**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

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| TULL N. GEARREALD, JR., NELY GEARREALD, B & J LLC, BILL HARBERT CONSTRUCTION, a Division of BILL HARBERT INTERNATIONAL CONSTRUCTION, INC., RAYMOND SCHETTINO, M.D., WAYNE D. THORNBROUGH and RODGER BRUNK,<br><br>Petitioners,<br><br>v.<br><br>JUST CARE, INC.,<br>a Delaware corporation,<br><br>Respondent. | ) | C.A. No. 5233-VCP |

**OPINION**

Submitted: January 9, 2012
Decided: April 30, 2012

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**PARSONS, Vice Chancellor.**

This is an appraisal proceeding brought pursuant to 8 *Del. C.* § 262. Petitioners, former shareholders and managers of a prison healthcare detention company, seek appraisal of their shares following an all cash acquisition of the company for $40 million. Collectively, Petitioners are entitled to appraisal of 533,792 Series A preferred and 1,479,551 common shares.[1] For the reasons set forth below, the Court concludes that, as of the merger date, the fair value of the company was $34,244,570.

## I. FACTUAL BACKGROUND

### A. The Parties

Respondent Just Care, Inc. ("Just Care" or the "Company") is a privately held prison healthcare services company. Just Care operates a private healthcare detention facility that provides an alternative to public and private hospitals for the care of sick, aging, and mentally ill inmates and detainees. Before the merger, Just Care was controlled by majority shareholder Maxor National Pharmacy Services Corp. ("Maxor").

Petitioner Tull N. Gearreald, Jr. was the principal founder and former CEO of Just Care. He was also a director. As a director, Gearreald voted in favor of the merger, but he later voted against it as a shareholder.

Petitioner Rodger A. Brunk was Just Care's CFO, a position he held since the Company's founding. As a shareholder, Brunk originally voted in favor of the merger before revoking his proxy and ultimately voting against it.

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[1] Verified Pet. for Appraisal ¶¶ 1-7. As discussed *infra*, this number includes certain shares attained through the exercise of options by two of the Petitioners.

Petitioners B&J LLC and Bill Habert Construction, a division of Bill Habert International Construction, Inc., are shareholders of Just Care. Both companies are controlled by James Rein, a former director of Just Care who failed to perfect his appraisal rights in his individual capacity and was dismissed from this appraisal proceeding.

Petitioners Nely Gearreald, Raymond Schettino, M.D., and Wayne D. Thornbrough are Just Care shareholders.

Nonparty GEO Care, Inc. ("GEO") "provides government-outsourced services specializing in the management of correctional, detention, and mental health and residential treatment facilities" in the United States and abroad.[2] GEO acquired Just Care through its acquisition subsidiary, nonparty GEO Care Acquisition, Inc.

## B. Facts

### 1. The business

Just Care was founded in 1996 and became operational on June 9, 1998 with 326 beds. Since its inception, the Company has operated a single facility, the Columbia Regional Care Center in Columbia, South Carolina (the "Columbia Center"). Following an expansion in 2007, the facility currently has a capacity of 350-360 beds and receives prisoners and detainees from four primary customers: (1) the South Carolina Department

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[2] JX 126.

of Mental Health; (2) the Georgia Department of Corrections; (3) the U.S Marshals Service; and (4) U.S. Immigration and Customs Enforcement.[3]

### 2. The transaction

GEO first contacted Jerry Hodge, a Maxor employee and Just Care director, about a possible acquisition of Just Care in November 2008. GEO and Maxor entered into a confidentiality agreement relating to a potential transaction on November 21, 2008, but discussions between the parties cooled in December 2008 after Maxor expressed uncertainty about wanting to go through with due diligence. At the time, Hodge had not informed the Just Care board (the "Board") of GEO's advance.

On April 20, 2009, GEO sent Hodge a nonbinding letter of interest to purchase the Company for cash consideration between $30 and $35 million. Hodge immediately rejected GEO's offer as inadequate. Four days later, GEO increased its offer to $35-40 million, which Hodge again rejected as inadequate. Finally, on May 6, 2009, GEO offered to acquire Just Care for 5.9x the Company's facility-level EBITDA, which equated to approximately $40 million. After receiving that offer, Hodge informed the entire Board for the first time of GEO's interest in an acquisition.

At a meeting on May 21, 2009, the Board approved pursuing negotiations with GEO related to a potential sale of the Company. To resolve any potential conflicts that

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[3] Just Care's top four customers represented over 90% of its fiscal year-to-date June 2009 revenues. JX 198 at 9.

might arise during the course of the negotiations, the Board formed a special committee (the "Special Committee") on June 12, 2009. The Special Committee retained Thompson & Knight LLP as independent legal counsel and Harris Williams & Co. LLC ("Harris Williams") as their independent financial advisors.

Although the Special Committee did not authorize Harris Williams to conduct a formal market check, the Company received an unsolicited competing bid from private equity firm Brookstone Partners ("Brookstone") on July 6, 2009. The Brookstone offer valued the Company between $38.25 and $40.25 million. Daniel Carbonara, a Just Care shareholder, led the Brookstone group with assistance from Gearreald and Rein, who were interested in participating in the post-buyout Company if Brookstone succeeded. As a result of the Brookstone offer, the Board expanded the Special Committee's mandate to include considering the relative merits of the Brookstone and GEO proposals. Brookstone was given access to the Company's data room on July 16.

Just Care typically did not prepare management projections beyond the current fiscal year. On July 18, 2009, however, Harris Williams requested that management prepare updated financial projections for the Company through 2013 (the "Management Projections"). Although Harris Williams used the Management Projections in its fairness opinion, the projections were not formally approved by the Board.

Gearreald and Brunk presented the Management Projections to Harris Williams on August 6. As discussed *infra*, the Management Projections contained three different growth scenarios for Just Care. The base scenario (the "Static Case") assumed that Just Care would continue operating close to full capacity without further expansion of its

facilities. The second scenario projected that Just Care would continue operating its current facilities under the Static Case and also would build a new facility at the Columbia Center to house sixty sexually violent predators (the "SVP Case"). Finally, management's most optimistic scenario included the Static Case, the SVP Case, and an additional expansion into a prison center in Milledgeville, Georgia (the "Georgia Case").

Because Brookstone never was able to obtain firm financing for any of its offers, Harris Williams eventually opined that the GEO offer was superior. On August 25, 2009, the Board unanimously approved the Agreement and Plan of Merger (the "Merger Agreement") between Just Care and GEO. The Merger Agreement was executed on August 28 and a proxy statement informing shareholders that the Board considered the transaction to be "advisable, fair to and in the best interests of, the Company and the Company Stockholders"[4] was disseminated to shareholders on September 8.[5] Just Care's shareholders approved the merger at a meeting on September 29, 2009, and the deal closed on September 30. Although a majority of the outstanding shares approved the

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[4] JX 152 at P000124.

[5] Although Gearreald and Rein originally approved the merger and consented to the proxy statement, both later voted against the merger in their capacities as shareholders. A related action for breach of fiduciary duty against Gearreald and Rein currently is proceeding in Texas. JX 300.

merger, 65 of the Company's 115 shareholders, representing approximately 36% of the Company's shares on an as-converted basis, voted against it.[6]

Under the terms of the Merger Agreement, GEO acquired Just Care as a wholly owned subsidiary for $40 million in cash. Of that amount, however, $6 million was held in escrow to pay claims against the Company arising during the two-year period following the close of the merger, including appraisal claims and costs.

### C. Procedural History

Following the merger, Petitioners filed their Verified Petition for Appraisal on January 27, 2010. A trial was held on July 18-20, 2011, followed by extensive post-trial briefing and oral argument.

### D. Parties' Contentions

Petitioners contend that the fair value of Just Care is $55.2 million. In support of this valuation, Petitioners rely on their expert, Frank Torchio, who is the founder and president of Forensic Economics, Inc. In valuing the Company, Torchio performed a discounted cash flow ("DCF") analysis, trading multiples analysis, and a precedent transactions analysis. Torchio relied, however, only on his DCF analysis in reaching his valuation opinion because his trading multiples analysis yielded a wide range of values.[7]

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[6] JX 163.

[7] Because a precedent transactions analysis generally captures anticipated synergies from the transaction, both experts excluded it from their final appraisal computations.

Respondent claims that Just Care's fair value is $33.6 million. In support of its valuation contentions, Respondent relies on the expert testimony and report of J.T. Atkins, who is the founder and managing director of Cypress Associates LLC.[8] Atkins valued the Company using a DCF analysis, comparable public companies analysis, and a precedent transactions analysis. Atkins weighted the values derived from his DCF analysis at 66.7% and his comparable companies analysis at 33.3% in coming to a final value for the Company.

As discussed *infra*, much of the difference between the parties' valuations can be accounted for by two disputed aspects of their respective valuation analyses: (1) whether the cash flow projections for the Georgia and SVP Cases should be included in calculating the value of Just Care, and (2) the appropriate small company size premium to be applied to the Company's cost of equity. Together, these two areas of dispute account for most of the difference between the parties' respective valuations.[9]

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8 Cypress Associates LLC is an investment banking firm that provides financial advisory services related to mergers and acquisitions, corporate restructuring and recapitalizations, private placements of debt and equity, and litigation consulting services and expert witness work. Tr. 613 (Atkins).

9 According to Atkins, if Torchio's analysis were changed to disregard the Georgia Case and use the full small company size premium implied by Just Care's actual size, Torchio's own methodology would value the Company at $31 million. *Id.* at 638.

## II. ANALYSIS

An appraisal action is a "limited legislative remedy which is intended to provide shareholders, who dissent from a merger asserting the inadequacy of the offering price, with an independent judicial determination of the fair value of their shares."[10] The Delaware General Corporation Law ("DGCL") entitles petitioners to their pro rata share of the "fair value" of the companies in question as of the merger date.[11] The Court is given broad discretion to determine fair value.[12] In doing so, it should take into account all relevant factors known or ascertainable as of the merger date that illuminate the future prospects of the company.[13] The Court, however, must determine the fair value of "the company to the stockholder as a going concern."[14] Determining the value of a "going concern" requires the Court to exclude any synergistic value, that is, "the amount of any value that the selling company's shareholders would receive because a buyer intends to

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[10] *Ala. By-Prods. Corp. v. Neal*, 588 A.2d 255, 256 (Del. 1991).

[11] 8 *Del. C.* § 262(h) ("Through such proceeding the Court shall determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger or consolidation, together with interest, if any, to be paid upon the amount determined to be the fair value.").

[12] *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 299 (Del. 1996).

[13] 8 *Del. C.* § 262(h); *Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983) (quoting *Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950)).

[14] *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 795 (Del. 1999); *accord Technicolor*, 684 A.2d at 298 ("[T]he Court of Chancery's task in an appraisal proceeding is to value what has been taken from the shareholder, *i.e.*, the proportionate interest in the going concern.").

operate the subject company, not as a stand-alone going concern, but as a part of a larger enterprise, from which synergistic gains can be extracted."[15]

In an appraisal proceeding, both sides have the burden of proving their respective valuations by a preponderance of the evidence.[16] The Court may consider "proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court."[17] Acceptable techniques include the DCF approach and the comparable transactions approach.[18] If neither party satisfies its burden, however, the Court must use its own independent judgment to determine the fair value of the shares.[19]

### A. Credibility Claims

Before discussing the competing valuations presented by the parties' experts, I briefly discuss Petitioners' challenges to Respondent's credibility and the sales process

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15 *Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Gp., Ltd.*, 847 A.2d 340, 356 (Del. Ch. 2004).

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

17 *Weinberger*, 457 A.2d at 713.

18 *See Dobler v. Montgomery Cellular Hldg. Co.*, 2004 WL 2271592, at *8 (Oct. 4, 2004); *see, e.g.*, *Cede & Co. v. JRC Acq. Corp.*, 2004 WL 286963, at *2 (Del. Ch. Feb. 10, 2004) (utilizing the DCF approach); *Gentile v. Singlepoint Fin., Inc.*, 2003 WL 1240504, at *6 (Del. Ch. Mar. 5, 2003) (utilizing the comparable transactions approach).

19 *Gonsalves v. Straight Arrow Publ'rs, Inc.*, 701 A.2d 357, 362 (Del. 1997); *Taylor v. Am. Specialty Retailing Gp., Inc.*, 2003 WL 21753752, at *2 (Del. Ch. July 25, 2003).

employed in selling Just Care to GEO. Petitioners claim that "the merger was the result of an unfair process not designed to achieve the highest price" and that the sales process was "a blueprint for faithless conduct, designed solely to benefit Maxor to the detriment of the majority."[20] Specifically, Petitioners aver that the Board conducted an inadequate sales process, that the Special Committee was conflicted, and that Maxor orchestrated the merger at an inadequate price to curry favor with GEO in order to obtain a nationwide pharmacy contract.[21] As a result, Petitioners argue that "Respondent's valuation contentions simply are not credible in light of the flawed sales process . . . . [and] the Court should reject Respondent's valuation contentions, including its contention that the Georgia expansion should be accorded no value."[22]

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[20] Pet'rs' Opening Br. ("POB") 26. Petitioners and Respondent simultaneously filed their respective post-trial opening and answering briefs.

[21] *Id.* at 2 (Petitioners allege that "[d]uring the sales process, Maxor was in the delicate position of negotiating for the sale of its Just Care stock, but not at a price so high that it soured the potential for a pharmacy contract between Maxor and GEO. Thus, the 'price Maxor could accept' included a discount equal to the value Maxor implicitly placed on a nationwide pharmacy contract with GEO"). Notably, Petitioners Gearreald and Rein have not brought any action for breach of fiduciary duty. Indeed, as directors, they actually voted to approve the merger and authorized a proxy statement informing shareholders that the transaction was fair and in the best interests of the Company and its shareholders, despite having knowledge of at least some of the facts underlying their allegations against Maxor and the Board. Later, however, Gearreald and Rein voted against the merger and perfected their appraisal rights as shareholders.

[22] *Id.* at 28.

In making this argument, Petitioners misunderstand the nature of an appraisal action under § 262. The "only litigable issue in a statutory appraisal under [§] 262" is "the value of the appraisal petitioners' shares on the date of the merger . . . ."[23] Considerations of whether corporate fiduciaries "engage[d] in self-dealing and fix[ed] the merger price by procedures not calculated to yield a fair price" are considered only when assessing the credibility of a party's specific valuation contentions.[24] Here, however, Petitioners do not attack the credibility of the specific valuation contentions made by Respondent. Instead, Petitioners attack the overall credibility of Respondent and its officers and directors, arguing that the Court should reject all of Respondent's valuation contentions because some of its directors allegedly were conflicted and exhibited bad faith during the sale of the Company.[25] Having considered these claims, I find that such a broad-based attack on Respondent's credibility is of little consequence to this appraisal action because Respondent does not rely on the merger price as evidence of fair value.[26]

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23 *Ala. By-Prods. Corp. v. Neal*, 588 A.2d 255, 256-57 (Del. 1991).

24 *Id.* at 257.

25 Pet'rs' Ans. Br. ("PAB") 7.

26 Where a company relies on the merger price as evidence of fair value, allegations of breach of fiduciary duty or other improper actions during the sales process are relevant to whether the merger price is credible evidence of fair value. *See Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 42 (Del. Ch. 2007) (noting that merger price can indicate fair value if "the transaction giving rise to the appraisal resulted from an arm's-length process between two independent parties.") Where evidence of fair value is supplied by expert analyses, however, allegations of improper conduct by the company's fiduciaries are relevant only to the extent that they relate to some assumption or input to the expert's valuation,

Respondent instead has presented an expert valuation of the Company derived from an analysis of the Company's business, financial statements, and projections.

Indeed, it is Petitioners' heavy reliance on the Management Projections that presents the primary credibility issue in this appraisal. Although the Court generally relies on management projections made in the ordinary course of business,[27] the Management Projections here were made outside of the ordinary course of business by Petitioners in this action. Before the creation of the Management Projections, Just Care's management had never prepared projections beyond the current fiscal year. Moreover, the projections were made at a time when Petitioners Gearreald and Brunk risked losing

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affecting in turn the credibility of the challenged valuation. *See Chang's Hldgs. v. Univ. Chems. & Coatings, Inc.*, 1992 WL 301327, at *1 (Del. Ch. Oct. 13, 1992) ("'Where [valuation] assumptions are values supplied by others, the conduct of such other persons is probative of their credibility and of the information being supplied to the expert.' Information concerning breach of fiduciary duty is thus relevant because it may concern either the conduct of other persons (namely the board who supplied the information to [the financial advisor]) or the credibility of the board." (quoting *Ala. By-Prods.*, 588 A.2d at 258)).

With these principles in mind, I have considered Petitioners' allegations of breaches of fiduciary duty only in connection with the reliability of information conveyed to Respondent's expert regarding, for example, the likelihood that Just Care would implement the Georgia expansion. Moreover, in making my own assessment as to the credibility of the SVP and Georgia projections, I did not rely on the Respondent directors' testimony regarding the reliability of those projections.

27 *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *7 (Del. Ch. Dec. 31, 2003) ("When management projections are made in the ordinary course of business, they are generally deemed reliable."), *aff'd in part, rev'd in part*, 884 A.2d 26 (Del. 2005).

their positions if the GEO bid succeeded and were involved in trying to convince the Board to pursue a different strategic alternative in which Gearreald and Brunk were involved. They were also made when the possibility of litigation, such as an appraisal proceeding, was likely. Therefore, I find that the Management Projections prepared by Gearreald and Brunk are not entitled to the same deference usually afforded to contemporaneously prepared management projections and that, in the circumstances of this case, Petitioners carry the burden of proving the credibility of those projections.[28]

### B. The DCF Analysis

Both experts rely primarily on their DCF analyses to value the Company. Therefore, in appraising Petitioners' shares, I focus on the competing contentions underlying the experts' respective DCF analyses.[29] In particular, the experts relied on various conflicting inputs and assumptions regarding the Company's projected cash flows, capital structure, and cost of capital. I now turn to those disputed inputs and assumptions.

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[28] *See id.* at *7 ("Contemporary pre-merger management projections are particularly useful in the appraisal context because management projections, by definition, are not tainted by post-merger hindsight and are usually created by an impartial body. In stark contrast, *post hoc,* litigation-driven forecasts have an 'untenably high' probability of containing 'hindsight bias and other cognitive distortions.'").

[29] Because Just Care has a unique business model and is a private company, I doubt the reliability of the comparable public companies analysis and do not give it any weight in arriving at a final value for the Company. I do consider that analysis, however, in the sense that it lends support to the final valuation arrived at in this Opinion.

### 1. Cash flow projections

### a. The Management Projections

A central dispute between the parties is whether the projected cash flows from the SVP and Georgia Cases should be included in Just Care's DCF analysis.[30] Torchio determined that both scenarios should be included, whereas Atkins rejected the Georgia Case as too speculative and performed analyses both with and without the SVP Case. Having considered the assumptions underlying each scenario, I agree with Atkins that the Georgia Case is too speculative. I further find that the SVP Case can be included with an appropriate probability weighting.

### 1. The Georgia Case

For at least one year before the merger, Just Care had been interested in expanding its operations through one of two potential projects in Milledgeville, Georgia. In 2008, Just Care first considered establishing a facility to house Georgia's "not guilty by reason of insanity" ("NGRI") patients in the Cook and Kidd buildings of the Georgia Central State Hospital (the "Kidd Project"). When a request for proposal ("RFP") for the Kidd Project was issued in November 2008, however, Just Care found the financial terms of

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[30] Although Respondent challenges even the Static Case presented by Petitioners as "aggressive" because it assumed occupancy levels based on an allegedly temporary spike in the patient census in August 2009, Respondent nonetheless gave Petitioners the "benefit of the doubt" and accepted the Static Case in its own valuation. Therefore, I consider here only whether to include the SVP and Georgia Cases.

the RFP so "appalling" that the Company decided not to bid on the project.[31] As a result, GEO was the only bidder for the project, and Georgia eventually rescinded the RFP for lack of competition.

Following the disappointment of the Kidd Project RFP, Just Care refocused its efforts throughout 2009 on another project in Georgia, which involved the renovation of the Bostick State Prison into a medical detention facility.[32] In the Management Projections for the Georgia Case, Gearreald and Brunk projected that an RFP would be issued within two to six months after August 2009 and that the Bostick facility would be operational in 2010.[33] The Georgia Case projections anticipated that the Bostick facility would house up to 304 patients, with a guaranteed occupancy of 200.[34] The project was expected to generate $20-25 million in annual revenues and profits of more than $5 million.

Here, I find that the Georgia Case was too speculative to be included in the valuation of the Company as of the merger date. In an appraisal proceeding, "the corporation must be valued as a going concern based upon the 'operative reality' of the

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31 JX 50 at P001773.

32 *See* JX 48 at JCI00005645 (materials from February 5, 2009 board meeting characterizing the Bostick project as the "Highest Probability 2009 New Facility").

33 JX 126 at 9.

34 JX 48 at JCI00005645.

company as of the time of the merger."[35] The Court should consider "all factors known or knowable as of the Merger Date that relate to the future prospects of the Companies," but should avoid including speculative costs or revenues.[36] As an initial matter, I consider it highly relevant that, in the approximately eleven years of its existence before the merger, Just Care had operated only one facility. Although Petitioners assert that Just Care would have had to expand to grow,[37] its business model was not predicated on maintaining multiple facilities and it had no prior experience with expanding its business outside of the Columbia Center. Moreover, as Petitioners admit, the Bostick facility would be significantly different from the Columbia Center, operating in a different regulatory environment and providing different services.[38] In the absence of any history of expansion outside South Carolina, projections regarding the viability and profitability of future expansions would be subject to greater uncertainty.[39] Furthermore, even if the

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[35] *M.G. Bancorporation, Inc. v. LeBeau*, 737 A.2d 513, 525 (Del. 1999).

[36] *In re U.S. Cellular Operating Co.*, 2005 WL 43994, at *14 (Del. Ch. Jan. 6, 2005); *accord Weinberger v. UOP, Inc.*, 457 A.2d 701, 713 (Del. 1983) ("[E]lements of future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger and not the product of speculation, may be considered.").

[37] POB 31.

[38] Tr. 78 (Gearreald).

[39] *Cf. Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 315 (Del. Ch. 2006) ("The dangers for the minority [shareholders] arguably are most present when the controller knows that the firm is on the verge of break-through growth, *having gotten the hang of running the first few facilities, and now being well-positioned to replicate its success at additional locations.*" (emphasis added)). In

new facility was successful, there was a risk that Georgia would move its prisoners currently housed at the Columbia Center back to Georgia, thereby reducing the value of the Columbia Center.[40]

I also find it significant that, as of the merger date, Georgia had not decided to go forward with the Bostick project. As Petitioners admit, "Georgia's ultimate course of action (whatever that course of action may have been) was not susceptible of proof as of the date of the merger."[41] This uncertainty is fatal to the Georgia Case because Just Care could not undertake the expansion unilaterally without a decision by Georgia to move forward. The fact that the Company was focused on expanding into Georgia and had taken actions in furtherance of that goal is insufficient to make the Georgia Case part of Just Care's operative reality. Similarly, Petitioners' evidence that Just Care had (1)

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*Delaware Open MRI*, on which Petitioners rely, then-Vice Chancellor, now Chancellor, Strine found it appropriate to include expansion plans for new facilities in the company's value at the time of the merger because the future facilities were part of an "obvious strategy of creating a statewide network of MRI Centers." *Id.* at 319. At the time of the merger, the company, Delaware Radiology, had two fully operational facilities and had formed and formalized leases for two more sites, leading the Court to analogize the business to a McDonald's or Starbucks. Chancellor Strine later noted that "[p]ervading this analysis is an obvious point: [radiology centers] I through V are all premised on the same model of operation . . . ." *Id.*; *see also id.* at 317 ("[E]ven more importantly . . . [radiology center] III represented an extension of a business model that Delaware Radiology already had used successfully twice."). Here, the nature of Just Care's business model is substantially different from the standardized business model in *Delaware Open MRI*.

40 JX 59 (projecting the effect on the Columbia Campus if a new Georgia facility were built and Just Care's Georgia patients were moved back to Georgia).

41 Pet'rs' Mot. in Limine ¶ 9.

commissioned architects to design plans for renovating the facility, (2) sent its construction firm to survey and estimate the costs of the project, and (3) received a verbal commitment for financing from Wells Fargo, may reflect a strong intent on the part of the Company to pursue the project, but "intent does not equate to ability."[42] Indeed, Just Care had taken the same actions while it was pursuing the Kidd Project, but ended up not even bidding for the RFP.[43]

Even assuming that Georgia decided to proceed with the project, the process and the economics of any potential RFP were also speculative. Although Petitioners now argue Georgia conceivably might proceed without an RFP process for the facility, the Management Projections assumed that Georgia would issue an RFP.[44] If it did, Just Care would have had to compete for the project, and the existence of such competition likely would affect both the economics of the project and the probability that Just Care would win the project. Furthermore, because GEO had found the economics of the Kidd Project feasible, Just Care probably would have faced serious competition from GEO for the Bostick facility.

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42 *Lane v. Cancer Treatment Centers of Am., Inc.*, 2004 WL 1752847, at *23 (Del. Ch. July 30, 2004).

43 Tr. 270 (Brunk).

44 *See* JX 126 at 9.

For all these reasons, I find that the Georgia Case was too speculative as of the merger date to be included in the Company's value.[45]

### 2. The SVP Case

In 2008, Just Care expanded its lease at the Columbia Center to include another twenty acres on which it intended to build a new, sixty-bed building to house sexually violent predators from the South Carolina Department of Corrections ("SCDOC"). According to Petitioners, at the time of the merger, Just Care was operating near capacity and recognized it would have to expand its facilities. Under the SVP Case, Gearreald and Brunk projected that the Company would expand to a new building at the Columbia Center. The expansion would be financed through Just Care's cash flows, house a

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[45] In coming to this conclusion, I note that Harris Williams also found that the Georgia Case carried substantial uncertainty and risk. According to Geoffrey Smith, the lead Harris Williams partner for the merger with GEO, Harris Williams "had questions about whether or not Georgia would ever issue an RFP, the timing of such an RFP, if such an RFP were to be issued, if Just Care . . . would choose to participate, if they chose to participate, if they would ultimately win, given the fact that there was a very high likelihood that there would be other bidders on that RFP. In particular, GEO had already demonstrated in a previous RFP process for the State of Georgia that they had bid on that. So we expected that at least they would bid again. And so had we put all that together, in addition to . . . it being a political process and that having a significant impact on whether it actually happened or not, as well as the potential timing, we felt like that there was significant risk associated with the Georgia opportunity." Tr. 456-57. The speculative nature of both the Georgia and SVP Cases led Harris Williams to apply a company-specific risk premium of 6% when valuing Just Care. Smith further testified that Harris Williams "believed that the financial projections, in particular associated with SVP and Georgia . . . were so speculative that [they] needed to make an adjustment to reflect the risk associated with those." Tr. 458. Moreover, Gearreald himself stated at the Board meeting approving the merger with GEO that it was his belief that "[i]f someone asserted their dissenting rights to an appraisal . . . an expert would look at the static projections assuming no expansion . . . ." JX 144 at 13.

homogeneous population of civilly-incarcerated individuals, and maintain a run rate occupancy of 95%. According to Petitioners, Just Care had experience housing similar patients through its existing contract with the South Carolina Department of Mental Health. Moreover, because an RFP process had not been used for the establishment of Just Care in 1997 and its original expansion in 2007, management was confident that the SVP Case also would be undertaken without an RFP process.

For many of the same reasons stated in the discussion of the Georgia Case, I find that the SVP Case involved a high degree of risk. Similar to the Georgia Case, there was substantial uncertainty about whether the SCDOC would move forward with the project, whether it would use an RFP process, and whether Just Care would win the RFP. The SCDOC had issued and revoked an RFP to house the same patient population eighteen months before the merger, and Smith testified that "[t]here was no assurance that such an RFP would be issued again."[46] Even if an RFP was issued, "there was no guarantee that . . . Just Care would be selected . . . ."[47] Indeed, in its fairness opinion, Harris Williams observed that there was "significant risk associated with the value and timing of the projected financial results" associated with the SVP Case.[48]

Despite these risks, the evidence presented provides a sufficient basis to include the SVP Case to at least some extent in the determination of the Company's value on the

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46 Tr. 455.

47 *Id.*

48 JX 126 at 10.

merger date. Unlike the Georgia Case, Just Care could expand unilaterally into a new facility at the Columbia Center. In fact, Just Care already had extended its lease to include the twenty acres on which it planned to build the SVP facility. Moreover, the Company had a history of expansion at the Columbia Center, having added a sixty-bed wing in 2007. Just Care also had experience housing similar patients to those expected under the SVP Case and was housing thirteen such inmates at the time of the merger. As Respondent's own expert report admits, the SCDOC had 100 more inmates that it could transfer to the new facility.[49]

Because the SVP Case essentially represented an extension of Just Care's existing business at the Columbia Center and Just Care successfully had expanded its Columbia operations in 2007, the SVP Case is significantly more credible than the Georgia Case. The SVP Case represented a relatively small expansion, at the same location, in the same state, for the purpose of adding additional business for patients similar to those already being treated by Just Care. Therefore, although there still was significant risk as to whether the SCDOC would go forward with the project, the SVP Case is sufficiently reliable to be considered part of Just Care's "operative reality" as of the merger date. Based on the uncertainty related to the SCDOC's decision to go forward with the project and the possibility that it might proceed by way of an RFP process, however, I require that the values for the SVP Case be probability weighted by 66.7%.

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[49] JX 198 at 16. Indeed, Atkins accepted the SVP Case in one version of his DCF analysis, even though he characterized it as "very aggressive." Tr. 710.

#### b. Terminal Value

In addition to their disagreement as to the credibility of the Management Projections, the experts dispute the appropriate terminal growth rate for the Company. Atkins applied a terminal growth rate of approximately 5.5%, whereas Torchio applied a more conservative terminal growth rate of 3.5%. Because I have adopted growth projections more consistent with Respondent's view of Just Care's prospects, I also adopt Respondent's terminal growth rate projections. Therefore, I apply a terminal growth rate of 5.5% for the Company.[50]

### 2. Just Care's cost of capital

In order to discount the cash flow projections for the Company, both experts computed a weighted average cost of capital ("WACC"). Because WACC is estimated based on the relative percentages of debt, preferred stock, and common equity in a company's capital structure, both experts made assumptions about what they believed to be the appropriate capital structure for the Company. The experts then estimated the Company's costs of debt, preferred stock, and equity. I turn next to these contentions.

#### a. Just Care's capital structure

Atkins chose a capital structure under which the Company consisted of 100% common equity, which he asserts was the Company's actual capital structure immediately before the merger. Torchio used a capital structure consisting of 5% debt, 35%

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[50] Atkins magnanimously offered "to give the benefit of the doubt" to Petitioners on this issue. Tr. 630. Because the higher terminal growth rate will benefit Petitioners and otherwise comports with Atkins's analysis, I consider it more appropriate to treat Atkins's terminal growth rate as uncontested.

nonconvertible preferred stock, and 60% common equity. Torchio asserts that this ratio best represents what the Company's capital structure would have been as a going concern based on Just Care's historical capital structure and the average debt to total capital ratios of comparable companies over the last five years.

In considering the appropriate capital structure to apply in this context, I note that this Court is required to "determine the fair value of the shares exclusive of any element of value arising from the accomplishment or expectation of the merger."[51] As a going concern, Just Care historically operated with a capital structure comprised of both preferred and common equity, as well as some debt. The Company paid off all of its debt, however, as a condition of the Merger Agreement.[52] Moreover, in connection with the merger, all of Just Care's preferred stock was converted to common equity.

At trial, Atkins testified that he understood Delaware law to require him to apply the actual capital structure of the Company as of the merger date, which for Just Care was 100% common equity.[53] Such an approach was inappropriate here, however, because the capital structure applied by Atkins arose directly out of the expectation of the merger. This Court previously has rejected the proposition that changes to a company's capital

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[51] 8 *Del. C.* § 262(h).

[52] JX 147 § 7.02(j) ("Payoff of Company Indebtedness and Termination of Liens" Condition).

[53] Tr. 633 ("Our understanding . . . in the context of appraisal, is that the Delaware Courts [require] . . . that we look at the actual capital structure at the time of closing to develop our capital structure.").

structure in relation to a merger should be included in an appraisal. For example, in *Cede & Co. v. JRC Acquisition Corp.*,[54] this Court refused to include debt incurred as part of the merger in the company's capital structure because to do so would "contravene[] the valuation statute's command to appraise shares 'exclusive of any element of value arising from the accomplishment or expectation of the merger.'"[55] Instead, the Court found that because the company had no debt before the merger and because "Petitioner ha[d] introduced no evidence of non-speculative plans to incur significant debt that is not due to the accomplishment of the merger," it was inappropriate to include the actual additional debt for purposes of appraisal.[56]

Therefore, I find that the correct capital structure for an appraisal of Just Care is the theoretical capital structure it would have maintained as a going concern. Because Torchio's estimation of a capital structure as including 5% debt, 35% preferred stock, and 60% common equity more reasonably reflects the capital structure the Company would have had as a going concern, I adopt Torchio's capital structure for purposes of this appraisal.[57]

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[54] 2004 WL 286963 (Del. Ch. Feb. 10, 2004).

[55] *Id.* at *7 (quoting 8 *Del. C.* § 262(h)).

[56] *Id.* at *8.

[57] This finding is supported by the possibility that Just Care might have sought to expand under the SVP Case had it not merged with GEO. *See id.* (holding that a hypothetical "debt ratio of 10% is . . . reasonable and accounts for the probability that JR Cigar may seek to incur limited debt to pursue expansion opportunities."). Although management projected that the SVP Case could be financed out of the

As to the treatment of Just Care's preferred stock, however, I agree with Respondent that, in the circumstances of this case, the preferred stock should be treated as common equity for purposes of calculating Just Care's WACC. Just Care was capitalized initially with a fairly typical venture capital structure consisting almost entirely of convertible preferred stock and a small sliver of common equity allocated to the Company's management.[58] Just Care has never paid a dividend on its preferred shares and, in the event of a merger, the Company was entitled to convert the preferred shares into common.[59] In essence, Just Care's preferred stock was treated as a common stock equivalent, not a dividend-paying debt instrument. Therefore, when determining the actual cost of Just Care's preferred equity for appraisal purposes, the preferred stock should be treated as common equity because that was the true economic nature of the Company's preferred stock financing. If Just Care had continued as a going concern, it is unlikely that it would have paid a dividend on its preferred stock and, more likely than not, the value of the preferred stock would have been realized by converting to common

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Company's cash flows, it is not unreasonable to assume that the Company would have continued to maintain a limited amount of debt for the expansion, in line with its historical practice. *See* JX 201 (Atkins Rebuttal Report) ("It was conceivable that the Company might incur a modest amount of debt in the future.").

58 Tr. 110 (Gearreald); Tr. 686 (Atkins).

59 In his rebuttal report, Torchio acknowledged that "[p]resumably, the preferred holders are sophisticated investors who understand that the rights of the preferred stock would only give them the conversion value in a change of control event. It follows then, that the preferred stock's appraisal value cannot exceed the preferred stock's proportion of the enterprise value that can be obtained upon conversion of the preferred stock." JX 200 at 9-10.

equity through some liquidity event, as occurred in this case.[60] Consequently, treating Just Care's preferred stock as a dividend-paying instrument would distort Just Care's actual financing costs at the time of the merger. Therefore, I find that Just Care's cost of preferred equity is equivalent to its cost of common equity. Accordingly, for purposes of calculating the WACC, I treat the Company's capital structure as if it was composed of 5% debt and 95% common equity.

### b. Cost of equity

Both experts employed the capital asset pricing model ("CAPM") to determine the Company's cost of equity.[61] They also agreed that the appropriate risk-free rate at the time of the merger was 4.02%.[62] The experts disagreed, however, on the appropriate beta, equity risk premium, and size premium to be used in calculating the Company's cost of equity.

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60 Atkins explained that, "[w]hen people put money into a venture capital, it always comes in as a preferred stock and the management usually gets common. But the investors, venture capital stocks look at it as common stock from a valuation point of view, simply supervoting common. And they're still expecting – venture capitalists are still expecting a 25 percent-plus return, which is the same thing as the cost of equity." Tr. 686.

61 *JRC Acq. Corp.*, 2004 WL 286963, at *8 ("Under CAPM the cost of equity is equal to the risk-free rate (the yield on 20 year Treasury bonds) plus a large company equity risk premium multiplied by the specific company adjusted beta . . . .").

62 In determining the Company's cost of equity capital, both experts used data from the Ibbotson Associates 2009 Valuation Yearbook.

### 1. Beta

Atkins, assuming a capital structure of 100% common equity, calculated an unlevered beta of 0.69 by analyzing the betas of comparable publicly-traded companies. Torchio calculated a levered beta of 1.3, assuming a capital structure of 5% debt, 35% preferred stock, and 60% common equity. In arriving at his beta, Torchio utilized a sum beta model. Sum beta is calculated by "regressing the security return in the current period with both the market return in the current period and the market return in the prior period."[63] Torchio considered it more appropriate to apply a sum beta for Just Care because it accounts for the possibility that price changes for small, thinly-traded stocks may lag the overall market.[64]

In considering which approach to use, I note that neither side seriously contested the other's beta calculation. Indeed, most of the difference between the two beta values stems from the experts' divergent capital structure assumptions. According to Atkins, unlevering Torchio's beta results in a beta of 0.79, as compared to Atkins's unlevered beta of 0.69.[65] Because Respondent has not provided a substantive basis for rejecting the use of sum beta and because Torchio's justification for applying sum beta in this context appears reasonable based on Just Care's size and the illiquidity of its stock, I accept Torchio's methodology. Furthermore, by adjusting Torchio's beta calculation to account

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[63] JX 197 at 19.

[64] *Id.*

[65] JX 201 Ex. A at 4.

for a theoretical capital structure of 5% debt and 95% common equity, I find that the Company's relevant beta is equal to 0.82.[66]

### 2. Equity risk premium

As for the company's equity risk premium, the experts dispute whether a historical or supply side equity risk premium should apply. Torchio supports the use of a supply side equity risk premium of 5.73%, whereas Atkins applied a historical risk premium of 6.47%. In support of using a historical equity risk premium, Atkins explained that the historical equity risk premium has been the industry standard and that Torchio has used the historical equity risk premium in past cases. Atkins failed to articulate, however, any substantive financial reason why a supply side equity risk premium would be inappropriate in this specific case.

This Court recently observed in *Global GT LP v. Golden Telecom, Inc.*[67] that, although experts and this Court traditionally have applied the historical equity risk premium, the academic community in recent years has gravitated toward greater support for utilizing the supply side equity risk premium.[68] As Chancellor Strine reasoned in *Golden Telecom* in support of the application of a supply side equity risk premium:

> when the relevant professional community has mined additional data and pondered the reliability of past practice and come, by a healthy weight of reasoned opinion, to believe that a different practice should become the norm, this court's

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66 *Id.*

67 993 A.2d 497 (Del. Ch. 2010).

68 *Id.* at 517.

> duty is to recognize that practice if, in the court's lay estimate, the practice is the most reliable available for use in an appraisal.[69]

Therefore, upon considering the opinions of Atkins and Torchio and having been provided with no persuasive substantive financial reason as to why the application of a supply side equity risk premium would be inappropriate in this case, I find that the supply side equity risk premium of 5.73% is the appropriate metric to be applied in valuing the Company.

### 3. Size premium

In addition to the equity risk premium, an equity size premium generally is added to the company's cost of equity in the valuation of smaller companies to account for the higher rate of return demanded by investors to compensate for the greater risk associated with small company equity.[70] Small company premiums are empirically estimated and both experts utilized Ibbotson size premiums in performing their analyses.

Both experts agree that, by size alone, Just Care falls within Ibbotson decile 10b, which includes companies with a market capitalization between $1.6 million and $136 million.[71] Decile 10b implies an equity size premium of 9.53%, and Atkins applied that size premium in calculating Just Care's cost of equity. Torchio, however, applied a lesser

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[69] *Id.*; *see generally id.* (discussing the academic literature related to the application of supply side versus historical equity risk premiums).

[70] *JRC Acq. Corp.*, 2004 WL 286963, at *8 ("An equity size premium is added because smaller companies have higher returns on average than larger ones, *i.e.*, small companies have a higher cost of equity." (footnotes omitted)).

[71] Tr. 636 (Atkins); JX 201 at 9.

size premium of 4.11%, which is the premium applied to Ibbotson decile 10a companies.[72] Torchio supports this adjustment primarily on the basis that 4.11% represents the Company's size premium after eliminating the "well-documented liquidity effect" contained within the size premium.[73] According to Torchio, because "the illiquidity premium reflected in the size premium data for small cap stocks is akin to a liquidity discount" such a discount "must be eliminated in a fair value determination -- much like a discount for lack of marketability or minority interest."[74]

As a matter of law, Torchio is correct that a general liquidity discount cannot be applied in an appraisal proceeding. Such a discount generally relates to the marketability of the company's shares and is therefore prohibited. As Vice Chancellor Lamb stated in *Borruso v. Communications Telesystems International*:[75]

> To the extent Respondent is arguing for the application of a "corporate level" discount to reflect the fact that all shares of WXL shares were worth less because there was no public market in which to sell them, I read *Cavalier Oil* as prohibiting such a discount. This is simply a liquidity discount applied at the "corporate level." Even if taken "at the corporate level" (in circumstances in which the effect on the fair value of the shares is the same as a "shareholder level" discount) such a discount is, nevertheless, based on trading characteristics of the shares themselves, not any factor

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72 For 2009 valuation dates, decile 10a companies were those companies with a market capitalization between $136 million and $218 million. JX 201 at 9.

73 POB 35.

74 *Id.*

75 753 A.2d 451 (Del. Ch. 1999).

> intrinsic to the corporation or its assets. It is therefore prohibited.[76]

Although a liquidity discount related to the marketability of a company's shares is prohibited, that does not mean that the use of *any* input that is correlated with a company's illiquidity is per se invalid. As Atkins correctly points out, a company's liquidity is highly correlated with its size, *i.e.*, smaller companies tend to be less liquid. As a result, their equity is riskier and investors will demand higher returns from such investments, increasing the cost of capital.[77] It is this kind of liquidity effect that is captured in the Ibbotson size premium. As this Court held in *JRC Acquisition Corp.*:

> The *Ibbotson* size premium number reflects the empirical evidence that smaller firms have higher returns than larger firms. Petitioner's position that JR Cigar is a low-cap company (rather than a micro-cap company) decreases the expected rate of return on JR Cigar's stock by lowering the "size premium" applied. The problem with using liquidity as a basis for justifying a lower expected return, however, is that low liquidity is associated with higher expected returns. Investors seek compensation for the high transaction costs of illiquid securities, *e.g.*, the bid/ask spread. In other words, even if JR Cigar had a higher market capitalization than the market price of its stock suggested *because of its illiquidity,* investors would still expect higher returns *because of its illiquidity.*[78]

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[76] *Id.* at 460.

[77] Tr. 664; *see JRC Acq. Corp.*, 2004 WL 286963, at *8.

[78] *JRC Acq. Corp.*, 2004 WL 286963, at *9.

The liquidity effect in this case arises in relation to transactions between Just Care and its providers of capital and, as such, is part of the Company's value as a going concern. Where a company's illiquidity affects its ability to obtain financing for its operations, the company's overall risk and return profile will be affected, *i.e.*, the company will be worth less as a going concern because its financing costs are higher. The liquidity effect that is prohibited under our appraisal law, on the other hand, relates to transactions between a company's shareholders and other market participants. Thus, where the effect of the company's illiquidity relates only to the ability of an investor to exit his investment by selling his shares in the market, such a transaction relates more to the structure of the market than it does to the company's ability to generate profits. As a result, such a discount rightly is excluded in an appraisal because it does not relate to the company's intrinsic value. Here, because the liquidity effect at issue relates to the Company's ability to obtain capital at a certain cost, I find that the effect is related to the Company's intrinsic value as a going concern and should be included when calculating its cost of capital.

Furthermore, although I reject Torchio's adjustment as a matter of law, I note that I also would exclude it as unreliable. Small company size premiums regularly are applied in appraisal proceedings in Delaware without the type of adjustment performed by Torchio. Moreover, in addition to his adjustment being unprecedented, Torchio's methodologies for removing the liquidity effect from the size premium are novel and

have not been peer reviewed.[79] Indeed, he himself could not decide on a single methodology for performing this adjustment. Instead, Torchio applied four different methodologies for adjusting the size premium and arrived at four different values, ranging from 3.35% to 6.35%. These divergent values resulted in an unusually large variation in the range of values he calculated for the Company. As a result, I also reject Torchio's adjustment on the basis that it was not the product of reliable principles and methods.[80]

Finally, Petitioners attempt to justify the application of a smaller size premium on the alternative basis that Just Care's individual characteristics make it comparable to a decile 10a company. This Court may adjust a company's size premium where sufficient evidence is presented to show that the company's individual characteristics make it less risky than would otherwise be implied under its corresponding Ibbotson decile based on

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[79] *See* Tr. 418 (Torchio) ("No one has tried to tease out this value like I have. I readily admit that."); *id.* at 429 ("[T]his is the first time that I'm aware that the specific size premium is being adjusted to account for liquidity inherent in that size premium.").

[80] *See* D.R.E. 702 ("If scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise, if (1) the testimony is based upon sufficient facts or data, (2) the testimony is the product of reliable principles and methods, and (3) the witness has applied the principles and methods reliably to the facts of the case."); *Beard Research, Inc. v. Kates*, 8 A.3d 573, 592 (Del. Ch. 2010).

size alone.[81] Here, however, Torchio did not opine on whether Just Care was less risky than other companies in decile 10b and Petitioners made only conclusory assertions that Just Care's characteristics made it comparable to decile 10a companies. Indeed, Petitioners devoted only one sentence in their Opening Brief to attempting to justify the treatment of Just Care as a decile 10a company, stating that "its risk characteristics are more akin to those companies that fall within decile 10a; indeed, Respondent's expert testified that Just Care is 'not a young company,' and that healthcare is a 'very mature industry.'"[82] Therefore, because Petitioners have not provided a sufficient factual basis for treating Just Care as a decile 10a company, I decline to reduce the Company's size premium to less than what is implied by its actual size.[83]

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[81] *See Taylor v. Am. Specialty Retailing Gp., Inc.*, 2003 WL 21753752, *5 n.18 (Del. Ch. July 25, 2003) ("There is no indication of whether a company with a market capitalization of less than $48,345,000 may nonetheless fall within decile 10a or even decile 9 given certain characteristics."); *see, e.g.*, *id.* at *6 (applying a size premium closer to decile 10a even though the company being valued technically was categorized under decile 10b because the company "share[d] more risk characteristics with companies in decile 10a than it [did] with companies in decile 10b. . . . because companies falling within decile 10b include many start-up ventures that receive public funding and are inherently riskier"); *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1161 (Del. Ch. 2006) (reducing the size premium applied to the company on the basis that the company being valued formed part of the index for the stock exchange that it traded on and was part of an industry that might have been "less subject to the size premium than other industries").

[82] POB 37 (quoting Atkins at Tr. 725).

[83] Petitioners further argue that 4.11% represents an appropriate size premium based on their observation that this Court previously has approved size premium adjustments that are roughly half of the implied decile 10b size premium in *Taylor*, *Gesoff*, and *ONTI, Inc. v. Integra Bank*, 751 A.2d 904, 921-23 (Del. Ch. 1999). In each of the cited cases, however, the Court arrived at a final size

### 3. Cost of debt

In calculating Just Care's cost of debt, Torchio assumed that Just Care would be able to borrow long-term at a rate of 8.3%.[84] Torchio based that assumption on: (1) the fact that Just Care had existing medium-term debt on its balance sheet at a rate of 7.75%; (2) Wells Fargo's estimation that Just Care could borrow for its expansion plans at a rate of 6 to 7%; and (3) Harris Williams's calculation that the average cost of debt for comparable public companies was 7.31%.[85] In arriving at the 8.3% rate, Torchio specifically determined that "[t]he intermediate-term debt rate of 6%-7% proposed by [Wells Fargo] is consistent with a BB+ and BB rating" and that the long-term debt for BB+ to BB rated debt in September 2009 was 8.3%.[86]

Atkins argues that Torchio's cost of debt underestimates Just Care's credit risk because it is based largely on Just Care's ability to borrow for the Bostick project. As Atkins points out, the debt for that expansion by Just Care would have been secured by

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premium through analysis of the specific facts of the case, as well as empirical data related to the performance of small company stocks over time. The fact that the adjusted size premiums applied in each case were approximately half of the size premium suggested by each company's corresponding Ibbotson decile appears to be coincidental. Petitioners have not shown that any reasoned principle or methodology reflected in the cited decisions supports use of the low size premium that their expert applied in this case.

84 Because Atkins assumed the Company should be valued on the basis of 100% common equity, he did not address extensively the Company's cost of debt in his report. Atkins did apply, however, a cost of debt of 12% for the Company, based on Harris Williams's estimation.

85 JX 197 at 27.

86 *Id.*

the Bostick facility, making it less risky. Moreover, the Bostick project would have provided Just Care with an additional stream of income, improving the Company's overall creditworthiness.[87]

I agree with Atkins that Torchio underestimated the cost of debt for Just Care. Torchio did not undertake a credit analysis of the Company and his estimate assumes the success of the Georgia Case, which I reject as too speculative. Instead, I find more reliable the cost of debt estimates made by Harris Williams and Brookstone at the time of the merger. In preparing its fairness opinion, Harris Williams estimated that Just Care's cost of debt was 12.38%.[88] Brookstone estimated it to be between 10.5 to 11%. Therefore, I find that Just Care had a cost of debt of 11% as of September 30, 2009. Assuming a tax-rate of 36%, that would produce an after-tax cost of debt for Just Care of 7.04%.[89]

#### 4. Just Care's fair value

To summarize, I find that Just Care's WACC should be calculated using: (1) a capital structure consisting of 5% debt and 95% common equity; (2) an after-tax cost of debt of 7.04%; (3) a risk-free rate of 4.02%; (4) a levered beta of 0.82; (5) a supply side equity risk premium of 5.73%; and (6) a size premium of 9.53%. Using these values, Just Care's WACC is 17.69%.

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87 Tr. 690-91 (Atkins).

88 JX 142 at HFS00146.

89 Both experts assumed a tax-rate of 36% for Just Care.

Applying that discount rate to Just Care's cash flow projections including the Static Case and the probability-weighted SVP Case, with a terminal growth rate of 5.5%, I find that the fair value of Just Care as a going concern, based solely on a DCF analysis, is $34,244,570.

### C. The Escrow Provision

Under the Merger Agreement, $6 million of the merger consideration was placed in escrow to cover claims brought against the Company in the two years following the merger, including claims for appraisal. Therefore, if an appraisal petitioner prevails in proving a higher valuation of the Company, *i.e.*, a value above the merger consideration of $40 million, the additional amount would be paid to those petitioners from the funds held in escrow. The practical effect of this provision, therefore, is that the risk of appraisal (or other claims) is transferred from the acquirer, GEO, to Just Care's consenting shareholders.[90] In other words, the consenting shareholders are guaranteed total consideration of $34 million, with the possibility of receiving additional consideration based on whatever value remains in escrow after two years, up to a maximum of $6 million.

Petitioners strenuously criticize the escrow provision, claiming that the Special Committee had no reasonable basis to rely on the Harris Williams fairness opinion because it failed to consider the effect of the escrow provision on the overall fairness of

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[90] *See* 8 *Del. C.* § 262(i) ("The Court shall direct the payment of the fair value of the shares, together with interest, if any, by the surviving or resulting corporation to the stockholders entitled thereto.").

the merger.[91] Petitioners also assert that "it is not mere 'coincidence' that Mr. Atkins' valuation . . . is virtually identical to the $40 million merger price less the $6 million escrow."[92]

Having considered the details of the escrow provision and its practical effect on the merger transaction, I find that the escrow provision is immaterial to the determination of fair value in this appraisal action. If nobody sought appraisal and no other claims were asserted against Just Care in the two years following the merger, each consenting shareholder would receive their pro rata share of the full purchase price of $40 million. Therefore, dissenting shareholders still must prove that the value of the Company was greater than $40 million at the time of the merger in order to receive additional consideration from the escrow account. In total, the escrow fund could result in the transfer of up to $6 million from the consenting shareholders to the dissenting shareholders.[93] At any value less than $40 million, as is the case here, however, Petitioners will receive less than the consideration they would have received had they approved the merger and the consenting shareholders will receive their pro rata share of

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91 POB 22.

92 *Id.* at 41.

93 Because attorneys' fees and costs related to any appraisal action presumably also would come from the escrow account, less than $6 million actually would be available following an appraisal.

the excess amount that Petitioners forfeited as a consequence of pursuing appraisal.[94] Therefore, as a matter of valuation, I find that the existence of the escrow provision is immaterial and, in any case, even if the escrowed amount were excluded entirely from the merger consideration, the transaction would have been at a value close to what the Court has determined to be the fair value.[95]

**D. Options Issue**

Petitioners Gearreald, Brunk, and an additional dissenter, Alicia E. Dunne,[96] claim that they also are entitled to appraisal for the shares they acquired through properly exercising their options immediately before the merger. Although Respondent reserved the right to argue that Petitioners failed to exercise their options effectively before the merger, Respondent did not pursue that argument in its post-trial briefing or argument. Therefore, Respondent has waived its challenges to the Gearreald and Brunk options.[97] Furthermore, and in any case, I find that the factual record shows that Petitioners, in fact,

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[94] JX 147 § 2.06(b) ("[T]o the extent that the fair value as finally determined pursuant to Section 262 is less than the Merger Consideration . . . the Exchange Agent shall pay such excess amount to the Company Stockholders in accordance with their Pro Rata Percentage.").

[95] In this context, I need not consider Petitioners' additional argument that Harris Williams's fairness opinion was unreliable because it did not consider the escrow provision.

[96] Alicia Dunne is not a Petitioner in this action; therefore, her shares are not included in this appraisal.

[97] *See Emerald P'rs v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999) ("Issues not briefed are deemed waived.").

did exercise their options before the merger and that they are entitled to appraisal of those additional shares.[98]

**E. Compounded Interest**

In appraisal proceedings, "the general rule is that an award of interest is routinely made unless the petitioner brought the action in bad faith."[99] Under 8 *Del. C.* § 262(h):

> [u]nless the Court in its discretion determines otherwise for good cause shown, interest from the effective date of the merger through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment.

Respondent argues that prejudgment interest should be denied here because Petitioners Gearreald and Rein acted in bad faith by voting for the merger in their capacities as directors before voting against the merger as shareholders. In considering this contention, I note that Rein is no longer an individual Petitioner in these proceedings and that, in any case, Gearreald and Rein are only two of seven Petitioners. Respondent makes no claim that the other Petitioners acted in bad faith. Furthermore, although Gearreald's and Rein's alleged duplicity in approving the merger and later dissenting from it is troubling, the matter was not fully litigated in this action. Gearreald has put forth at least a colorable justification that he voted for the merger as a director to obtain a

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[98] Tr. 219-20 (Brunk); JX 211; JX 214.

[99] *Cooper v. Pabst Brewing Co.*, 1993 WL 208763, at *11 (Del. Ch. June 8, 1993).

reduction of the termination fee for the deal and, thereby, increased the possibility of a topping bid. Therefore, because Respondent has not shown good cause to deny prejudgment interest, I award Petitioners prejudgment interest consistent with § 262(h) on the value of their appraised shares.

## III. CONCLUSION

For the reasons discussed in this Opinion, I find that the fair value of Just Care as of September 30, 2009 was $34,244,570.[100] The parties shall cooperate to determine the amount of the interest award in accordance with the rulings in this Opinion and Petitioners shall present, on notice, an appropriate proposed order of final judgment specifying, among other things, the corresponding fair value per common share and per Series A preferred share within ten days.

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[100] This value was calculated by inputting the conclusions in this Opinion into the model provided by Atkins.