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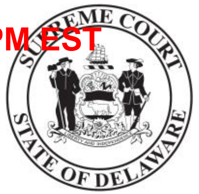

IN THE SUPREME COURT OF THE STATE OF DELAWARE

DELL INC., Respondent-Below, Appellant/ Cross-Appellee, v. MAGNETAR GLOBAL EVENT DRIVEN MASTER FUND LTD., MAGNETAR CAPITAL MASTER FUND LTD., GLOBAL CONTINUUM FUND, LTD., SPECTRUM OPPORTUNITIES MASTER FUND LTD., MORGAN STANLEY DEFINED CONTRIBUTION MASTER TRUST, BLACKWELL PARTNERS LLC, AAMAF, LP, WAKEFIELD PARTNERS, LP, CSS, LLC, MERLIN PARTNERS, LP, WILLIAM L. MARTIN, TERENCE LALLY, ARTHUR H. BURNET, DARSHANAND KHUSIAL, DONNA H. LINDSEY, DOUGLAS J. JOSEPH ROTH CONTRIBUTORY IRA, DOUGLAS J. JOSEPH & THUY JOSEPH, JOINT TENANTS, GEOFFREY STERN, JAMES C. ARAMAYO, THOMAS RUEGG, CAVAN PARTNERS LP, and RENE A. BAKER, Petitioners-Below, Appellees/Cross-Appellants.	No. 565, 2016 Court below: Court of Chancery, Consolidated C.A. No. 9322-VCL

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TABLE OF CONTENTS

TABLE OF CITATIONS.......... iv

NATURE OF PROCEEDINGS.......... 1

SUMMARY OF ARGUMENT.......... 3

STATEMENT OF FACTS.......... 5

A. Dell's Uncertain Future.......... 5

B. The Sale Process.......... 7

C. The Dueling Valuation Opinions.......... 11

D. The Trial Court's Decision.......... 12

ARGUMENT.......... 14

I. THE TRIAL COURT ERRED ON THE FACTS OF THIS CASE BY PLACING NO WEIGHT ON THE MERGER PRICE WHEN MAKING ITS FAIR VALUE DETERMINATION.......... 14

A. Question Presented.......... 14

B. Scope of Review.......... 14

C. Merits of Argument.......... 15

1. The Trial Court Committed Legal Error In Failing To Place Any Weight On The Merger Price.......... 15

a. The trial court erred in disregarding the merger price on the theory that it was not the "most reliable" or "best" evidence of fair value.......... 16

b. The trial court erred in disregarding the merger price on the basis that it could not "quantify the exact degree of sale process mispricing.".......... 20

RLF1 16607719v.1

c. The trial court erred by assigning no weight to the merger price on the basis that it resulted from an MBO transaction. 25

2. The Trial Court Abused its Discretion In Failing To Place Any Weight On The Merger Price 27

a. The trial court assumed that a gap existed for three years between Dell's market and intrinsic values. 27

b. The trial court's discussion of the MBO model and process do not support its decision to disregard the merger price. 30

c. The trial court's criticisms of the pre-signing process are unsound and lack record support. 34

d. The trial court's criticisms of the go-shop are unsound and lack record support. 36

e. The trial court's decision creates uncertainty for directors of Delaware corporations. 40

II. THE TRIAL COURT'S DISCOUNTED CASH FLOW ANALYSIS CONTAINS THREE FUNDAMENTAL MODELING ERRORS THAT NEGATE ITS RELIABILITY AS AN INDICATOR OF FAIR VALUE. 43

A. Question Presented 43

B. Scope of Review 43

C. Merits of Argument 43

1. The Trial Court Erred By Failing to Correctly Account For Dell's FIN 48 Contingent Liability Reserve. 44

2. The Trial Court Erred By Failing to Account For Dell's Residual U.S. Tax Liability Resulting From Its Foreign Earnings 47

3. The Trial Court Erred By Failing to Apply The Marginal Tax Rate in The Terminal Period........................49

4. Summary..52

CONCLUSION..53

TABLE OF CITATIONS

Cases **Page(s)**

Andaloro v. PFPC Worldwide, Inc.,
2005 WL 2045640 (Del. Ch. Aug. 19, 2005)....................16

In re Appraisal of Ancestry.com, Inc.,
2015 WL 399726 (Del. Ch. Jan. 30, 2015)....................19, 50

In re Appraisal of DFC Global Corp.,
2016 WL 3753123 (Del. Ch. July 8, 2016).................... 16, 19, 22

In re Appraisal of Orchard Enters., Inc.,
2012 WL 2923305 (Del. Ch. July 18, 2012)....................24, 49

C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust, 107 A.3d 1049 (Del. 2014)....................28

Cede & Co. v. Technicolor, Inc.,
2003 WL 23700218 (Del. Ch. Dec. 31, 2003), *aff'd in part, rev'd in part*, 884 A.2d 26 (Del. 2005) 49

Chesapeake Corp. v. Shore,
771 A.2d 293 (Del. Ch. 2000)....................28

Corwin v. KKR Fin. Hldgs. LLC,
125 A.3d 304 (Del. 2015)....................27

Crescent/Mach I P'ship, L.P. v. Dr. Pepper Bottling Co. of Tex.,
2008 WL 2440303 (Del. Ch. June 4, 2008), *rev'd*, 962 A.2d 205 (Del. 2008)....................24

Del. Open MRI Radiology Assocs., P.A. v. Kessler,
898 A.2d 290 (Del. Ch. 2006)....................48

Dobler v. Montgomery Cellular Hldg. Co.,
2004 WL 2271592 (Del. Ch. Oct. 4, 2004), *aff'd in part, rev'd in part*, 880 A.2d 206 (Del. 2005) 16

Gesoff v. IIC Indus., Inc.,
902 A.2d 1130 (Del. Ch. 2006) 24

Gholl v. eMachines, Inc.,
2004 WL 2847865 (Del. Ch. Nov. 24, 2004), *aff'd*, 875 A.2d 632
(Del. 2005) (TABLE) 24

Global GT LP v. Golden Telecom, Inc.,
993 A.2d 497 (Del. Ch.), *aff'd*, 11 A.3d 214 (Del. 2010) 24, 25, 26, 49

In re Hanover Direct, Inc. S'holders Litig.,
2010 WL 3959399 (Del. Ch. Sept. 24, 2010) 17

Highfields Capital, Ltd. v. AXA Fin., Inc.,
939 A.2d 34 (Del. Ch. 2007) 16, 19

Huff Fund Inv. P'ship v. CKx, Inc.,
2013 WL 5878807 (Del. Ch. Nov. 1, 2013), *aff'd*, 2015 WL
631586 (Del. Feb. 12, 2015) 19, 23

Kleinwort Benson Ltd. v. Silgan Corp.,
1995 WL 376911 (Del. Ch. June 15, 1995) 49

Lane v. Cancer Treatment Ctrs. of Am., Inc.,
2004 WL 1752847 (Del. Ch. July 30, 2004) 16

Levitt v. Bouvier,
287 A.2d 671 (Del. 1972) 14, 43

LongPath Capital, LLC v. Ramtron Int'l Corp.,
2015 WL 4540443 (Del. Ch. June 30, 2015) 19, 22

Lyondell Chemical Company v. Ryan,
970 A.2d 235 (Del. 2009) 41

M.G. Bancorporation, Inc. v. Le Beau,
737 A.2d 513 (Del. 1999) 14, 43

M.P.M. Enters., Inc. v. Gilbert,
731 A.2d 790 (Del. 1999) 14, 18, 24, 43

Merion Capital, L.P. v. 3M Cogent, Inc.,
2013 WL 3793896 (Del. Ch. July 8, 2013) 17

Merion Capital L.P. v. Lender Processing Servs., Inc.,
2016 WL 7324170 (Del. Ch. Dec. 16, 2016) .... *passim*

RLF1 16607719v.1

Merion Capital LP v. BMC Software, Inc.,
2015 WL 6164771 (Del. Ch. Oct. 21, 2015)................................ 19, 22, 48

Merlin P'rs LP v. AutoInfo, Inc.,
2015 WL 2069417 (Del. Ch. Apr. 30, 2015)...19

Paramount Commc'ns Inc. v. QVC Network Inc.,
637 A.2d 34 (Del. 1994)..35

Prescott Grp. Small Cap, L.P. v. Coleman Co.,
2004 WL 2059515 (Del. Ch. Sept. 8, 2004)...24

Towerview LLC v. Cox Radio, Inc.,
2013 WL 3316186 (Del. Ch. June 28, 2013)...24

Tri-Continental Corp. v. Battye,
74 A.2d 71 (Del. 1950)...17

Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.,
847 A.2d 340 (Del. Ch. 2004).. 18, 23, 24

Van de Walle v. Unimation, Inc.,
1991 WL 29303 (Del. Ch. Mar. 7, 1991)...................................... 18, 20, 22

In re Walt Disney Co. Deriv. Litig.,
906 A.2d 27 (Del. 2006)...14, 43

Statutes

8 *Del. C.* § 262 .... 17, 26, 47

Other Authorities

Bradford Cornell, *Corporate Valuation* (1993) 24

Asworth Damodaran, *Investment Valuation* (3d ed. 2012)...........................44, 50

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NATURE OF PROCEEDINGS

On October 29, 2013, Michael Dell and affiliates of Silver Lake Partners acquired Appellant Dell Inc. ("Dell" or the "Company") for $13.75 per share in cash. Although the merger price represented a 44% premium to Dell's unaffected stock price, a number of mutual funds, hedge funds, risk arbitrageurs, and individual stockholders sought appraisal under Section 262 of the Delaware General Corporation Law. The Court of Chancery held a consolidated trial in October 2015 to determine the fair value of Dell as required by the statute.

On May 31, 2016, the trial court issued its post-trial decision. The court commended the fourteen-month sale process conducted by Dell's independent special committee, stating that the "process easily would sail through if reviewed under enhanced scrutiny." Op. 61. Nonetheless, the court placed no weight on the merger price resulting from that process in making its fair value determination. Instead, the trial court relied solely on its own discounted cash flow ("DCF") model to determine the fair value of Dell as of the merger date. This approach resulted in a valuation that was more than $7 billion – *i.e.*, 28% – above the highest price offered for the Company.

For the reasons set forth herein, this Court should reverse and determine fair value in an amount no greater than the merger price. Alternatively, the Court should remand this case to the trial court with instructions that it determine fair

value in a manner consistent with the instructions of this Court regarding the weight to be accorded to the merger price and consistent with this Court's determinations as to modeling errors in the trial court's DCF analysis.

SUMMARY OF ARGUMENT

1. The trial court committed legal error in determining the fair value of Dell by assigning no weight to the price resulting from the sale process on the grounds that (i) the merger price was not the "most reliable" or "best" evidence of fair value; (ii) the court could not "quantify the exact degree of sale process mispricing" in the merger price; and (iii) the merger price resulted from a management buy-out ("MBO") transaction. The trial court's reasoning is inconsistent with the statutory requirement that it "take into account all relevant factors" in an appraisal proceeding. Delaware courts have consistently found that the merger price is a reliable indicator of fair value where, as here, the court determines that there has been a sound transaction process. The trial court compounded its error by creating a broad presumption against the reliability of the merger price in MBO transactions, even in cases where no topping bid emerges despite a robust market check involving both strategic and financial parties.

The trial court's determination to place no weight on the merger price also constitutes an abuse of discretion. The court assumed that a gap existed for years between Dell's market and intrinsic values without showing the existence of a significant information disparity, and then relied on that purported gap to disregard the merger price. The court made similar missteps in its analysis of the relationship between the MBO valuation model and the merger price, and in its

review of Dell's pre-signing and go-shop market checks. The unsurprising result of these errors and assumptions is an unsound valuation determination that is contradicted by real-world indicators of value.

2. The trial court abused its discretion by relying on a discounted cash flow model that (i) incorrectly accounts for Dell's FIN 48 contingent liability reserve; (ii) credits foreign earnings in its free cash flow calculation but omits offsetting taxes attendant to those earnings; and (iii) assumes that Dell will never pay the U.S. marginal tax rate. Correcting just these three errors in the trial court's DCF analysis results in a fair value determination consistent with the merger price.

STATEMENT OF FACTS

The trial court found that Dell engaged in a sale process that "easily would sail through if reviewed under enhanced scrutiny." Op. 4-41, 61. Dell briefly summarizes the evidence regarding that process and the other facts relevant to this appeal.

A. Dell's Uncertain Future.

Michael Dell founded Dell in 1983. Op. 1. Over the next twenty-five years he and his team built the Company into one of the world's preeminent PC manufacturers. In 2009, Mr. Dell concluded that "the business was changing, value was shifting into software and services, and we felt that we needed to go beyond just having products" to remain competitive. A580. The Company then expanded into the enterprise business. Op. 2; A292; A1207-08; A2565. As part of that strategy, the Company acquired eleven businesses to expand its portfolio and extend its core capabilities. Op. 2; A1406; A3822-51.

In 2013, Dell found itself "in a difficult situation economically and competitively." A352. At that time, the Company confronted a tepid recovery from the U.S. financial crisis, an emerging sovereign debt crisis in Europe, and slowing growth in Asia. A3265-68. It also faced serious long-term structural challenges in its primary business segments. Op. 2.

Consumers were shifting purchases from personal computers, where Dell had strong market share, to tablets and smartphones, where Dell had virtually no presence. Op. 2; A226-27; A3268-71. Dell also faced increased competition from Asian rivals such as Lenovo, as the PC market shifted towards lower-end products and away from the premium products that were Dell's strength. Op. 2. In the enterprise market, the shift from on-site servers to "cloud" storage transferred demand from brand name servers where Dell had invested substantial resources to low-cost "white-box" servers at a time when competitive pressures were reducing margins. Op. 2; A293; A3277. There also "were rumors that Google was going to enter the cloud business, in addition to Amazon and Microsoft." A606. These market forces increased pressure on Dell at a time when its "acquisitions were not quite as successful as was expected . . . ." A293; A703-04.

The challenges also resulted in a decline in consumer and market confidence in the Company's long-term prospects. Op. 3-4; A231-32. Analysts reduced their price targets during the fall of 2012 and early 2013 and eventually cut their FY14 and FY15 EBIT forecasts from over $4 billion per year to just over $2 billion per year. A3309-10. The Company's lead director observed that during this period "the company was struggling, had missed a number of expectations from a revenue point of view and from an earnings point of view. And clearly it was in the

process of reassessing where it should go, because the current position was not working particularly well." A291-92; A537-38.

At the time the proposed merger was announced, Dell had reported revenue below consensus analyst estimates in six of the seven prior quarters. Op. 16. Throughout this period of change and uncertainty, the market reacted to the objective reality that Dell's performance was lagging behind the Company's guidance and analysts' forecasts. Op. 3-4, 7-8, 16-17, 31-34, 38; A2550-21; A3283-85. Dell's stock price hovered below $10 in the fall of 2012. Op. 74.

B. The Sale Process.

Mr. Dell approached the Company in August 2012 with interest in exploring a going-private transaction. Op. 4-5. Mr. Dell owned 13.9% of the Company's common stock at the time. A3313. Dell formed an independent special committee (the "Committee") to (i) consider proposals to acquire the Company from Mr. Dell and any other parties; (ii) engage independent legal and financial advisors; (iii) make a recommendation to the Board with respect to any proposed transaction; and (iv) review strategic alternatives. Op. 5-8; A1516-20; A1530-31. The Board resolved not to recommend a transaction for stockholder approval without a prior favorable recommendation by the Committee. *Id.* The Committee had the power to say "no" to Mr. Dell, or anyone else. *Id.*

Guided by its independent advisors, the Committee evaluated various alternatives available to the Company. A305-07; A1613-15; A1637; A1754. Mindful that Mr. Dell was a potential participant in a transaction, the Committee took additional steps to protect the integrity of the process. Mr. Dell was required to enter into an agreement requiring that he explore in good faith the possibility of working with other potential sponsors and, later, a voting agreement pursuant to which he and his affiliates agreed to vote their shares "in the same proportion as the number of [s]hares voted by the [u]naffiliated [s]tockholders." Op. 8-9; A1535; A1893; A2295-96; A298; A313; A899. The merger agreement also contained an unaffiliated vote provision requiring that the merger be adopted by a majority of the shares not held by Mr. Dell and his affiliates. Op. 36; A2212; A1811-12. Finally, Mr. Dell committed that he would remain with the Company if stockholders failed to approve the transaction. A2454.

The Committee invited Silver Lake, KKR, and TPG as bidders into a confidential pre-signing market canvass.[1] Op. 15-18. Mr. Dell "encouraged all the bidders to bid as high as they possibly could." A619; A1616-19; Op. 15. Even

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[1] Silver Lake, KKR, and TPG are three of the largest and most sophisticated private equity firms in the world. A3316. Given the expectation that few, if any, strategic bidders would be interested in Dell and a concern that leaks might compromise the process and business, the Committee agreed with J.P. Morgan and Evercore that it should not seek out additional parties prior to the commencement of the go-shop. A515-17.

though Mr. Dell and one of KKR's founders were personal friends, KKR withdrew from the process after making an initial indication of interest at $12-13 per share because it "could not get [its] arms around the risks of the PC business." A1635; A328; A592-94; Op. 17. TPG similarly dropped out of the process because it "felt that the cash flows attached to the PC business were simply too uncertain, too unpredictable to establish an investment case for them." Op. 19; A314-15; A595-96. The Committee continued to engage with Silver Lake and negotiated six increases to offers from Silver Lake, despite the latter's resistance to go higher. A2462; A2464; A1639; A1642. Mr. Dell ultimately agreed to take a lesser value for the portion of his own shares that were being sold in the transaction "to break the impasse in order to effect the higher bid price." Op. 26, 37; A586; A2210; A2254. Dell entered into a merger agreement with Silver Lake on February 5, 2013. Op. 24-25; A1781.

The Committee negotiated a 45-day go-shop during which Dell could solicit and negotiate with other potential bidders. Op. 26-27; A1826-27. The Committee paid Evercore a $400,000 per month retainer fee to run the go-shop process and offered it a $30 million incentive fee in the event that the go-shop resulted in a superior transaction. Op. 21; A513-14. Evercore contacted 67 parties, including 20 strategic parties and 17 financial sponsors. Op. 27; A2119; A1914-45. Eleven parties expressed interest in a transaction. A1908-13; A1947-48; A1953-55;

A1963-64; A2119. The Committee offered $25 million in expense reimbursement "to help level the playing field." Op. 30; A4365.[2] Those efforts led to proposals from Carl Icahn and Blackstone that the Committee deemed to be potentially superior proposals. Op. 29-30; A2114; A2151; A2156. As a result, Icahn and Blackstone had another four months to attempt to top the proposed transaction with Silver Lake. Op. 90. Blackstone's team was led by Dave Johnson, a former member of Dell's executive team who had recently been responsible for Dell's acquisitions and strategy and therefore had extensive knowledge of the Company and its prospects. Op. 92-93. Blackstone undertook extensive due diligence, involving over 460 individuals and commanding more of Mr. Dell's and Company management's time than any other participant in the process, including Silver Lake. Op. 31; A2137-40; A2144-45; A2152.

In April 2013, Blackstone withdrew from the process, citing: "(1) an unprecedented 14 percent market decline in PC volume in the first quarter of 2013, its steepest drop in history, and inconsistent with Management's projections for modest industry growth; and (2) the rapidly eroding financial profile of Dell." Op. 32; A2161; A2148; A538-39. Despite these adverse market forces and without a topping bid, the Committee negotiated a seventh increase in the merger consideration with Silver Lake to overcome initial stockholder opposition to the

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[2] Blackstone and Silver Lake ultimately agreed to the Committee's terms for expense reimbursement; Carl Icahn did not. A2220-21.

transaction. Op. 36-37; A2646-48. Under the revised merger agreement, Silver Lake agreed to (i) increase the purchase price from $13.65 to $13.75 per share; (ii) provide for the payment of a $0.13 per share special dividend; and (iii) guarantee Dell's third quarter dividend of $0.08 per share. Op. 36-37; A2540; A2605. Stockholders approved the merger on September 12, 2013, and the transaction closed on October 29, 2013. Op. 40-41; A2725; A2739.

C. The Dueling Valuation Opinions.

At trial, Petitioners' valuation expert, Brad Cornell, opined that the fair value of Dell as of the merger date was $28.61 per share. Op. 99. Cornell created a two-stage DCF model using projections that he did not test and would not endorse, a 1% perpetuity growth rate reflecting the challenging future for the PC market, a 21% tax rate, and a 9.03% discount rate. A3472; A3525; A3528; A3533; A4279; A242. Cornell's valuation, even with the low perpetuity growth rate, implied that the stock market had undervalued one of the most well-known companies in the world by more than $26 billion (*i.e.*, 108%), a stunning gap that he could not explain. A212; A262; A286.

Dell's valuation expert, Glenn Hubbard, the Dean of the Columbia University Graduate School of Business, utilized a three-stage DCF model to allow for normalization of cash flows, a 2% perpetuity growth rate, a 35.8% terminal tax rate (with a lower tax rate during the projection period reflecting Dell's near-term

reality) and a 9.46% discount rate. A3363-73. After reviewing various projections prepared around the time of the transaction, Hubbard selected cash flow projections prepared by an outside consultant to the Committee, Boston Consulting Group. The trial court found this approach was persuasively supported by the record. Op. 102-03; A3330-57. Hubbard tested the integrity of his result by reviewing other valuation methodologies, including a comparable company analysis and an alternative DCF analysis based on Silver Lake's internal projections. A3401-13. Hubbard's DCF produced a point estimate for fair value of $12.68. He further observed that the merger price provided "the best view of how individuals and institutions who were actually putting real money to use valued Dell." A3261; A3413-14. In light of the "many uncertainties associated with the changing industry outlook and company strategy" and their potential impact on valuation, Hubbard concluded that the merger price represented a valuation ceiling that was consistent with his DCF point estimate. A751; A3326-27.

D. The Trial Court's Decision.

In its post-trial decision, the trial court found it "counterintuitive and illogical – to the point of being incredible – to think that another party would not have topped Mr. Dell and Silver Lake if the Company was actually worth" what Petitioners advanced at trial. Op. 83-84. Nonetheless, the trial court placed

no weight on the merger price or the real-world actions of market participants in making its fair value determination. Op. 114. Instead, the court created its own DCF model and then relied solely on that model for its valuation determination. *Id*. The trial court largely adopted Hubbard's assumptions and methodology, but deviated from his model in three significant ways: (i) by incorrectly accounting for Dell's FIN 48 contingent liability reserve; (ii) by crediting foreign earnings in its free cash flow calculation but omitting offsetting taxes attendant to those earnings; and (iii) by modeling the terminal tax rate in a manner that assumes that Dell will never pay the U.S. marginal rate. The cumulative impact of these errors produced an incredible and implausible valuation of $17.62 per share – a figure 77% higher than Dell's unaffected stock trading price and more than 28% above the highest price any bidder offered for the Company.

ARGUMENT

I. THE TRIAL COURT ERRED ON THE FACTS OF THIS CASE BY PLACING NO WEIGHT ON THE MERGER PRICE WHEN MAKING ITS FAIR VALUE DETERMINATION.

A. Question Presented.

Whether the trial court erred in its statutory determination of fair value pursuant to 8 *Del. C.* § 262 by placing no weight on the merger price despite finding that Dell was sold through a process that "easily would sail through if reviewed under enhanced scrutiny" because "the Committee and its advisors did many praiseworthy things."[3] Preserved at A4392-96; A4451-52.

B. Scope of Review.

The trial court's "interpretation and application of the mandates in Section 262 . . . presents a question of law . . . [which] must be reviewed *de novo* on appeal." *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d 513, 524 (Del. 1999); *M.P.M. Enters., Inc. v. Gilbert*, 731 A.2d 790, 795 (Del. 1999). The Court should overturn findings of fact that are not supported by the record or are not the product of an orderly and logical deductive process. *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972). Findings of fact also should be overturned when they are "clearly wrong and justice so requires." *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 48 (Del. 2006).

[3] The trial court declined to enumerate those many "praiseworthy" actions because "it would burden an already long opinion to catalog them." Op. 61.

C. Merits of Argument.

The trial court's decision "does not give weight to the Final Merger Consideration." Op. 114.[4] The court's reasoning constituted both legal error and an abuse of discretion.

1. The Trial Court Committed Legal Error In Failing To Place Any Weight On The Merger Price.

The trial court committed legal error in determining the fair value of Dell by adopting a methodology that assigned no weight to the merger price on the grounds that (i) the merger price was not the "most reliable" or "best" evidence of fair value; (ii) the court could not "quantify the exact degree of sale process mispricing" embedded in the merger price; and (iii) the merger price was unreliable because it resulted from an MBO transaction. Op. 46, 98, 114.

[4] Notwithstanding this holding, the trial court subsequently stated in a recent case that it "gave limited weight to the deal price" in *Dell*. *See Merion Capital L.P. v. Lender Processing Servs., Inc.*, 2016 WL 7324170, at *32 (Del. Ch. Dec. 16, 2016). In its Opinion in this case, however, the trial court explicitly stated that it gave zero – *not limited* – weight to the deal price when deriving the fair value of Dell. The trial court rejected Petitioners' extreme valuation because it found that if the Company were worth in excess of $28 per share (*i.e.*, more than $26 billion above the merger consideration), a strategic bidder would have topped the merger price. Op. 84. But when the trial court actually determined Dell's fair value, it gave no weight to the merger price and used "the DCF methodology exclusively to derive a fair value of the Company." Op. 114.

a. The trial court erred in disregarding the merger price on the theory that it was not the "most reliable" or "best" evidence of fair value.

The trial court committed legal error in assigning no weight to the merger price on the ground that it was "certainly a relevant factor, but it is not the best evidence of the Company's fair value." Op. 46; *see also* Op. 87 (evidence "not sufficient to prove that the Final Merger Consideration was the best evidence of fair value"); Op. 98 (evidence "d[oes] not establish that the outcome of the sale process offers the most reliable evidence of the Company's value as a going concern"). That is an incorrect formulation of the law: on the facts presented here, the trial court was required to take the merger price into account in deriving fair value, even if it did not believe the merger price was the single best or most reliable indicator of fair value.

Courts routinely rely "on multiple valuation techniques to determine fair value, giving greater weight to the more reliable methodologies in a particular case." *In re Appraisal of DFC Global Corp.*, 2016 WL 3753123, at *21 (Del. Ch. July 8, 2016).[5] "Generally speaking, 'it is preferable to take a more robust

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[5] *See, e.g.*, *Andaloro v. PFPC Worldwide, Inc.*, 2005 WL 2045640, at *20 (Del. Ch. Aug. 19, 2005) (applying weight to different valuation methodologies); *Highfields Capital, Ltd. v. AXA Fin., Inc.*, 939 A.2d 34, 64 (Del. Ch. 2007) (same); *Dobler v. Montgomery Cellular Hldg. Co.*, 2004 WL 2271592, at *17 (Del. Ch. Oct. 4, 2004) (same), *aff'd in part, rev'd in part*, 880 A.2d 206 (Del. 2005); *Lane v. Cancer Treatment Ctrs. of Am., Inc.*, 2004 WL 1752847, at *35 (Del. Ch. July 30, 2004) (same).

approach involving multiple techniques . . . to triangulate a value range . . . .'" *Merion Capital, L.P. v. 3M Cogent, Inc.*, 2013 WL 3793896, at *5 (Del. Ch. July 8, 2013) (quoting *S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co.*, 2011 WL 863007, at *20 (Del. Ch. Mar. 9, 2011)); *In re Hanover Direct, Inc. S'holders Litig.*, 2010 WL 3959399, at *2 (Del. Ch. Sept. 24, 2010) ("[M]ultiple valuation techniques . . . serve to cross-check one another's results. . . ."). The trial court's belief that it could rely only on the "best" or "most reliable" evidence of fair value was legal error and conflicts with the statutory requirement that it "take into account all relevant factors" in determining fair value in an appraisal proceeding. 8 *Del. C.* § 262(h); *see also Tri-Continental Corp. v. Battye*, 74 A.2d 71, 72 (Del. 1950) ("[C]ourts must take into consideration all factors and elements which reasonably might enter into the fixing of value.").

The trial court itself employed a very different standard in *Lender Processing*. There, the trial court relied exclusively on the merger price on the basis that it "provide[d] *a reliable indicator* of the Company's fair value at the time of the signing of the Merger Agreement." 2016 WL 7324170, at *16 (emphasis added).

Here, by contrast, the same court imposed a significantly higher standard by assigning no weight to the merger price in its valuation determination because Dell had not proven the merger price to be "the most reliable" evidence of fair value.

Op. 98. Similarly, the trial court rejected the merger price in this case because it supposedly "functioned *imperfectly* as a price discovery tool." Op. 113 (emphasis added). Perfection was not required in *Lender Processing*, however, where the trial court embraced the merger price solely based on its "determination that the sale process that the Board conducted provided an effective means of price discovery." 2016 WL 7324170, at *16.

Delaware courts have consistently recognized that the merger price is a relevant and reliable indicator of fair value where the parties have engaged in an appropriate transaction process. *See, e.g.*, *M.P.M. Enters.*, 731 A.2d at 797 ("A merger price resulting from arms-length negotiations where there are no claims of collusion is a very strong indication of fair value."); *Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 357 (Del. Ch. 2004) ("[O]ur case law recognizes that when there is an open opportunity to buy a company, the resulting market price is reliable evidence of fair value."); *Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at *17 (Del. Ch. Mar. 7, 1991) ("The fact that a transaction price was forged in the crucible of objective market reality (as distinguished from the unavoidably subjective thought process of a valuation expert) is viewed as strong evidence that the price is fair.").

In six recent appraisal cases, the Court of Chancery has anchored its fair value determination exclusively on the merger price (less synergies).[6] Op. 80. In several others, the trial court ascribed weight to multiple methodologies, including the merger price. *See, e.g.*, *DFC Global,* 2016 WL 3753123, at *21-23; *AXA Fin.*, 939 A.2d at 42. The proper inquiry is to determine whether the merger price provides reliable evidence of fair value and, if so, what weight to assign to that evidence.[7]

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[6] *See Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at *13 (Del. Ch. Nov. 1, 2013) ("[T]he process that generated the merger price supports a conclusion that the merger price is a relevant factor in determining CKx's fair value."), *aff'd*, 2015 WL 631586 (Del. Feb. 12, 2015) (affirming "on the basis of and for the reasons assigned by the Court of Chancery"); *LongPath Capital, LLC v. Ramtron Int'l Corp.*, 2015 WL 4540443, at *20 (Del. Ch. June 30, 2015) (reliance on merger price appropriate following "a proper transactional process likely to have resulted in an accurate valuation of an acquired corporation"); *Merlin P'rs LP v. AutoInfo, Inc.*, 2015 WL 2069417, at *17 (Del. Ch. Apr. 30, 2015) (valuation based on merger price appropriate where "the market prices a company as the result of a competitive and fair auction"); *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726, at *23 (Del. Ch. Jan. 30, 2015) ("robust" sales process produced a more reliable determination of fair value than a DCF based on "problematic" projections); *Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771, at *18 (Del. Ch. Oct. 21, 2015) (finding merger price "to be the best indicator of fair value of BMC"); *Lender Processing*, 2016 WL 7324170, at *33 ("The Company ran a sale process that generated reliable evidence of fair value"; "I give 100% weight to the transaction price.").

[7] The trial court tried to distinguish the foregoing cases on the basis that (i) they did not involve an MBO transaction; (ii) "reliable projections and persuasive evidence of a significant valuation gap did not exist"; and (iii) "[a]ll the cases either involved a more active pre-signing market check or the process was kicked off by an unsolicited third-party bid." Op. 50 n.13. These attempted distinctions, some of which are inaccurate or inapplicable here, do not override

Measured against this legal construct, the trial court's findings concerning the sale process undercut any claim that the merger price was an unreliable indicator of value. The appointment of the Committee and hiring of independent advisors, the neutralization of Mr. Dell's shares, the pre- and post-signing market checks (including the "open" go-shop with potential reimbursement of third-party fees), the negotiation of multiple bid increases, the absence of preclusive deal protections, and the unwillingness of any party to come forward with a topping bid following a widely publicized go-shop all provide real-world indicia that the merger price was a relevant and reliable indicator of fair value in this case. The trial court erred by failing to take the merger price into account.

b. The trial court erred in disregarding the merger price on the basis that it could not "quantify the exact degree of sale process mispricing."

As a second basis for disregarding the merger price, the trial court concluded: "[b]ecause it is impossible to quantify the exact degree of the sale process mispricing, this decision does not give weight to the Final Merger Consideration. It uses the DCF methodology exclusively to derive a fair value of the Company." Op. 114. This too constituted legal error.

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the critical and common finding in each of the cases that the parties engaged in a sound transaction process that resulted in a merger price "forged in the crucible of objective market reality." *Unimation,* 1991 WL 29303, at *17. *See, infra*, Sections I(C)(1)(b-c), I(C)(2)(a-c).

No Delaware precedent supports the proposition that the merger price should be disregarded as an indicator of value on the basis that any purported sale process mispricing could not be quantified exactly. If that were the correct legal standard (and it is not), the merger price would never be considered as a relevant factor in an appraisal proceeding, as the court could never obtain sufficient certainty to exclude the possibility of any mispricing, no matter how small, inconsequential, or immaterial.[8]

Moreover, this incorrect exactitude standard implies a false measure of precision that would equally doom other valuation methodologies. For example, the trial court in this case relied exclusively on a DCF methodology based on projections containing "over 1,100 specific assumptions." Op. 100, 114. The challenge in using the DCF methodology was exacerbated by a number of issues. For example, KKR, TPG, and Blackstone all withdrew from the process citing "uncertainty" and "risk" over the future of the PC market. Op. 2-4, 17, 19, 32. Uncertainty affects the fundamental reliability of projections, which form the basis

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8 This exactitude was expressly rejected by the court in *Lender Processing*: "[A] party is not required to prove its claims by clear and convincing evidence or to exacting certainty. Rather, a party must prove only that it is more likely than not that it is entitled to relief." 2016 WL 7324170, at *12 (quoting *Triton Constr. Co. v. E. Shore Elec. Servs., Inc.*, 2009 WL 1387115, at *6 (Del. Ch. May 18, 2009)).

of a DCF analysis, just as much as it does the reliability of the merger price. *See DFC Global*, 2016 WL 3753123, at *1.

Indeed, it is precisely because of the inherent imprecision resulting from countless assumptions embedded in a DCF analysis that courts often rely on transaction prices forged in the "crucible of objective market reality." *Unimation, Inc.*, 1991 WL 29303, at *17.[9] The trial court erred in creating a new and unachievable standard for assessing the reliability of the merger price in appraisal proceedings – a standard that it failed to apply to its own DCF analysis.

The application of an elevated standard of precision for the merger price (but not the DCF) is particularly inappropriate in light of the challenges to Dell's business at the time of the transaction. As discussed above, the Company's quarterly results fell short of consensus analysts' forecasts in six of the seven quarters immediately prior to the announcement of the proposed merger. Op. 16; A3283-85. Similar circumstances have led other courts to question using the DCF methodology for its valuation determination. *See, e.g.*, *Ramtron*, 2015 WL 4540443, at *11-12, *18 (Del. Ch. June 30, 2015) (finding DCF analysis unreliable because management's "ability to forecast its own business more than two quarters out was quite poor" and "[m]any of [its] forecasts were wildly incorrect"); *BMC*

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[9] *See Lender Processing*, 2016 WL 7324170, at *33 ("[A] DCF analysis depends heavily on assumptions.").

Software, 2015 WL 6164771, at *2, *18 (finding DCF analysis unreliable because management's historical inadequacies were "problematic, in a way that could distort value").

The wide divergence in outcomes suggested by the competing DCF analyses in this case further underscores the imprecision embedded in that methodology. Op. 99 ("Two highly distinguished scholars of valuation science, applying similar valuation principles, thus generated opinions that differed by 126%, or approximately $28 billion."); A3401-14. Even after rejecting the Petitioners' valuation as "counterintuitive and illogical . . . to the point of being incredible" (Op. 83-84), the trial court was still left averaging two sets of supposedly "reliable" forecasts that produced wildly varying valuations more than $4 billion apart. Op. 104, 112. There is nothing exact about the DCF methodology: all valuation methodologies are inherently imperfect, and it was legal error for the trial court to impose an unattainable level of precision only on the merger price.[10]

The trial court's findings concerning the sale process also belie any claim that the sale process here produced a significant mispricing – and they certainly do

[10] *See, e.g.*, *Union Ill.*, 847 A.2d at 359 ("In view of the market's opportunity to price [the company] directly as an entity, the use of alternative valuation techniques like a DCF analysis is necessarily a second-best method to derive value."); *CKx*, 2013 WL 5878807, at *11 (same).

not support a market mispricing of 28%.[11] As Petitioners' expert noted: "[a] market that is not perfectly efficient may still value securities more accurately than appraisers who are forced to work with limited information and whose judgments by nature reflect their own views and biases." Bradford Cornell, *Corporate Valuation* 46 (1993).[12]

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[11] The median divergence between the merger price and the fair value determined by the court in public company appraisal cases decided over the last twenty years is 9%. The few cases that have resulted in results above the median have almost always involved controlling stockholders, no-shops, or significant process defects, none of which is present here. *See, e.g.*, *Towerview LLC v. Cox Radio, Inc.*, 2013 WL 3316186 (Del. Ch. June 28, 2013) (controlling stockholder/no-shop); *In re Appraisal of Orchard Enters., Inc.*, 2012 WL 2923305 (Del. Ch. July 18, 2012) (controlling stockholder); *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497 (Del. Ch.), *aff'd*, 11 A.3d 214 (Del. 2010) (controlling stockholder/no-shop); *Crescent/Mach I P'ship, L.P. v. Dr. Pepper Bottling Co. of Tex.*, 2008 WL 2440303 (Del. Ch. June 4, 2008), *rev'd*, 962 A.2d 205 (Del. 2008) (controlling stockholder); *Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130 (Del. Ch. 2006) (controlling stockholder); *Gholl v. eMachines, Inc.*, 2004 WL 2847865 (Del. Ch. Nov. 24, 2004), *aff'd*, 875 A.2d 632 (Del. 2005) (TABLE) (flawed process); *Prescott Grp. Small Cap, L.P. v. Coleman Co.*, 2004 WL 2059515 (Del. Ch. Sept. 8, 2004) (controlling stockholder).

[12] *See also Union Ill.*, 847 A.2d at 359 ("For me (as a law-trained judge) to second-guess the price that resulted from that process involves an exercise in hubris and, at best, reasoned guess-work."); *M.P.M. Enters.*, 731 A.2d at 796 ("Values derived in the open market through arms-length negotiations offer better indicia of reliability than the interested party transactions that are often the subject of appraisals under § 262.").

c. The trial court erred by assigning no weight to the merger price on the basis that it resulted from an MBO transaction.

A theme permeating the trial court's decision is the idea that the merger price is unreliable evidence of fair value and should be disregarded because it resulted from an MBO transaction. In advancing this narrative, the trial court asserted that "when proposing an MBO, a financial sponsor determines whether and how much to bid by using an LBO model" such that price negotiations are driven by a sponsor's willingness to pay rather than fair value. Op. 63-64. This same mindset infected the trial court's assessment of the go-shop, where the court reasoned that since the indications of interest were received from financial sponsors, "they undercut the notion that the Final Merger Consideration provided fair value." Op. 84. The trial court's rejection of the reliability of the merger price in MBO transactions constituted legal error.

The statutory language of 8 *Del. C.* § 262 and this Court's prior decisions reject bright line rules and broad presumptions for determining fair value. For example, in *Golden Telecom*, this Court declined to "adopt a standard requiring conclusive or, in the alternative, presumptive deference to the merger price in an appraisal proceeding." 11 A.3d 214, 216 (Del. 2010). The Court reasoned that doing so "would contravene the unambiguous language of the statute and the reasoned holdings of our precedent." *Id.* at 218. The Court noted that "inflexible

rules governing appraisal provide little additional benefit in determining 'fair value.'" *Id.*

The trial court's premise that the merger price is inherently suspect and should be disregarded in MBO transactions is inconsistent with the flexible nature of the appraisal inquiry. An inquiry into the subjective and idiosyncratic processes used by particular bidders (financial sponsors or otherwise) to determine the amount they are willing to bid for a company also is irrelevant to the determination of fair value in the context of a broad public sale process that included both financial sponsors and strategic companies.[13]

Finally, Delaware law recognizes mechanisms for dealing with issues presented by certain types of transactions, including the appointment of independent special committees and approval by disinterested stockholders. *See,*

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[13] The trial court's suggestion (Op. 62-69) that the merger price should be disregarded because financial sponsors pay less than strategic bidders for companies is misplaced. The suggestion has no bearing on whether the successful bidder has paid fair value. Moreover, strategic buyers often pay more than other types of bidders to take advantage of perceived synergies. Those synergies are not included in a fair value determination under 8 *Del. C.* § 262(h). Finally, the premise is incorrect in many cases. *See* Alexander S. Gorbenko & Andrey Malenko, *Strategic & Financial Bidders in Takeover Auctions*, 69 J. Fin. 2513, 2514 (2014) ("[A] typical financial bidder values the target more than a typical strategic bidder in approximately one out of four takeover auctions (precisely, 22.64%). This result contradicts the view that strategic bidders are always willing to pay more because they can always implement the same changes as financial bidders, but can also generate potential synergies or are willing to pay more due to agency conflicts.").

e.g., *Corwin v. KKR Fin. Hldgs. LLC*, 125 A.3d 304 (Del. 2015). The careful process in this case militates against the adoption of a new standard that the merger price is unreliable simply because it resulted from an MBO transaction.

2. The Trial Court Abused its Discretion In Failing To Place Any Weight On The Merger Price.

Even beyond its legal errors, the trial court abused its discretion by disregarding the merger price as an indicator of fair value. The trial court's explanations for the divergence between the merger price and the results of its DCF calculation are unsound, lack record support, and were not the product of an orderly and logical deductive process.

a. The trial court assumed that a gap existed for three years between Dell's market and intrinsic values.

The trial court first erred by assuming that a gap existed for three years between Dell's market and intrinsic values and then relying on that purported gap to disregard the merger price as a reliable indicator of fair value. Op. 70, 74. The court's analysis was grounded on its predicate assumption that Dell's management could better determine the value of the Company than securities analysts and other market participants who followed Dell. Op. 72-75. The trial court reasoned this was so because Dell's stockholders were focused on the Company's short-term performance. Op. 75. The court's reasoning and analysis are unsound.

First, the assumption that an actual gap existed between Dell's market and intrinsic values is unsupported by any evidence. To be sure, Dell's senior management believed that the Company was undervalued (Op. 3-4), but that does not necessarily make it so. Indeed, "[t]here is virtually no CEO in America who does not believe that the market is not valuing her company properly." *Chesapeake Corp. v. Shore*, 771 A.2d 293, 327 (Del. Ch. 2000). A difference between the value assigned by the market and the value at which members of management believe the stock should trade constitutes a difference of opinion, not evidence of an actual valuation gap. The relevant inquiry is whether undisclosed information creates an information asymmetry that causes a divergence between intrinsic and market value. No such evidence was presented in this case.

In fact, the trial court found that "there is no evidence that Mr. Dell or his management team sought to create the valuation disconnect so that they could take advantage of it. To the contrary, they tried to convince the market that the Company was worth more." Op. 74-75. In light of the absence of any meaningful information asymmetry, there is no basis to discount the collective assessment of stockholders, analysts, and other market observers as to Dell's value in favor of optimistic forecasts by Dell's managers that had not come to fruition.

Second, there is no evidence to support the trial court's companion assumption that any divergence between intrinsic and market values continued for

years. At the time of the merger, Dell was one of the most widely covered stocks in the world. A3424. It traded in substantial volumes on the public markets and was highly liquid. A3285-86. The notion that Dell traded in an inefficient market that substantially undervalued Dell for *three years* is inconsistent with the efficient market theory and the evidence in this case. A3285-87; A751-52.

Third, the trial court relied on academic articles to support its supposition that stockholders were focused on short-term earnings to the exclusion of Dell's long-term value. Op. 70-73. The trial court gleaned from these writings that a valuation gap could exist because "[i]nvestors focused on short-term, quarterly results can excessively discount the value of long-term investments." Op. 73. While that may be possible in the abstract, the record in this case evidences that analysts covering Dell were focused on the Company's long-term transformation efforts. A3280-82; A3326; A3426-33; A3727-28; A3822-51. Unlike Company management, however, they were pessimistic about the long-term success of those efforts.[14] In other words, the trial court's real quarrel appears to be with the fact

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[14] *See, e.g.*, Op. 7-8 ("bottom line is that the transformation beyond PCs is tougher and taking much longer than the bulls expected," quoting A1521); Op. 10 n.2 ("investors' concerns included '(1) over half of operating profits still come from the deteriorating PC business, and (2) skepticism that Dell can become a successful enterprise player,'" quoting A1540); 17 ("Analysts cut their price targets, citing structural problems in the PC market and concerns about the Company's transformation," quoting A1625); *see also* A3822-51 (collecting analyst statements).

that investors did not believe management's optimistic vision of the future, not that they failed to consider it. As noted by Hubbard, "[b]asing a fair value opinion on an individual optimistic opinion that is misaligned with the prevailing real-world indicators of value generated from actual market participants is not a reliable method of developing a valuation." A3414.

In sum, the trial court abused its discretion in assuming that a gap existed for years between Dell's market price and intrinsic value, and allowing this error to infect its conclusion about the reliability of the merger price as an indicator of fair value.

b. The trial court's discussion of the MBO model and process do not support its decision to disregard the merger price.

Dell previously demonstrated that the trial court committed legal error in creating a presumption against the reliability of the merger price in MBO transactions. The court compounded that error through the manner in which it arrived at that presumption. The trial court suggested that the Committee "did not focus on fair value" because "the price negotiations during the pre-signing phase were driven by the financial sponsors' willingness to pay based on their LBO pricing models, rather than the fair value of the Company." Op. 64, 67.

The trial court's only purported support for this conclusion is a reference to a proxy disclosure that the Committee "did not seek to determine a pre-merger going

concern value for the Common Stock to determine the fairness of the merger consideration to the Company's unaffiliated stockholders." Op. 67-68. The trial court misconstrued both the import of this disclosure and the undisputed record evidence in this case. Indeed, the very next sentence of the proxy discloses that the Committee "believe[d] that the trading price of the Common Stock at any given time represents the best available indicator of the Company's going concern value at that time, so long as the trading price at that time is not impacted by speculation regarding the likelihood of a potential transaction." A2232.

Moreover, during the sale process, J.P. Morgan and Evercore "presented valuation methodologies that relate[d] to Dell as a going concern." A549-50. They presented separate fairness opinions and a "football field" range of values produced from different methodologies, rather than a single, point-estimate of fair value. A1692-32; A1665-66. The Committee considered those "opinions and related financial analyses" in determining whether the merger price represented fair value. A2232. The trial court was incorrect in suggesting that the Committee did not have an adequate understanding of Dell's fair value, or that it had some special obligation to conduct its own separate going concern valuation prior to retaining those advisors to negotiate a sale transaction.[15]

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[15] The trial court's statement that "the Committee negotiated without determining the value of its best alternative to a negotiated transaction" (Op. 68) is

The evidence also does not support the trial court's threshold premise that an MBO model produces a valuation result meaningfully different than the result achieved through a DCF model. A547 (LBO analysis "incorporate[s] the concept . . . of valuing Dell as a going concern"). The court cited an October 2012 illustrative presentation prepared by J.P. Morgan which reflected different valuation outputs between the two models. Op. 65 ("[T]he very same projections generated lower prices when run through an LBO model than when analyzed using a DCF analysis."). The trial court failed to appreciate that the two illustrations employed different assumptions:

- The MBO illustration assumed an exit multiple equal to the initial EBITDA multiple; the DCF illustration assumed an implied expansion of the EBITDA multiple. *Compare* A1584 ("exit multiple equals entry multiple") with A2615; A1646 (implying multiple expansion based on Gordon Growth Model).
- The MBO illustration assumed repatriation taxes of $2.8 billion; the DCF illustration did not include any such taxes. *Compare* A1582 with A2612-13.
- The MBO illustration reflected $5.5 billion in required cash; the DCF illustration did not account for required cash. A1582; A2612-13.

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inconsistent with the record evidence. A305-07; A1613; A1614-15; A1637; A1754.

The fact that different models employing different assumptions produced different valuations is not surprising, nor is it a sound basis for disregarding the merger price as a reliable indicator of value.[16] In fact, had the same assumptions in the MBO illustration been used in the DCF illustration, the output range would have been $11.76-$13.21 in the DCF illustration – *i.e.*, below the value in the MBO illustration.[17] In other words, the trial court's premise that the MBO model produces a value less than the DCF model is exactly backwards in this case.

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[16] The trial court's theory also does not make economic sense. Because the MBO and DCF models both rely on the same cash flows, they should support the same enterprise value result on a risk-adjusted basis. The primary difference between the MBO and DCF models is that the MBO model assumes a significant increase in leverage post-transaction. According to standard finance theory, the shift to greater reliance on debt in the capital structure should result in both an increased return on equity and a higher level of risk for the equity-holder. Thus, an MBO bidder's demand for a higher return on equity (to compensate for the higher risk) is offset by its ability to finance much of the purchase price with debt and therefore generate a higher return on equity. In focusing exclusively on the demand for higher return on equity in an MBO, the trial court failed to consider the other side of the equation. When both aspects of an MBO are considered, however, it becomes clear that the MBO structure should not impact the price a bidder would pay for any given company. Accordingly, it is not surprising that there is no evidence in the record that bidders using MBO models to determine their bids systematically pay less than fair value, or less than bidders that determine their bids with different models.

[17] This can be seen by (i) recalculating the terminal value in the DCF Model (A2615) using a constant 3.8x EBITDA multiple to match the MBO Model which uses an "exit multiple [that] equals entry multiple" (A1584); and (ii) subtracting $8.3 billion from the enterprise value calculated in the DCF Model to account for repatriation taxes and required cash that are reflected in the MBO Model (A1582).

The trial court also erred in suggesting that the merger price was constrained by limits on available leverage at the time of the merger. Op. 84, 86. Hiltz, the senior Evercore banker, testified that "[c]redit availability was quite good, both in the bank market as well as the junk bond market" at the time of the merger and that "the financing of this transaction was never a significant problem." A525-26; A556-57. Rajkovic, the J.P. Morgan banker, testified that leverage up to $19 per share (*i.e.*, higher than the court's fair value determination) was available at the time of the merger. A3161. There is no record support for the thesis that potential acquirers did not bid up to $17.62 per share because of insufficient available leverage. If Dell's financial prospects supported a valuation $7 billion over the merger price, potential bidders would have been able to obtain financing to pursue a transaction above the merger price. A3316; A3326-27; A556-57.

The trial court abused its discretion in disregarding the merger price on the basis that it resulted from an MBO transaction.

c. The trial court's criticisms of the pre-signing process are unsound and lack record support.

The trial court next erred in disregarding the merger price based on the theory that there was a "lack of meaningful price competition during the pre-signing phase." Op. 78, 82. Although the court acknowledged competition from KKR, TPG, and Silver Lake during that phase, it dismissed that competition as a tool for price discovery on the basis that the pre-signing phase did not include

strategic bidders. Op. 82 ("The lack of any outreach to strategic bidders and the assessment that strategic interest was unlikely meant that the financial sponsors did not have to push their prices upward to pre-empt potential interest from that direction."). The trial court's reasoning was not the product of an orderly and logical deductive process.

This Court has long held "that there is 'no single blueprint' that directors must follow" in a sale transaction. *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 44 (Del. 1994). Including strategic parties in a pre-signing auction is not required where, as here, directors allow for an effective post-signing market check. *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1053 n.7 (Del. 2014). That is particularly true here, as the Committee had been advised that strategic bidders were unlikely to emerge as likely purchasers of Dell. Op. 11-12, 64, 82.

More importantly, the absence of strategic bidders during the pre-signing process does not undermine the reliability of the merger price as an indicator of value. The trial court noted: "it is the presence or realistic threat of competition during this period that drives up the price." Op. 81; *see also Lender Processing*, 2016 WL 7324170, at *18 ("[I]f bidders perceive a sale process to be relatively open, then a credible threat of competition can be as effective as actual competition . . . ."). Here, even without knowing the nature and extent of the competition for

Dell during the pre-signing phase, potential purchasers knew that their bids were going to be subject to further market scrutiny and price discipline during a post-signing go-shop.[18] Blackstone conducted extensive due diligence of Dell, but walked away without bidding due to the "rapidly eroding financial profile of Dell." A2161. The lack of topping bids during the go-shop reflects the market's assessment that the merger price fairly reflected Dell's intrinsic fair value, rather than a price constrained by the absence of strategic bidders during the pre-signing process or the value of the company to one specific bidder. Op. 62. The absence of strategic bidders during the pre-signing process does not explain a $7 billion valuation gap.

d. The trial court's criticisms of the go-shop are unsound and lack record support.

The trial court's criticisms of the go-shop as a tool for price discovery are equally unsound and devoid of record support. The court found that Evercore reached out to more than sixty parties during a go-shop that generated serious indications of interest from Blackstone and Carl Icahn, and inquiries from many other sophisticated parties, including strategic bidders. Op. 27-29. After initially

[18] *See* Brian J.M. Quinn, *Omnicare: Coercion and the New* Unocal *Standard*, 38 J. Corp. L. 835, 844 (2013) ("[K]nowing that a transaction will include a go-shop, wherein the seller will treat the initial bidder as a stalking horse to generate an active post-signing auction, may incent initial bidders to offer a preemptive bid to deter subsequent bids. In that view, the prospect of competition, even if no competition subsequently emerges, should be sufficient incentive for a bidder to shift transaction surplus to the seller.").

characterizing this market check as "good," the trial court reversed course and re-characterized it as proof that the original merger price was inadequate. Op. 85. The critical fact that the trial court disregarded is that while the go-shop produced multiple indications of interest, none ever led to an offer in excess of the merger price.

The trial court incorrectly viewed Blackstone and Icahn as having submitted "topping bids" that "undercut" the fairness of the original merger consideration. Op. 84. In fact, neither made a topping bid: Icahn proposed a leveraged recapitalization, and Blackstone dropped out after submitting only a preliminary indication of interest. Op. 28-29, 32. Blackstone's decision to withdraw from the go-shop process actually supports the integrity of the merger price as a reliable indicator of fair value. In a letter filed with the SEC, Blackstone was clear in its reasons for withdrawing from the sale process: "(1) an unprecedented 14 percent market decline in PC volume in the first quarter of 2013, its steepest drop in history, and inconsistent with Management's projections for modest industry growth; and (2) the rapidly eroding financial profile of Dell." Op. 32; A2161; A2148; A538. Blackstone's decision underscores the real-world assessment that Dell's prospects were faltering and the Company was not worth more than the merger price.

The trial court's other criticism of the go-shop centers on hypothetical concerns advanced by Petitioners' rebuttal expert, Guhan Subramanian. The trial court erred by elevating those academic theories over the actual facts presented in this case, especially in light of its finding that Dell succeeded in minimizing the impact of those concerns. For example, Subramanian testified about structural barriers inherent in go-shops, but the trial court found that the go-shop in this case was "relatively open" and "raised fewer structural barriers than the norm." Op. 89. Subramanian testified as to risk of information asymmetries, but the trial court found no specific information asymmetries and concluded that the Committee "appears to have addressed the problem of information asymmetry . . . as best as they could." Op. 94. Ultimately, Subramanian testified that the crux of his opinion was his view that Mr. Dell's value to the Company would inhibit topping bids if he were not part of the buyout group – a concern nullified by the trial court's finding that Mr. Dell's role was not an "insuperable" impediment to a topping bid as he "was willing to work with other buyout groups" (Op. 97-98; A1050), and by his entry into a voting agreement dictating how he would vote his shares in the event the merger agreement was terminated in favor of a superior proposal. A1892-93. Subramanian's opinion also fails to explain the lack of topping bids from strategic parties.

Several additional reasons limit Subramanian's relevance to this proceeding. Subramanian acknowledged that he never "assessed whether there was a disconnect between the market price and the intrinsic value" of Dell. A979. He did not form an opinion as to the impact that his concerns had on the merger price. A981. Subramanian did not attempt to evaluate whether his concerns represented "a big hill or a small one, big speed bump, little speed bump." A997; A982. Instead, Subramanian conceded that the go-shop in this case was "robust" and has "some probative weight" to Dell's value. A1050. The trial court erred in elevating Subramanian's theoretical, academic, and unquantifiable concerns over the actual facts in this case.

Finally, in discounting the importance of the go-shop, the trial court created a paradigm for fair value that was unattainable in the real world: (i) investors undervalued Dell because of their short-term focus on earnings (Op. 75); (ii) financial sponsors undervalued the Company because they used MBO pricing models (Op. 63-64); and (iii) strategic purchasers passed on $4 billion in potential synergies because of integration risks even when the Company was offered at a $7 billion discount to fair value (Op. 82, 113). That the trial court's valuation so greatly exceeded the market-clearing price suggests that its DCF analysis generated an inaccurate value for Dell. The conclusion that Dell's fair value at the

merger date was an amount $7 billion higher than any real-world entity was willing to pay was illogical, implausible, and clearly erroneous.

e. The trial court's decision creates uncertainty for directors of Delaware corporations.

The trial court's decision presents troubling questions for directors and their advisors with potential fiduciary liability implications. The merger price did not represent the value of Dell to one specific buyer or class of buyers, but rather a market-clearing price achieved after a process that "easily would sail through if reviewed under enhanced scrutiny," Op. 61, *i.e.*, under *Revlon*. Although the *Revlon* and appraisal inquiries are different, well-motivated directors should want to adopt a process that will achieve at least "fair value."

The substantial gap between the merger price and the trial court's valuation decision inevitably throws a pall over directorial decision-making because, depending on the facts and circumstances, boards should not sell at all if the highest value reasonably available may be materially less than the perceived going concern value of the business. If the buyer's use of an MBO model or the absence of strategic bidders in the pre-signing phase suggest that a deal price may represent an amount substantially below what a Delaware court will later determine to be fair value, *compare* Op. n.19, possibly by billions of dollars, the gulf may prevent

directors from approving transactions they deem to be in the best interests of stockholders. [19]

The trial court's decision also subverts the teaching of *Lyondell Chemical Company v. Ryan*, 970 A.2d 235 (Del. 2009). In *Lyondell*, the trial court held that to fulfill *Revlon* duties a board must either conduct an auction, conduct a market check, or demonstrate impeccable knowledge of the market. *Id.* at 242. This Court rejected that approach, holding that "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties." *Id.* at 243. While conceding the satisfaction of *Revlon* duties in this case, the trial court attempted to prescribe steps for directors to achieve fair value. According to the trial court, a sale process that does not involve what the court deems to be an optimal pre-signing competition or involves only financial bidders employing an MBO pricing model will yield transaction prices that should be disregarded in determining fair value.

Regardless of whether personal liability is implicated, no director wants to employ a process that sails through enhanced scrutiny but results in stockholders receiving consideration a Delaware court deems not even close to fair value. To avoid the risk of substantial disparity in value created by the trial court's decision, directors will be forced to conduct sales processes in the manner favored by the

[19] Even where MBO transactions are approved, stockholders may nevertheless have difficulty resisting the pursuit of an appraisal action.

trial court. Independent, sophisticated directors should determine how best to sell their companies, not the trial court.

This Court should rectify the trial court's errors in order to provide sufficient comfort to directors such that they will not deny stockholders the opportunity to receive substantial premia to current share prices out of a concern that they are failing to meet the academically-driven fair value determination mechanism proposed by the trial court.

II. THE TRIAL COURT'S DISCOUNTED CASH FLOW ANALYSIS CONTAINS THREE FUNDAMENTAL MODELING ERRORS THAT NEGATE ITS RELIABILITY AS AN INDICATOR OF FAIR VALUE.

A. Question Presented.

Whether the trial court erred in its determination of fair value pursuant to 8 *Del. C.* § 262 by creating a DCF model that (i) incorrectly accounts for Dell's FIN 48 contingent liability reserve; (ii) credits foreign earnings in its free cash flow calculation but omits offsetting taxes attendant to those earnings; and (iii) assumes that Dell will never pay the U.S. marginal tax rate. Preserved at A4422-24; A4431-38; A4486-89; A4492-95.

B. Scope of Review.

The trial court's "interpretation and application of the mandates in Section 262 . . . presents a question of law . . . [which] must be reviewed *de novo* on appeal." *M.G. Bancorporation*, 737 A.2d at 524 (Del. 1999); *M.P.M. Enters.*, 731 A.2d at 795. The Court should overturn trial court findings that are not supported by the record or are not the product of an orderly and logical deductive process. *Levitt*, 287 A.2d at 673. Findings of fact should be overturned when they are "clearly wrong and justice so requires." *In re Walt Disney*, 906 A.2d at 48.

C. Merits of Argument.

After eschewing any reliance on the merger price, the trial court performed its own DCF analysis to determine Dell's fair value as of the merger

date. The reliability of the trial court's analysis was compromised by three fundamental DCF modeling errors.

1. The Trial Court Erred By Failing to Correctly Account For Dell's FIN 48 Contingent Liability Reserve.

The trial court's first error resulted from its failure to correctly account for an item on Dell's balance sheet – its FIN 48 contingent liability reserve. A FIN 48 reserve measures a company's expected tax obligations relating to *past* positions taken in jurisdictions where it is subject to taxation.[20] It represents a "reserve reflected on the balance sheet in the liability section in accordance with generally accepted accounting principles." A280. FIN 48 is a relatively new requirement that generally creates a material valuation impact only for large, multinational companies that are subject to taxes in multiple foreign jurisdictions.

The trial court appropriately recognized that "it is reasonable to subtract [the FIN 48 contingent liability reserve] as a non-operating liability" when converting from enterprise to equity value. Op. 112.[21] The trial court erred, however, when it deducted only $650 million of that liability on the theory that subtracting the full

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[20] *See* A4364 (Financial Accounting Standards Board, "FASB Interpretation No. 48: Accounting for Uncertainty in Income Taxes," *Financial Accounting Series*, June 2006, ("FASB Interpretation No. 48"), codified as FASB Accounting Standards Codification 740-10-55-3).

[21] *See* Asworth Damodaran, *Investment Valuation* 441 (3d ed. 2012) (there "may be other claims on the firm that do not show up in debt that you should subtract from firm value" and specifically calling out contingent liabilities).

amount "would imply that this court better understands the merits of the Company's tax positions than the Company does . . . ." Op. 111.[22] In reaching this conclusion, the trial court misconstrued the nature of the FIN 48 reserve. Indeed, the trial court's reasoning is exactly backwards.

The parties stipulated prior to trial that Dell's FIN 48 reserve at the time of the merger consisted of $3.01 billion in contingent tax liabilities, penalties, and interest. A98.[23] The amount was not an expert-derived number, but rather it was determined by Dell's management in conjunction with its tax advisors and auditors and reflected in Dell's audited financial statements (both before and after the transaction) and in its ASC 805 Valuation Analysis.[24] A4366-70; A3121; A446-51.

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[22] The trial court erred to the extent that it determined the $650 million figure based on a presentation by Houlihan Lokey. That estimate was provided in connection with a short-term financial solvency analysis and only reflected amounts expected to be paid through 2018. A2727; A452; A471. Houlihan Lokey's estimate was unaudited and determined under the less rigorous FAS 5 standard, which is not permitted as a measure of tax exposure under generally accepted accounting principles. A452-53.

[23] This amount is not discounted because it accrues interest and penalties until paid. A450; A872. In fact, "if you were to actually be discounting, you would discount a stream that's growing at a relatively high interest rate by the default-free, risk-free rate and [the amount of deduction for the reserve] would probably be even higher." A809-10.

[24] Ernst & Young assisted Dell in complying with the business combination accounting requirements for financial reporting purposes under FASB Accounting Standards Codification ("ASC") 805. A2766.

The trial court appears to have erroneously assumed that the $3.01 billion amount reflected Dell's *maximum* exposure in the event that the Company were to be unsuccessful in defending its previously-asserted tax positions. Op. 111-12. Both the technical literature and the evidence presented at trial make clear, however, that the FIN 48 reserve reflects management's best judgment as to the amount of taxes that Dell expects to pay eventually, including interest. A446; A455-56; A807-08; A1091-92; A3393-95. The reserve reflects a probability weighted assessment reflecting only a fraction of the amount sought by the taxing authorities. A446; A455-56; A807-08; A1091-92; A3393-95. As Dell's CFO testified: "what [the taxing authorities] assessed me and what I reserve are two different things." A469.[25]

By failing to deduct the actual reserves reflected on Dell's audited financial statements, the trial court did the very thing that it stated it wished to avoid: substituting its own estimate of the merits of Dell's tax positions for the estimates prepared by the Company and reviewed annually by its auditors. In so doing, the trial court created a model that did not reflect Dell's operative reality.

[25] Under FIN 48, the amount reserved represents the amount that "more likely than not" will be paid, plus interest. A452-53; A4364.

2. The Trial Court Erred By Failing to Account For Dell's Residual U.S. Tax Liability Resulting From Its Foreign Earnings.

The trial court's second error concerned its treatment of undistributed book earnings from Dell's foreign subsidiaries. The parties stipulated, Dell's financial statements reflect, and the trial court found that the Company's undistributed book earnings from its foreign subsidiaries totaled $19 billion at the time of the merger. A93; A1190. If those earnings had been distributed on the merger date, Dell's U.S. tax liability on those earnings would have been $6.3 billion. A4343; A3395; A812; A1073-74; A100. Hubbard estimated that additional deferred taxes of $5.4 billion would accrue during the projection and transition periods, for a combined deferred tax liability of $11.7 billion. He then made the conservative assumption that these deferred taxes would be paid over a 25-year period, which produced a present value liability of $2.24 billion. By contrast, Cornell ignored this issue altogether. A4343; A4363; A3457; A4371-72. The trial court held that because Dell had made an "indefinite" election to reinvest its foreign earnings overseas, it need not account for this liability in its valuation determination. Op. 110.

The trial court's decision to exclude this tax liability from its valuation calculation was not the product of an orderly and logical deductive process. By statute, Petitioners are permitted to recover only their share of the going concern value of Dell. 8 *Del. C.* § 262. That share is bounded by the future stream of

income available for distribution to stockholders. *See Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 329 (Del. Ch. 2006) ("[N]o one should be willing to pay for more than the value of what will actually end up in her pocket."). In other words, as the experts all agreed: "if you can't return your cash flows to investors, you're not going to be worth anything." A236-38; A816; A1079.

Because Dell cannot repatriate its foreign earnings without incurring U.S. tax liability on those earnings, the trial court should have accounted for those liabilities in its DCF model. *See BMC Software*, 2015 WL 6164771, at *13 ("I find it appropriate to include a reasonable offset for the tax associated with repatriating those funds."). To ignore repatriation taxes would overestimate the value of Dell and "lead to a value that no rational investor would be willing to pay." *Del. Open MRI Radiology*, 898 A.2d at 329.

Alternatively, if the trial court's assumption is correct and Dell's foreign earnings will never be repatriated and available for distribution to stockholders, then the court erred by including those earnings in its DCF model. Either way, the court inappropriately credited foreign earnings in its free cash flow calculation without offsetting those amounts by the tax burden directly related to those earnings and profits.

3. The Trial Court Erred By Failing to Apply The Marginal Tax Rate in The Terminal Period.

The trial court also erred in modeling the tax rate used to derive its terminal value. The terminal value is designed to "predict the company's cash flow into perpetuity." *Golden Telecom, Inc.*, 993 A.2d at 511. In deriving that value, a "sound valuation principle" requires that "the net cash flow figure used to generate the terminal value should be normalized." *Orchard Enters.*, 2012 WL 2923305, at *15.[26] A component of the net cash flow figure is the tax rate applied to the terminal period earnings. The trial court mistakenly applied a 21% rate to those earnings, rather than the U.S. marginal rate of 35.8% used by Hubbard.[27] Op. 107.

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[26] *See also Kleinwort Benson Ltd. v. Silgan Corp.*, 1995 WL 376911, at *8 (Del. Ch. June 15, 1995) (rejecting model that "unrealistically extrapolates [respondent's] short run circumstances into perpetuity"); *Cede & Co. v. Technicolor, Inc.*, 2003 WL 23700218, at *18 (Del. Ch. Dec. 31, 2003) ("It does not, however, seem probable that this low level of capital investment would be sustainable into perpetuity."), *aff'd in part, rev'd in part*, 884 A.2d 26 (Del. 2005).

[27] Cornell used the same 21% rate in the perpetuity period that he used for his projection period. Cornell testified that he "didn't make an independent decision that it was an appropriate terminal tax rate" and did not perform any analysis to determine whether Dell's "business and tax strategies will allow it to pay a lower effective tax rate in perpetuity." A268. Instead, he simply took the *projection period* tax rate used by J.P. Morgan and then inserted it into his model as the terminal tax rate. A267-68. In doing so, he disregarded evidence that J.P. Morgan "built in a tax rate circa 20 [percent] in the near term as per the management forecast, and then in our terminal year, we stepped it up to the marginal 35 percent tax rate." A920.

Indeed, it is "overly speculative to apply the current tax rate in perpetuity" because of the "transitory nature of tax deductions and credits." *In re Appraisal of Ancestry.com, Inc.*, 2015 WL 399726, at *20 (Del. Ch. Jan. 30, 2015) (quoting *Henke v. Trilithic Inc.*, 2005 WL 2899677, at *9 (Del. Ch. Oct. 28, 2005)).[28] Tax strategies are deferral strategies, not avoidance strategies. As a result, the finance and academic literature overwhelmingly support use of the marginal tax rate during the terminal period.[29]

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[28] The application of the marginal tax rate during the terminal period does not mean that different tax rates cannot be modeled during other periods.

> If the same tax rate has to be applied to earnings every period, the safer choice is the marginal tax rate, because none of the . . . reasons noted can be sustained in perpetuity. As new capital expenditures taper off, the difference between reported and tax income will narrow; tax credits are seldom perpetual and firms eventually do have to pay their deferred taxes. There is no reason, however, why the tax rates used to compute the after-tax cash flows cannot change over time. Thus, in valuing a firm with an effective tax rate of 24% in the current period and a marginal tax rate of 35%, you can estimate the first year's cash flows using the [effective] tax rate of 24% and then increase the tax rate to 35% over time. It is good practice to assume that the tax rate used in perpetuity to compute the terminal value be the marginal tax rate.

Damodaran, *Investment Valuation*, at 252.

[29] *See* Donald M. DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities* 229-30 (7th ed. 2013) ("It is critical to use the marginal rate in calculating after-tax operating income in perpetuity. Otherwise, the implicit assumption is that taxes can be deferred indefinitely."); Pratap Giri Subramanyam, *Investment Banking: Concepts, Analysis and Cases* 218 (2d ed. 2013) ("[I]t is always the marginal tax rate that has to be used since all deferred tax assets get neutralized over a period of time and the company will eventually pay tax at the marginal rate."); Damodaran, *Investment Valuation*, at 252 ("It is

Here, the trial court acknowledged that "applying the marginal tax rate in most cases has both intuitive as well as academic support" (A1199), but strayed from that sound methodology based on its conclusion that Dell intends to "reinvest its overseas earnings indefinitely in foreign projects." Op. 106. The trial court missed the critical point: whether and when Dell intends to reinvest its overseas earnings is distinct from the question as to the rate at which those earnings are taxed. The marginal rate is the normalized rate that should apply in the terminal period.

Moreover, the unrebutted evidence established that Dell cannot maintain its current 21% effective tax rate indefinitely, as the Company's "significant tax holidays expire in whole or in part during Fiscal 2016 through Fiscal 2022." A2013; A438-39; A1191. Thus, the trial court had no rational basis to model a 21% tax rate during the terminal period.[30] By focusing solely on Dell's operative tax reality at the merger date in 2013 rather than its long-term normalized rate

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good practice to assume that the tax rate used in perpetuity to compute the terminal value be the marginal tax rate."); Tim Koller, et al., *Valuation* 234 n.4 (5th ed. 2010) ("The marginal tax rate used to determine the after-tax cost of debt must match the marginal tax rate used to determine free cash flow.").

[30] Even if the Court were inclined to adopt a single, unitary tax rate across all periods (as some courts have done), that tax rate logically should fall somewhere between the Company's long-term historical rate of 28.1% and the U.S. marginal rate of 35.8%. A795-96; A3372-74; A4209.

during the terminal period, the trial court failed to follow an orderly and logical deductive process in deriving its terminal value.

4. Summary.

Correcting just these three modeling errors in the trial court's DCF analysis results in a fair value determination consistent with the merger price even after assuming all of the court's other modeling assumptions and inputs.

Trial Court DCF	**$17.62**
Less FIN 48 error	($1.34)
Less repatriation tax error	($1.28)
Less marginal tax rate error	($1.71)
Corrected Trial Court DCF	**$13.29**
Merger Price	**$13.75**

CONCLUSION

For the foregoing reasons, under the circumstances presented here, the merger price represents a valuation ceiling. Accordingly, the Court should reverse and determine fair value in an amount no greater than the merger price. Alternatively, the Court should remand this case for a determination of fair value consistent with the instructions of this Court regarding the weight to be accorded to the merger price and consistent with determinations to be made by this Court as to the modeling errors in the trial court's DCF analysis. Dell respectfully submits that the trial court's complete rejection of the merger price is contrary to Delaware law and policy and cannot be allowed to stand.

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