262(h) provides that "the Court shall appraise the shares . . . together with *a fair rate of interest*, if any, to be paid upon the amount determined to be the fair value."[108] The interest award "may be simple or compound,"[109] but the Court must give an explanation for its choice.[110] The award of interest serves two important purposes. First, "[i]t compensates the plaintiff for the loss of the use of his money during this period," and thus "endeavors to place the dissenting shareholder in the position she would

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sum, these alternate approaches to value – best used in this case as "checks" – bracket the Court's conclusion. Because each suffers from shortcomings, no one check (or the various checks considered collectively) leads to a different conclusion.

[108] 8 *Del. C.* § 262(h) (emphasis added).

[109] *Id.* § 262(i).

[110] *Cede & Co.*, 2003 WL 23700218, at *45; *Gonsalves v. Straight Arrow Publishers, Inc.*, 725 A.2d 442 (Del. Feb. 25, 1999) (Order) (TABLE).

have been in had the corporation promptly paid the value of her shares."[111] Second, "it forces the surviving corporation to disgorge the benefit it received from having use of the plaintiff's funds."[112]

"In determining the fair rate of interest, the Court may consider all relevant factors, including the rate of interest which the surviving or resulting corporation would have had to pay to borrow money during the pendency of the proceeding."[113] In addition to looking to the company's cost of borrowing, or "borrowing rate," the Court "has historically examined the return that a prudent investor would have received if he had invested the judgment proceeds at the time of the merger."[114] The Court may also consider the legal rate of interest; indeed, "[t]he legal interest rate serves as a useful default rate when the parties have inadequately developed the record on the issue."[115]

The Petitioners' argument that the interest rate should be based solely on the borrowing rate or the rate "a prudent investor would require to provide a substantial unsecured loan to Respondent"[116] must be rejected. As noted above, this Court traditionally looks at both the "prudent investor rate" and "borrowing rate" in fixing the interest rate and the Petitioners have provided no compelling argument as to why this

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[111] *Chang's Holdings, S.A. v. Universal Chems. & Coatings*, 1994 WL 681091, at *1 (Nov. 22, 1994).
[112] *Id.*
[113] 8 *Del. C.* § 262(h).
[114] *Cede & Co. v. Technicolor, Inc.*, 1990 WL 161084, at *33 (Del. Ch. Oct. 19, 1990).
[115] *Chang's Holdings*, 1994 WL 681091, at *3; *Taylor v. Am. Specialty Retailing Group, Inc.*, 2003 WL 21753752, at *12 (Del. Ch. July 25, 2003).
[116] Pet'rs' Post-Tr. Br. at 49.

Court should deviate from this practice. Awarding the proposed interest rate of 9.949% would grant an "undeserved windfall"[117] given the volatility of the market.

The Petitioners, by deciding to argue only for its "unsecured loan" interest rate, have provided the Court with no alternative to the Company's proposed value for the "prudent investor rate" of 2.24%. Simply because this prudent investor rate was the only one submitted to this Court, however, does not mean that the Court must accept it. Ruback derived this rate by assuming that the typical prudent investor would invest in 20% 10-year Treasury bonds with a rate of 9.94%%, 20% Moody's AAA corporate bonds with a rate of 10.79%, 15% 90-day Treasury bills with a rate of 1.79%, 15% 90-day commercial paper with a rate of 1.81%, 10% one-year certificates of deposit with a rate of 2.69%, and 20% average risk mutual funds with a rate of negative 13.58%.[118] This proposed rate must be rejected.[119]

While this Court has noted that '"[t]he prudent investor takes both a long term and short term investment strategy . . . . [and] employs a mix of conservative investments . . .

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[117] *Ryan v. Tad's Enters., Inc.*, 709 A.2d 682, 705 (Del. Ch. 1996).

[118] RX 77.

[119] Similarly, the Court must reject the argument that the proper weight to accord the two interest rates is two-thirds to the prudent investor rate and one-third to the borrowing rate. This argument was recently rejected by this Court. *In re Emerging Communications Inc., S'holders Litig.*, 2004 WL 1305745, at *27 ("The Delaware cases require that the interest rate be determined by weighting the cost of borrowing and the prudent investor rate of return equally."). The weighting proposed by the Company would allow the corporation undue advantage from the spread between its cost of borrowing and any rate the Court might determine and may provide an unwarranted incentive for the corporation to seek to retain the shareholders' funds.

and . . . riskier investments"'[120] the Company's contention that the prudent investor would have placed substantial funds in an equity investment which returned a negative 13.58% is simply unreasonable for the prudent investor standard and the purposes it is designed to achieve.

As the parties have failed to develop a record which allows this Court to determine an accurate and reasonable prudent investor rate,[121] the legal interest rate shall instead be used. The legal interest rate on September 28, 2001 was 7.50%.[122]

B. *The Interest Should be Compound*

Under 8 *Del C.* § 262(i) an interest award may be either "simple or compound." This Court has recently noted that "where an interest award is warranted in an appraisal action, compound interest would generally be necessary to satisfy the purposes of that award."[123]

> [T]he fair rate of interest should be compound. It is simply not credible in today's financial markets that a person sophisticated enough to perfect his or her appraisal rights would be unsophisticated enough to make an

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[120] *Lane*, 2004 WL 1752847, at *37 (quoting *Chang's Holdings, SA*, 1994 WL 681091, at *4).

[121] I acknowledge that this is a problem largely of the Petitioners' creation and that they ultimately benefit from its consequences. During the applicable period, any prudent investor rate would be less than Carter-Wallace's borrowing rate. Thus, any number proposed by the Petitioners would undercut their suggestion that the Court simply employ the Company's borrowing rate. Even in a time of low interest rates and a stagnant or declining stock market, a prudent investor return of only 2.24% seems paltry, given the purposes of our appraisal statute. I also note, as an aside, and for these purposes I go beyond the record, that, since Ruback developed his proposal for a prudent investor rate, the broad market indices have performed better.

[122] 6 *Del. C.* § 2301(a); *see Taylor*, 2003 WL 21753752, at *12.

[123] *Gonsalves*, 2002 WL 31057465, at *10. *But see M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 527 (Del. 1999) (noting that compound interest should not be awarded routinely).

> investment at simple interest – in fact, even passbook savings accounts now compound their interest daily. . . . As for the defendant company in an appraisal action, it is even harder to imagine a corporation today that would seek simple interest on the funds it holds. One cannot imagine that a sophisticated businessman . . . would invest his companies' funds in instruments yielding simple rates of interest.[124]

The Company has suggested that only simple interest should be awarded in this case. While I do note that this Court has awarded only simple interest in previous cases, this is usually done where there was some sort of dilatory conduct in pursuing the action,[125] something which did not occur in this case. Furthermore, as has been recently reiterated by this Court, '"the dual purpose of compensation and restitution may only be served by a compounding interval at least as frequent as one month."'[126]

Thus, because prudent investors, if they had had full use of the proceeds, probably would not have made an investment that awarded only simple interest, interest compounded monthly would have been deserved in this case, had the Court used a mix of the Company's borrowing rate and the prudent investor rate. However, this Court has previously noted that when the legal rate of interest is used, the proper compounding frequency is quarterly.[127] "This is due to the fact that the legal rate of interest most nearly resembles a return on a bond, which typically compounds quarterly."[128] Therefore, the interest on the award in this action shall also be compounded quarterly.

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[124] *Onti, Inc. v. Integra Bank*, 751 A.2d 904, 926–27 (Del. Ch. 1999) (footnotes omitted).
[125] *See, e.g.*, *Tads Enters. Inc.*, 709 A.2d at 705.
[126] *In re Emerging Communications, Inc. S'holders Litig.*, 2004 WL 1043794, at *27 (quoting *JRC Acquisition Corp.*, 2004 WL 286963, at *15 (quoting *Grimes v. Vitalink Communications Corp.*, 1997 WL 538676, at *11 (Del. Ch. Aug. 28, 1997))).
[127] *Travelocity.com, Inc.*, 2004 WL 1152338, at *12; *Taylor*, 2003 WL 2173752, at *13.
[128] *Taylor*, 2003 WL 2173752, at *13.

VII. THE "UNPERFECTED" SHARES

Finally, I turn to the status of the 102,600 shares, for which the Petitioners claim appraisal rights but concede that the appraisal demands were not received by the Company until after the shareholder vote on the Merger, making their demands untimely. The Petitioners ask this Court to use its equitable discretion to deem these appraisal demands timely in light of the close proximity of the vote to the September 11, 2001 terrorist attacks on the United States.

As a general manner, the deadlines of 8 *Del C.* § 262 are strictly construed by this Court, and, thus, late demands are not excused.[129]

> [T]he statutory formalities concerning appraisal rights furnish an orderly method for withdrawal from a corporation by shareholders who dissent from a merger. Thus Delaware courts have emphasized the importance of deadlines such as those set forth in § 262, because when time is clearly of the essence under the terms of a statute, a late filing will not be judicially condoned.[130]

Indeed, this Court refused to excuse the late filing of a demand for appraisal, where the demand was only one day late because the petitioner mistakenly assumed that because § 262's 20-day time limit ended on a Sunday, the deadline would continue until the following Monday.[131]

While this Court has excused a late appraisal demand in the past, this has only been done under exceptional circumstances where the shareholder was prevented from

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[129] *Nelson v. Frank E. Best, Inc.*, 768 A.2d 473, 478 (Del. Ch. 2000).
[130] *Id.* at 479 (internal citations and quotations removed).
[131] *Id.* at 474–75.

making a timely demand "by reasons beyond his control."[132] For example, *In re Engle v. Magnavox Co.*, the Court excused a shareholder's late appraisal demand when the shareholder attempted to attend personally a shareholder meeting to oppose the merger, but his plane was delayed for mechanical reasons, and the shareholder's demand was "otherwise properly perfected."[133]

In this instance, the Petitioners have provided no other evidence as to why these appraisal demands were presented late, other than the proximity to September 11. While the Court, of course, is sensitive to the disruptions that the attacks caused, the Court cannot excuse the deadline simply because the deadline passed less than two weeks after those events. Indeed, the Petitioners have made no specific showing that the delay is attributable to the attacks. Thus, the Court will leave the record for the Petitioners to present evidence that the attacks, in fact, contributed to the timing of these appraisal demands.

VIII. CONCLUSION

For the foregoing reasons, the fair value of a share of Carter-Wallace, as of the Merger Date, was $24.45. Interest, compounded quarterly, at an annual rate of 7.50% is also awarded. The appraisal demand for the shares of State Street was filed timely and those shares are subject to the Court's fair value determination. With respect to those shares remaining subject to dispute as to the timely filing of the demands, the record will be kept open.

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[132] *In re Engle v. Magnavox Co.*, 1976 WL 2449, at *6. (Del. Ch. Apr. 21, 1976).
[133] *Id.* at *5-*6.

Counsel are requested to submit an order, within ten days, to implement this letter opinion.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-NC