Nos. 17-1873(L), 17-2224, 17-2323, 17-2324, 18-1029

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

TIM P. BRUNDLE, on behalf of the Constellis Employee Stock Ownership Plan,

Plaintiff-Appellee,

and

ANDREW HALLDORSON, on behalf of the Constellis Employee Stock Ownership Plan, and on behalf of a class of all other persons similarly situated,

Plaintiff,

v.

WILMINGTON TRUST, N.A., as successor to Wilmington Trust Retirement and Institutional Services Company,

Defendant-Appellant.

Appeal from the United States District Court for the Eastern District of Virginia
No. 1:15-cv-01494-LMB-IDD, Honorable Leonie M. Brinkema

BRIEF OF *AMICUS CURIAE* AMERICAN SOCIETY OF APPRAISERS IN SUPPORT OF DEFENDANT-APPELLANT AND REVERSAL

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UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT
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Disclosures must be filed on behalf of all parties to a civil, agency, bankruptcy or mandamus case, except that a disclosure statement is **not** required from the United States, from an indigent party, or from a state or local government in a pro se case. In mandamus cases arising from a civil or bankruptcy action, all parties to the action in the district court are considered parties to the mandamus case.

Corporate defendants in a criminal or post-conviction case and corporate amici curiae are required to file disclosure statements.

If counsel is not a registered ECF filer and does not intend to file documents other than the required disclosure statement, counsel may file the disclosure statement in paper rather than electronic form. Counsel has a continuing duty to update this information.

No. 17-1873L Caption: Brundle v. Wilmington Trust, N.A.

Pursuant to FRAP 26.1 and Local Rule 26.1,

American Society of Appraisers
(name of party/amicus)

who is amicus, makes the following disclosure:
(appellant/appellee/petitioner/respondent/amicus/intervenor)

1. Is party/amicus a publicly held corporation or other publicly held entity? ☐ YES ☑ NO

2. Does party/amicus have any parent corporations? ☐ YES ☑ NO
If yes, identify all parent corporations, including all generations of parent corporations:

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity? ☐ YES ☑ NO
If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(a)(2)(B))? ☐ YES ☑ NO
If yes, identify entity and nature of interest:

5. Is party a trade association? (amici curiae do not complete this question) ☐ YES ☐ NO
If yes, identify any publicly held member whose stock or equity value could be affected substantially by the outcome of the proceeding or whose claims the trade association is pursuing in a representative capacity, or state that there is no such member:

N/A

6. Does this case arise out of a bankruptcy proceeding? ☐ YES ☑ NO
If yes, identify any trustee and the members of any creditors' committee:

Signature: /s/ Eliot T. Burriss Date: 6/25/2018

Counsel for: American Society of Appraisers

CERTIFICATE OF SERVICE

****

I certify that on 6/25/2018 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by serving a true and correct copy at the addresses listed below:

/s/ Eliot T. Burriss
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(date)

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STATEMENT OF THE IDENTITY AND INTEREST OF THE AMICUS CURIAE[1, 2]

The American Society of Appraisers (ASA) is the largest multi-discipline organization devoted to the appraisal profession. The ASA is a non-profit, professional organization that teaches, tests, and credentials highly-qualified appraisers of businesses and business interests, real estate, machinery and equipment, and other property. The ASA's world-renowned, discipline-based education programs are among the best in the industry and are taught by leading appraisal experts. The ASA is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE sponsors. Additional information about the ASA is available at http://www.appraisers.org.

There are over 7,000 Employee Stock Ownership Plans (ESOPs) in the United States, covering more than 14 million employees. The formation and administration of ESOPs rely on business valuation standards that are regularly vetted and endorsed by valuation and professional organizations such as the ASA.

[1] Pursuant to Fed. R. App. P. 29(a)(4)(E), no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money that was intended to fund the preparation and submission of this brief; and no person—other than the amicus curiae, its members, or its counsel—contributed money that was intended to fund the preparation and submission of this brief. Jeffrey S. Tarbell (Tarbell), defendant-appellant's expert, is the Chair of the ASA's Business Valuation Discipline Committee.

[2] Pursuant to Rule 29(a)(2), all parties have consented to the filing of this brief.

The Department of Labor's (DOL) recent ESOP-focused national enforcement project has spawned a rise in lawsuits like this one, in which a private plaintiff submits a blanket accusation, without any factual knowledge, that ESOP fiduciaries breached their duties under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and violated prohibited transaction rules because they relied upon an appraisal that allegedly resulted in the ESOP's overpayment for the shares it purchased. The more spurious of these lawsuits challenge the conclusions of contemporaneous appraisals performed by highly-qualified and credentialed individuals and have been pursued even where ESOP-owned companies have performed as well as, or better than, the projected financial data underlying the appraisal. It is settled law that ESOP fiduciaries must make their decisions based upon relevant information known or knowable at the time a particular transaction closes. Because ERISA fiduciaries cannot foresee the future, these are, by necessity, decisions made before it is known or knowable how a business will in fact perform following the transaction in question.

The ASA therefore has a strong interest, on behalf of its members, in clarifying the obligations of ESOP fiduciaries that select and monitor the appraisers who advise such fiduciaries as to the proper valuation of company stock held by an ESOP.

ARGUMENT

Section 406 of ERISA requires fiduciaries to, among other things, take reasonable and prudent steps to ensure that the ESOP pays no more than adequate consideration for the stock of the company being purchased. In order to discharge this fiduciary obligation, an ESOP fiduciary often hires a qualified professional to appraise the value of the company on a per share basis.

This analysis requires a point-in-time judgment of the company's future financial performance based on information available to the ESOP fiduciary. ERISA therefore requires an ESOP fiduciary to engage in an appropriate and reasonably prudent process to ensure that its reliance on the appraiser's report is reasonable under the circumstances.

The trustee in this case, Wilmington Trust N.A. (Wilmington), retained a highly qualified and experienced appraiser, Stout Risius Ross, Inc. (Stout), who engaged in a thorough analysis of the company, Constellis Group, Inc., and the transaction, based on information known or knowable at the time, to provide a reasonable conclusion with respect to the range of value of the company at the time of purchase. The district court substituted those sound conclusions with an after-the-fact opinion of an underqualified "expert" hired by the plaintiff. Therefore, it comes as no surprise that the district court's opinion is laden with flaws, both in its methodology and application. This gratuitous second guessing runs contrary to

Congress's intent under ERISA, and it is dangerous precedent for appraisers, trustees, and ESOP transactions alike.

I. THE DISTRICT COURT APPLIED THE WRONG STANDARD, AND THEREFORE ERRED, IN EVALUATING WHETHER CONSTELLIS RECEIVED MORE THAN ADEQUATE CONSIDERATION FOR ITS SHARES.

As set forth below, the district court erred when it effectively rejected the qualified appraiser's opinion because of "issues" that it believed, in retrospect, Wilmington should have further probed. In reaching that conclusion, the district court allowed an expert witness at a trial—a witness that had a distinct motivation and the benefit of hindsight—to denigrate the work of the independent qualified appraiser that performed a comprehensive analysis at the time of the transaction.

A. The role of an appraiser and the importance of process in an ESOP transaction.

Under ERISA § 408(e), an ESOP fiduciary's purchase of a company's stock is not considered a "prohibited transaction" if the ESOP paid no more than "adequate consideration" for the stock, which ERISA defines as:

> [F]air market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the terms of the plan and in accordance with regulations promulgated by the Secretary.

ERISA § 408; 29 U.S.C. § 1108(e).

Under this analysis, the process is key. Courts have widely recognized that the § 408(e)'s "adequate consideration" analysis is not focused on the dollar amount paid, but on the process in which the fiduciary engaged when determining the value to be paid. *See Henry v. Champlain Enterprises, Inc.*, 445 F.3d 610, 620 (2d Cir. 2006) ("[T]he adequate consideration test focuses on the conduct of the fiduciaries in determining the price, not the price itself.") (quoting *Eyler v. Commissioner*, 88 F.3d 445, 455 (7th Cir. 1996)).

To determine whether no more than adequate consideration was paid for a company's shares, the ESOP fiduciary must estimate the value of the acquired stock. For companies with publicly traded stock, this determination is often simple—a fiduciary may rely on the market price, with certain limited exceptions. *See Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459, 2471 (2014). Appraisal of privately held stock, on the other hand, is a "very inexact science." *Donovan v. Cunningham*, 716 F.2d 1455, 1473 (5th Cir. 1983). Because of the "uncertainty inherent in the process and the variety of potential fact patterns," ESOP fiduciaries, when dealing with privately held companies, rely upon the expertise of qualified appraisers to determine whether no more than adequate consideration is paid. *Id.* at 1473-74. Although reliance on a qualified appraiser does not necessarily mean that an ESOP fiduciary discharged its obligations under ERISA, fiduciaries may point to an appraiser's guidance as evidence of a good faith investigation. *Perez v. Bruister*, 823 F.3d 250, 263 (5th Cir. 2016).

For privately held companies, "the most reliable fair value estimate is produced by a contemporaneous valuation performed by an unrelated valuation specialist." American Institute of Certified Public Accountants, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation* 107 (2013). Absent evidence of fraud, conspiracy, or self-dealing, reliance on an appraiser is a fiduciary decision not to be assessed using hindsight. *E.g.*, *Bruister*, 823 F.3d at 263 (explaining that a fiduciary's reliance on an appraiser is reasonable if it (1) investigates the appraiser's qualifications; (2) provides the appraiser complete and up-to-date information; and (3) ensures reliance on the appraiser's advice is reasonably justified under the circumstances); *see also* American Institute of Certified Public Accountants, *supra*, 107-09 (noting the risk of bias in a retrospective valuation).

B. The district court failed to provide any deference to Wilmington's process and effectively engaged in a de novo valuation analysis at trial.

Here, Wilmington retained an independent qualified appraiser with extensive ESOP appraisal experience. JA__(Opinion at 617). Stout estimated the range of value of Constellis using two commonly used valuation methodologies, the discounted cash flow method ("DCF") and the guideline company method ("GCM"). JA__(Opinion at 618). Stout conducted an extensive review, including evaluating management projections, reviewing numerous documents, and interviewing many employees to prepare its valuation report. Stout ultimately provided Wilmington with a detailed, comprehensive, and well-documented valuation of Constellis.

The professionals at Stout who performed the analysis have the appropriate education, training, skills, and experience to prepare an ESOP valuation. For the reasons set forth in Defendant-Appellant's brief, the process Stout employed satisfies the requirements of ERISA.

In its Conclusions of Law, however, the district court cast aside Stout's analysis and concluded Wilmington should have (i) considered the "McLean Report," a prior valuation (not prepared by Stout) that was prepared for an entirely unrelated purpose, (ii) probed Stout further as to Stout's reliance on management projections, and (iii) probed whether the ESOP would receive enough control rights to justify Stout's use of a modest 10% control premium.

The district court's opinion represents a dramatic departure from other courts that have considered challenges to a fiduciary's adequate consideration determination. Indeed, the Fifth, Second, and Sixth Circuit Courts of Appeal have held that district courts shall not review adequate consideration determinations *de novo*. *See Bruister*, 823 F.3d at 263; *Henry*, 445 F.3d at 619; *Chao v. Hall Holding Co., Inc.*, 285 F.3d 415, 437 (6th Cir. 2002). Circuit courts have imposed liability only when glaring defects exist, such as: (i) when the trustee failed to provide the expert full, accurate, or complete information; (ii) when the trustee overlooked evidence that the expert was conspiring to inflate the valuation; and (iii) when the trustee failed to evaluate the expert's qualifications. *Chao*, 285 F.3d at 430; *Bruister*, 823 F.3d at 264.

Here, there are no allegations of such improprieties and the district court made none of those findings. Specifically, the district court did not find that Wilmington withheld any information from Stout. The district court expressly found no evidence of bad faith. And, the parties do not dispute Stout's qualifications. Rather, the district court used the benefit of hindsight to identify certain "red flags." This result is untenable for several reasons.

First, with respect to the McLean Report, Stout reviewed, but chose not to rely, on the report because it was prepared nearly a year prior to Stout's work and for an entirely different purpose. For these reasons recited in Defendant-Appellant's brief, Stout considered but ultimately decided not to afford the McLean report any weight. (Defendant-Appellant's Brief, p. 24). And, contrary to the district court's conclusion, Stout communicated this fact to Wilmington. JA__-__(El-Tahch-1210:20-1211:8). With respect to control, Stout applied a modest control premium that reflected the rights of control the ESOP actually received. JA__ (El-Tahch-1212:17-23). With respect to management projections, Stout relied upon them because it found, after considerable investigation, the projections to be "conservative." JA__,__(El-Tahch-1204:4-23, 1226:21-24). Stout also communicated each of these matters to Wilmington. JA__(El-Tahch-1223:6-10).

Second, the district court relied on the testimony of an expert who approached the valuation from a litigation perspective, and who also had the benefit of hindsight. Under ERISA, appraisals for ESOPs acquiring private stock must be performed by an "independent qualified appraiser," which is determined by reference to the regulations prescribed under 26 U.S.C. § 170(a)(1).[3] 26 U.S.C. § 401. These regulations underscore the emphasis placed on independence in ESOP appraisals. *See generally* 26 C.F.R. § 1.170A-13; *see also Fish v. GreatBanc Tr. Co.*, 749 F.3d 671, 680-81 (7th Cir. 2014) ("When determining whether a fiduciary's process is sufficient, ***the degree to which a fiduciary makes an independent inquiry is critical***." (emphasis added) (internal quotation marks omitted)).

Specifically, the appraisal must make an unbiased estimate of the range of the company's "fair market value," without taking either a buyer's perspective or a seller's perspective. Fair market value is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any

[3] Under 26 U.S.C. § 170(a)(1), a qualified appraiser is an individual that "holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis" and who is qualified to perform the appraisal because of his or her qualifications, such as "the appraiser's background, experience, education, and membership, if any, in professional appraisal associations." 26 C.F.R. § 1.170A-13.

compulsion to buy or sell and both having reasonable knowledge of relevant facts."[4] JA__-__(*Brundle v. Wilmington Trust N.A.*, 241 F. Supp. 3d 610, 617-18 (E.D. Va. 2017) ("Opinion").

Dana Messina serves as the DOL's "primary valuation consultant and expert on leveraged ESOPs" JA__(Citation to Decl. of Messina, Dkt. 204-1 at 1). His lack of independence is transparent. Unlike Stout, Messina is not educated and trained as an appraiser, and is not experienced in rendering contemporaneous valuations for ESOP transactions. Instead, as recognized by a prior district court, Messina is an advocate; instead of approaching valuation from a neutral perspective, he sides with the DOL and his valuations fundamentally depart from fair market value. *Perez v. Bruister*, 54 F. Supp. 3d 629, 677 (S.D. Miss. 2014), *aff'd as modified*, 823 F.3d 250 (5th Cir. 2016).

For these reasons, an ESOP fiduciary would have erred by relying on Messina's conclusions contemporaneously with an ESOP transaction as he lacked independence and ignored the mandated concept of fair market value. *See* Agreement Concerning Fiduciary Engagements and Process Requirements for

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[4] Fair market value does not mean the value paid at a distressed sale or at a discount. *See* Shannon Pratt & Alina Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 42 (5th ed. 2008). It does not mean a "good deal." *See Am. Home Prods. Corp. v. United States*, 601 F.2d 540, 545 (Ct. Cl. 1979) ("[F]air market value . . . by definition . . . excludes the notion that a special bargain, out of line with the generality of the prevailing fair market value, can override.").

Employer Stock Transactions at 1 (*GreatBanc* Agreement), *Harris v. GreatBanc Trust Co.*, No. 5:12-cv-01648-R-DTB (C.D. Cal. June 2, 2014), ECF No. 166-1 (requiring ESOP fiduciary to "prudently investigate the valuation advisor's qualifications" and to "prudently determine that its reliance on the valuation advisor's advice is reasonable . . . .").

Third, the district court relied upon Messina's testimony even though he did not engage in the same prudent and contemporary process as did Stout. The district court itself concluded that Messina's analysis was "rough"—another issue that would disqualify an ESOP fiduciary from contemporaneous reliance on his conclusions. *See* JA__(Opinion at 646) ("Messina's calculations are a very rough approximation because he has not presented a detailed analysis of how he arrived at his replacement projections."). Despite this, as set forth below, the district court relied on Messina's recast projections, which unlike management's contemporaneous projections, were "rough" and lacking any detailed analysis. Similarly, as discussed below, the district court relied on Messina's testimony on beta, which was entirely conclusory and lacking any support within the appraisal industry.

A key illustration of the defects in his methodology lies in the fact that Messina's DCF and GCM values diverged by nearly $100 million.[5] Rather than attempting to reconcile this glaring deficiency, Messina simply averaged the two disparate values—another fundamental flaw.[6] Messina's testimony was repeatedly contradicted by record evidence on matters, including control. The district court took the opposite approach and relied on Messina's rough, conclusory testimony, which was contradicted by both record evidence and generally accepted appraisal principles. The district court instead should have excluded or heavily discounted Messina's testimony to reflect the serious errors in his analysis.

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[5] Although DCF and GCM methodologies rely on different underlying data, the resulting values should reconcile. *See* Shannon Pratt & Alina Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 476-77 (5th ed. 2008). Widely divergent values indicate something went wrong. *Id.*

[6] As Tarbell testified at trial, it is inappropriate for an ESOP fiduciary to rely on an appraisal that uses a simple, unweighted, arithmetic average to arrive at a company's final value estimate when the values are widely divergent. JA __-__(Tarbell-1534:4-1535:1); *see also* Shannon Pratt & Alina Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 244 (5th ed. 2008) ("A simple arithmetic mean implies that all the valuation methods have equal validity and equal weight. While this may occur in certain instances, this is usually not the case"); IRS Revenue Ruling 59-60 (Sec. 7) ("[V]aluations cannot be made on the basis of a prescribed formula . . . . For this reason, no useful purpose is served by taking an average of several factors (for example, book value, capitalized earnings, and capitalized dividends) and basing the valuation on the result.").

C. The district court's decision threatens to upend long-standing practice with respect to ESOP transactions.

Should the district court's decision stand, it will upset settled law. The district court's decision subjects independent qualified appraisers' reports to second guessing in litigation, as well as criticism by potentially biased expert witnesses who may not have been qualified to issue the valuation report in the first place. Rather than approaching estimates of fair market value from a position of independence, appraisers may be forced to conduct such inquiries under the cloud of litigation, knowing that their decisions will be second-guessed by under-qualified experts after the fact. This exposes independent qualified appraisers to the exact risk of bias that may affect the opinions of trial experts.

Moreover, Congress has repeatedly expressed its intent to encourage the formation of ESOPs by passing legislation granting such plans favorable treatment, and has warned against judicial and administrative action that would thwart that goal. *Donovan v. Cunningham*, 716 F.2d 1455, 1466 (5th Cir. 1983) (footnote omitted). Courts, therefore, must "balance these concerns so that competent fiduciaries will not be afraid to serve, but without giving unscrupulous ones a license to steal." *Id.* But this is clearly not a case involving an "unscrupulous" fiduciary. Thus, the need to balance that concern with Congress's encouragement of ESOPs is lacking. Mindful of Congress's careful balance of competing interests, the Supreme Court has expressly counseled against judicial rewriting of the statute. *See Mertens v. Hewitt Assoc.*, 508 U.S. 248, 261-62 (1993).

As the Supreme Court has noted, a high risk of litigation will discourage employers from sponsoring ESOPs, the exact opposite result of what Congress intended. *See Dudenhoeffer*, 134 S. Ct. at 2470. For this reason, "[i]n the complex setting of employee benefit plans, brightline rules are advantageous to beneficiaries and fiduciaries alike, providing assured protection to the former and clear notice of responsibility to the latter." *Donovan*, 716 F.2d at 1465. Unfortunately, no regulations exist to guide ESOP fiduciaries in valuing securities where there is not a generally recognized market. Since bright line rules do not exist, it is even more troublesome that the district court essentially reviewed Wilmington's conduct *de novo*.[7] "If more specific rules are needed, the better—and fairer—approach is to inform fiduciaries and appraisers of them beforehand by regulation." *Id.* at 1473.

II. FROM A QUALIFIED APPRAISER'S STANDPOINT, THE DISTRICT COURT'S ANALYSIS RESTS ON CRITICAL FLAWS.

The district court issued an opinion in this case that is deeply flawed. In this section, ASA highlights three core issues for this Court. First, contrary to the district court's conclusions, Stout's analysis concerning a control premium was justified and in line with appraisal industry standards. Second, Stout's

[7] The Secretary proposed regulations in 1988 but never finalized them. *Perez v. Bruister*, 823 F.3d 250, 262 n.13 (5th Cir. 2016).

investigations and reliance on management projections were both reasonable and in line with appraisal industry standards; the district court's rejection of this process was error. Third, the district court admittedly erred in its conclusions regarding the concept of beta but did not adjust its calculations to account for the error. These issues sufficiently undermine the district court's conclusions and warrant reversal.

A. The district court's analysis of the control premium is flawed and contrary to accepted appraisal theory and practice.

A control premium may be used to adjust the level of control if not otherwise accounted for in the underlying methodology. In the appraisal industry, there is no established control premium for a specific industry or company size, and there is no universally accepted definition of what does or does not constitute control. A leading and frequently cited authority on valuation, Shannon Pratt, explains in a company valuation, when an investor is not able to obtain a controlling interest in the company, a discount to the value for that lack of control may be appropriate. *See* Shannon Pratt & Alina Niculita, *Valuing a Business: The Analysis and Appraisal of Closely Held Companies* 398 (5th ed. 2008). On the other hand, however, when an investor purchases a controlling interest in a company, the investor may pay a control price because of the benefits associated with owning a control interest. *See id.* at 385-86.

Whether to apply a control premium in an appraisal of a privately held company is a subjective determination based upon the facts and circumstances known at the time of the relevant valuation date. Control shares are generally more valuable than minority shares "because they contain a bundle of rights that minority shares do not enjoy." *Id.* at 385. However, "[c]ontrol and lack of control do not have a bright line dividing point—they encompass a spectrum." *Id.* at 385. In other words, an investor need not acquire the entire bundle of control rights in order to reflect some degree of control value in the purchase price. As such, "[a] control determination is not a matter of law." *Estate of Godfrey v. C.I.R.*, 286 F.3d 210, 215 (4th Cir. 2002). Instead, a control premium is a well-reasoned, subjective determination based upon the available facts at the time of valuation. It is an inherently judgment-laden determination and it does not carry the benefit of hindsight.

While board control is an element of control, it is just one element and is not dispositive. Pratt at 385. In fact, in the appraisal profession and in the case law, board control is not considered to be a more significant factor than other elements. Pratt at 386; *see Hugler v. First Bankers Trust Services, Inc.*, No. 12 CV 8649, 2017 WL 1194692, at *17 (S.D.N.Y. Mar. 30, 2017) (noting a reduced control premium was applied to the ESOP's interest in the company because the ESOP "may have received some element of control but not voting control or control in fact"). Indeed, a leading authority on valuation identified twenty different rights that go with control shares, including the ability to "negotiate and consummate mergers and acquisitions" and to "determine management compensation." Pratt at 385.

Here, the district court rejected Stout's application of a 10% premium within the GCM analysis, and criticized Stout for not discounting the DCF analysis[8] for lack of control. The district court's analysis is flawed in two distinct ways. Despite an explicit recognition that the ESOP had meaningful control rights, such as "the power to veto certain actions by the Sellers and their chosen directors," the district court inexplicably came to the conclusion that the control premium should have been zero. JA__-__(Opinion at 638-39). The district court rejected the application of a moderate 10% premium within the GCM analysis, and criticized the failure to discount the DCF analysis for lack of control.

Of particular note, and contrary to record evidence, the district court found that "the ESOP essentially had no power to control Constellis." JA__(Opinion at 639). However, the court also found that the transaction "did give the ESOP certain powers beyond those of an ordinary shareholder," JA__(Opinion at 627 n.23), and that "the ESOP had certain rights to information that a minority stakeholder would not traditionally have." JA__(Opinion at 639 n.35). These two findings are

[8] As set forth *infra* page 20, no evidence was presented to support the notion that Stout's DCF method was a control analysis.

inconsistent and cannot both be true. While the district court focused its analysis on board control, as discussed above, this is just one factor among many.

Contrary to the district court's conclusion, the results Wilmington obtained on behalf of the plan participants in the sale of the Company to ACADEMI demonstrate the appropriateness of a control premium. Wilmington was able to successfully negotiate a $20 million "control premium" for ESOP participants during the sale of Constellis to ACADEMI. JA__(Opinion at 629). Wilmington would not have been able to negotiate this benefit of control for plan participants if the ESOP had no control. Second, Wilmington obtained a reduction in the amount the ESOP owed on the Sellers' notes by $33 million. JA__(Opinion at 629). Again, this demonstrates that Wilmington had sufficient control to negotiate key transaction terms on behalf of the stockholders of Constellis—the ESOP. Finally, Wilmington obtained immediate vesting for the ESOP participants, "a benefit at least to those participants who were contemplating leaving the company before reaching the six year mark for full vesting or retirement age." JA__(Opinion at 629).

Moreover, a 10% control premium is modest compared to market-observed control premiums which are often "in a 35 to 40 percent range." JA__(Tarbell-1543:14-24). In the public market, "control premiums are paid along the entire spectrum of creeping control, although at different levels." Pratt at 818. While no one in this case argues that a 35% to 40% control premium is appropriate here, it is undisputed that the ESOP maintained certain aspects of control, most notably the ability to unilaterally approve or reject the sale of Constellis. Thus, in light of the fact that the ESOP had "significantly more control than would be had by a holder of a single share of stock," JA__(Tarbell-1543:14-24) such as "the power to veto certain actions by the Sellers and their chosen directors," JA__(Opinion at 638), the ability to limit management compensation (through the Investor Rights Agreement), and the unilateral ability to approve or veto a sale transaction, a mere 10% control premium was entirely reasonable and warranted. JA__(Tarbell-1543:14-24). Furthermore, the ESOP enjoyed the "rights typically associated with being a majority shareholder," and as Defendant-Appellant explains in its brief, the ESOP had "aspects of control," which it employed to benefit ESOP participants. JA__(Opinion at 619); JA__-__(Tarbell-1503:21-1504:5).

Additionally, the district court erred in its calculation of damages with respect to the control premium. The ASA agrees with the damages arguments that Wilmington sets out in its opening brief, and highlights below the most fundamental errors the district court made in calculating damages for the control premium.

The district court calculated damages by subtracting the aggregate value of its findings ($29,773,250) from the price that the ESOP paid for shares it acquired

($201,529,032.77). JA__(Opinion at 649). It is undisputed that in doing so, the court failed to account for the fact that certain of its findings should have been applied to only one of the two valuation methodologies used by Stout. *See, e.g.*, *Brandt v. Grounds*, 687 F.2d 895, 898 (7th Cir. 1982). Remarkably, the plaintiff said nothing about this obvious error to the district court.

Any damage calculations corresponding to the inclusion of a control premium in the GCM analysis are only applicable to a portion of the enterprise value. JA__-__(Opinion at 618-19). Stout included a control premium in its GCM analysis (which was allocated one-third weighting) but not in its DCF analysis (which was allocated two-thirds weighting). The district court erred by not adjusting the damages to reflect the relative weighting of the DCF and GCM in in arriving at the enterprise value. This error extends beyond the control premium measurement to other findings including management projections, beta, and lack of control discount. The district court's failure to adjust for the two valuation methods resulted in a vast overstatement of damages because Stout weighted the GCM only one-third in its calculation of enterprise value. JA__(Opinion at 618). Therefore any damage calculations corresponding to the control premium, if they are to apply, are only applicable to 33% of the enterprise value.

B. The district court's rejection of management projections is unsupportable.

The district court took issue with Wilmington's failure to "probe" Constellis's projections that were used in the Stout valuation. Implicit in this criticism is the notion that Stout should not have relied upon management projections as it did.

Under the supervision of Wilmington, Stout received management projections that extended to the year 2018 that were used in calculating the DCF. Aziz El-Tahch testified on behalf of Stout that it "set out to determine whether or not [Constellis's] risks were inherently reflected in the financial projections [Stout] received." JA__(El-Tahch-1257:13-20). To do so, Stout investigated "the basis for preparing the financial projections" and understood that the "company management used a bottoms-up approach" and engaged in a "contract-by-contract" analysis when preparing the projections, including only contracts that were in hand or in pipeline, as opposed to unidentified future revenue or acquisition opportunities. JA__(El-Tahch-1257:13-20).[9] Throughout the valuation process Stout had "direct conversations with management." JA__(El-Tahch-1290:4-5). Messina did not. Upon completion of its investigation, Stout considered the projections "robust" and perhaps "conservative," JA__-__(Opinion at 620-21)

[9] Further, the present value discount rate used in the DCF method accounts for a reasonable level of risk that the projected cash flows would not be realized as expected.

since Constellis had "beaten its projections almost every year." JA__(Opinion at 620).

Courts have consistently preferred contemporaneous management projections to those prepared by trial experts because management is "in the best position to forecast" the company's future. *Gilbert v. MPM Enters., Inc.*, 709 A.2d 663, 669 (Del. Ch.1997), *aff'd* 731 A.2d 790 (Del. 1999). Courts have even recognized that "management projections will inevitably contain 'what if' scenarios," but such management projections are still preferable to projections made by experts with "limited experience with the Company." *Gray v. Cytokine Pharmasciences, Inc.*, No. Civ.A. 17451, 2002 WL 853549, at *8 (Del. Ch. Apr. 25, 2002).

Absent reason for suspicion—particularly in situations, like here, where a company's actual results have exceeded management's projections—it is commonplace to rely on projections prepared by company management. JA__(Opinion at 636); *see, e.g., Doft & Co. v. Travelocity.com Inc.*, No. Civ.A. 19734, 2004 WL 1152338, at *5 (Del. Ch. May 20, 2004). As the district court recognized, "[a]bsent any reason for suspicion, an ESOP fiduciary might reasonably rely on the projections provided by management without questioning those projections." JA__(Opinion at 636).

Here, even absent reason for suspicion, Stout diligently probed management projections. Emails between El-Tahch and Timothy Ma of CSG Partners stated that Ma was "coordinat[ing] with management to see if [they] were on track to forecast working capital levels are [sic] better." JA__(El-Tahch-1289:14-18). At no point did the district court criticize the methodology Constellis used in calculating the projections, nor did it explain how Wilmington should have further "probe[d]" the projections. In fact, Wilmington was aware of and testified to the detailed "bottoms up" approach Constellis used in calculating projections. JA__(Opinion at 620). Despite this, the district court substituted Messina's litigation-driven projections for the "robust" and contemporaneous projections prepared by management.

As a general matter, "litigation-driven projections [are] unreliable." *Gray v. Cytokine Pharmasciences, Inc.*, No. Civ.A. 17451, 2002 WL 853549, at *8 (Del. Ch. Apr. 25, 2002). Yet, the district court relied on them by accepting Messina's unsupported recasting of management's projections. In fact, having found Messina's "calculations [that] are . . . very rough approximation[s]" and lacked "a detailed analysis of how he arrived at his replacement projections,"[10] JA__(Opinion at 646), the district court should not have relied upon Messina's

[10] The district court recognized that there was "some merit" to the fact that Messina's method of calculating damages "was conceptually flawed because valuation estimates are highly-interdependent so that it is artificial to provide a line-item estimate of how any particular error might have affected the final valuation range." JA__(Opinion at 645).

calculations at all. At no point did Messina discuss his calculations with Constellis management to verify the accuracy of his assumptions. Additionally, the district court recognized that Messina's analysis "was likely impacted by his incentive to work on behalf of the plaintiff." JA__(Opinion at 646). Citing *Bruister* (and no other decision), the district court explained, "[a]s other courts have done in the past, faced with two competing expert analyses and no precise mechanism for resolving them, this Court will use the midpoint between Messina's calculation and that of Stout and Tarbell." JA__(Opinion at 646).

In *Bruister*, the Fifth Circuit approved the averaging of expert's projections because the experts' opinions, although divergent, were based on the consideration of all relevant information about the company. *Bruister*, 823 F.3d at 269-70. The Fifth Circuit expressly noted that it would be *improper* to average opinions if "one expert was more credible than another, and arrived at a reasonable average supported by evidence in the record." *Id.* Here, as the district court recognized, "Messina's calculations are a very rough approximation because he has not presented a detailed analysis of how he arrived at his replacement projections." JA__(Opinion at 646). For this reason, *Bruister* does not support the use of a "midpoint," especially since the Court found Messina's numbers to be a "rough" estimate and Messina's bias to be a concern.

C. The district court admittedly misunderstood the concept of beta and failed to correct its damages calculation in light of this error.

The district court's damages calculations were also based on a fundamental misunderstanding of the valuation factor known as beta. Beta is a measure of the risk of a particular industry relative to the risk of the market overall. JA__(*Brundle v. Wilmington Trust, N.A.*, 258 F. Supp. 3d 647, 658 (E.D. Va. 2017) ("Recon. Order")). The district court calculated damages, however, with the mistaken understanding that beta was a method "to assess the risk of Constellis relative to that of the industry overall." JA__(Recon. Order at 658). The district court conceded on reconsideration that it had misunderstood the definition of beta. JA__(Recon. Order at 658).

Using the incorrect definition of beta, the court determined that a beta of 0.7 determined by Stout was too low for Constellis and found that the improper beta calculation caused $2,936,000 in damages. JA__(Opinion at 646). Instead of correcting this error on reconsideration, the court stated it "did not rely heavily on the discussion of beta in its conclusions on liability," JA__(Recons. Order at 658), and yet, it specifically allocated almost $3 million dollars based on the use of a 0.7 beta. JA__(Opinion at 648). The district court even recognized that "beta leaves considerable room for judgment," but instead of deferring to Stout's contemporaneous calculation of beta, which was independently corroborated by Tarbell, the court retained a beta of 1.0 relying on Messina's highly-flawed and unconventional opinion that a beta of 1.0 was appropriate for Constellis because over time, most company's betas revert back to one. It was improper for the district court to substitute Messina's misapplied beta theory for the contemporaneous beta calculation by Stout. For these reasons, the district court should have adjusted the damages based on its misunderstanding of beta.

III. THE DISTRICT COURT'S DECISION IMPOSED SIGNIFICANT LIABILITY ON THE TRUSTEE EVEN THOUGH NO PLAN PARTICIPANT WAS HARMED.

The district court's judgment saddles Wilmington with a nearly $30 million judgment even though there was no finding that Wilmington acted in bad faith or that any of the ESOP participants suffered an actual economic loss. To the contrary, when the July 2014 $20 million cash payment to the ESOP is taken into consideration, it is clear that the participants materially benefitted from the ESOP transaction and the subsequent sale to ACADEMI.

It is not disputed that ERISA is founded upon principles of trust law and the basic remedy under trust law for a breach of fiduciary duty is to restore the plan participants to the position that they would have been in but for the breach. *See Dasler v. E.F. Hutton & Co.*, 694 F. Supp. 624, 634 (D. Minn. 1988). Courts have therefore held that the aim of ERISA is to make the plaintiffs whole, but not provide them with a windfall. *Henry v. Champlain Enter., Inc.*, 445 F.3d 610, 624 (2d Cir. 2006).

The district court's judgment conflicts with both principles. In connection with the ACADEMI sale, the ESOP participant's interests became fully vested, which would not have otherwise occurred for an additional six years. JA__(Opinion at 629). In addition, Wilmington secured a control premium of $20 million of cash to the ESOP and also secured a $33 million reduction in the amount the ESOP owed on the Seller notes as part of the sale to ACADEMI. JA__(Opinion at 629).

The foregoing considerations created millions of dollars of value to the ESOP at a rate faster than anticipated in the original ESOP transaction, and resulted in an unexpected, meaningful and immediate benefit to the individual participants. Plaintiff Brundle, for example, stands to receive $20,000 from his six months as an ESOP participant, even though he made no personal investment in the ESOP, sacrificed no other corporate benefit, took no risk, and would not have received anything in the absence of the ESOP transaction. Participants, such as Brundle, did not invest money in the plan, there was "no evidence that any employee relied on [the plan] for retirement," and plan participants were in no way damaged. JA__(Opinion at 645). In fact, the district court even recognized that there was "no evidence in this record showing that the participants in this ESOP have actually suffered a loss." JA__(Opinion at 645).

In spite of the foregoing, the district court's decision imposes a $30 million judgment on Wilmington. The judgment, if allowed to stand, creates an impermissible windfall for the ESOP participants and unjustly punishes a trustee that followed generally accepted procedures, including hiring a highly-qualified and independent appraiser.

IV. CONCLUSION

The district court's decision in this case runs contrary to applicable law and sets a dangerous precedent for ESOP transactions, as it will expose every appraiser and every ESOP fiduciary to potential litigation based on gratuitous second-guessing, hinging entirely on the "believability" of competing experts reviewing a transaction post-closing and with information unavailable to the appraiser at the time of the transaction. For the reasons expressed herein, the district court's decision should be reversed.

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Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32(g), I certify the following:

This brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B), Fourth Circuit Rule 32(b), and this Court's order of June 12, 2018 because this brief contains 6352 words as determined by the Microsoft 2010 word-processing system used to prepare the brief, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 word-processing system in a 14-point Time New Roman font.

/s/ Eliot T. Burriss
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CERTIFICATE OF SERVICE

I certify that on June 25, 2018, I electronically filed the foregoing Amicus Curiae Brief of the American Society of Appraisers with the Clerk of this Court using the Court's CM/ECF system, which will send a notice of such filing to the registered ECF users.

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