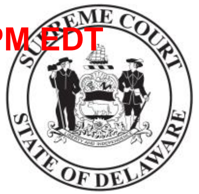
EFiled: Apr 03 2017 09:22PM EDT
Filing ID 60419731
Case Number 565,2016



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

APPELLANT'S REPLY BRIEF ON APPEAL AND
CROSS-APPELLEE'S ANSWERING BRIEF ON CROSS-APPEAL

OF COUNSEL:

ALSTON & BIRD LLP
John L. Latham
Susan E. Hurd
1201 West Peachtree Street
Atlanta, Georgia 30309
Tel.: (404) 881-7000

-and-

ALSTON & BIRD LLP
Gidon M. Caine
1950 University Avenue, 5th Floor
East Palo Alto, California 94303
Tel.: (650) 838-2000

-and-

ALSTON & BIRD LLP
Charles W. Cox
333 South Hope Street, 16th Floor
Los Angeles, California 90071
Tel.: (213) 576-1000

Gregory P. Williams (No. 2168)
John D. Hendershot (No. 4178)
Susan M. Hannigan (No. 5342)
Andrew J. Peach (No. 5789)
RICHARDS, LAYTON & FINGER, P.A.
One Rodney Square
920 North King Street
Wilmington, Delaware 19801
Tel.: (302) 651-7700

Attorneys for Appellant Dell Inc.

Dated: April 3, 2017

TABLE OF CONTENTS

TABLE OF CITATIONS.......... iii

INTRODUCTION.......... 1

SUMMARY OF ARGUMENT ON CROSS-APPEAL.......... 4

ARGUMENT.......... 5

I. THE TRIAL COURT ERRED BY PLACING NO WEIGHT ON THE MERGER PRICE WHEN MAKING ITS FAIR VALUE DETERMINATION IN THIS CASE.......... 5

A. The Trial Court Committed Legal Error By Adopting A Heightened Standard For Consideration Of The Merger Price In Certain Transactions.......... 5

1. This Court Has Never Endorsed A *Per Se* Rule Limiting Valuation Determinations To A Single Methodology.......... 8

2. The Trial Court Applied A Different Standard For The Merger Price Than It Did For Other Methodologies.......... 9

3. The Trial Court Created A Presumption Against The Reliability Of The Merger Price In MBO Transactions. 11

B. The Trial Court Abused Its Discretion By Failing To Place Any Weight On The Merger Price.......... 12

1. The Trial Court's Critical Assumptions And Findings Are Not Supported By The Record.......... 12

2. The Trial Court's Determination Of Fair Value Was Not The Product Of An Orderly And Logical Deductive Process.......... 16

3. The Trial Court's Decision To Place No Weight On The Merger Price In This Case Is Clearly Wrong.......... 20

C. Petitioners Minimize The Policy Implications Resulting From The Trial Court's Decision.......... 22

II. THE FUNDAMENTAL ERRORS IN THE TRIAL COURT'S DISCOUNTED CASH FLOW ANALYSIS NEGATE ITS RELIABILITY AS AN INDICATOR OF FAIR VALUE........................ 25

A. Petitioners Continue To Incorrectly Describe The Accounting Of Dell's FIN 48 Contingent Liability Reserve.................................. 25

B. Petitioners Continue To Ignore The Liabilities Associated With Dell's Foreign Earnings. 28

C. The Trial Court Erred By Failing To Apply The Marginal Tax Rate In The Terminal Period. 30

III. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN DETERMINING THE PROJECTIONS AND OPERATING CASH THAT SHOULD BE USED IN ITS DISCOUNTED CASH FLOW MODEL. 34

A. Question Presented 34

B. Scope of Review.. 34

C. Merits of Argument.. 34

1. The Trial Court Did Not Abuse Its Discretion In Selecting The Projections Used In Its DCF.. 34

2. The Trial Court Did Not Abuse Its Discretion In Determining The Appropriate Amount of Required Operating Cash... 38

CONCLUSION.. 42

TABLE OF CITATIONS

Page(s)

CASES

Barkan v. Amsted Indus., Inc.,
567 A.2d 1279 (Del. 1989) 14

C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust,
107 A.3d 1049 (Del. 2014) 14

Cede & Co. v. Technicolor, Inc.,
684 A.2d 289 (Del. 1996) 6

Cede & Co. v. Technicolor, Inc.,
884 A.2d 26 (Del. 2005) 24

Del. Open MRI Radiology Assocs., P.A. v. Kessler,
898 A.2d 290 (Del. Ch. 2006) 30

Golden Telecom, Inc. v. Global GT LP,
11 A.3d 214 (Del. 2010) 6, 11

Global GT LP v. Golden Telecom, Inc.,
993 A.2d 511 (Del. Ch. 2010) 32

Gonsalves v. Straight Arrow Publishers, Inc.,
701 A.2d 357 (Del. 1997) 6

Henke v. Trilithic Inc.,
2005 WL 2899677 (Del. Ch. Oct. 28, 2005) 31

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) 11

In re Appraisal of Ancestry.com, Inc.,
2015 WL 399726 (Del. Ch. Jan. 30, 2015) 22, 31

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

In re Appraisal of Orchard Enters., 2012 WL 2923305 (Del. Ch. July 18, 2012), *aff'd*, 2013 WL 1282001 (Del. Mar. 28, 2013) 32

In re Appraisal of Shell Oil Co., 607 A.2d 1213 (Del. 1992) 7, 8

In re Toys "R" Us, Inc., S'holder Litig., 877 A.2d 975, 1021 (Del. Ch. 2005) 18, 19

In re Walt Disney Co. Deriv. Litig., 906 A.2d 27, 48 (Del. 2006) 20

Kleinwort Benson Ltd. v. Silgan Corp., 1995 WL 376911 (Del. Ch. June 15, 1995) 33

Levitt v. Bouvier, 287 A.2d 671 (Del. 1972) 16

Merion Capital LP v. BMC Software, 2015 WL 6164771 (Del. Ch. Oct. 21, 2015) 29

M.G. Bancorporation, Inc. v. Le Beau, 737 A.2d 513 (Del. 1999) 5, 6, 41

M.P.M. Enters., Inc. v. Gilbert, 731 A.2d 790 (Del. 1999) 7, 9, 21

Montgomery Cellular Hldg. Co. v. Dobler, 880 A.2d 206 (Del. 2005) 40

Paskill Corp. v. Alcoma Corp., 747 A.2d 549 (Del. 2000) 6

Rapid-American Corp. v. Harris, 603 A.2d 796 (Del. 1992) 6, 16

Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Group, Ltd., 847 A.2d 340 (Del. Ch. 2004) 10, 22

Van de Walle v. Unimation, Inc., 1991 WL 29303 (Del. Ch. Mar. 7, 1991) 21

Weinberger v. UOP, Inc.,
457 A.2d 701 (Del. 1983)..7

STATUTES

8 *Del. C.* § 262 ....6, 8, 10

OTHER AUTHORITIES

William Ciconte et al., *Predictable Uncertainty: The Relation Between Unrecognized Tax Benefits and Future Income Tax Cash Outflows* (Sept. 2016)..27

Aswath Damodaran, *Investment Valuation* (3d ed. 2012) 26, 28, 32

Gaurav Jetley and Xinyu Ji, *Appraisal Arbitrage - Is There a Delaware Advantage?*, 71 BUS. LAW. 427 (Spring 2016) 24

Tim Koller et al., *Valuation* (5th ed. 2010)...13, 26

Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279 (2017) 21

Burton Malkiel, *Reflections on the Efficient Market Hypothesis: 30 Years Later*, 40 FIN. REV. 2 (2005) 13

Shannon Pratt & Roger Grabowski, *Cost of Capital: Applications and Examples* (5th ed. 2014)..26

INTRODUCTION

Petitioners ask this Court to believe that the market wildly mispriced a publicly traded, widely followed Fortune 50 company *for years*. They ask that it believe that a robust transaction process was insufficient to ascertain substantial market inefficiencies. They ask that it believe that sophisticated parties like Carl Icahn and Blackstone reviewed the transaction and simply walked away from more than $7 *billion* in value above the merger price. And, they ask that this Court ignore the trial court's application of an incorrect legal standard, the evidentiary record, and common sense, and affirm an appraisal award 28% above the merger price based on theoretical concerns that conflict with economic reality and the actions of real investors with real money at stake. Petitioners simply ask too much.

The answering brief defends Petitioners' economically irrational position by arguing for a broad presumption against reliance on the merger price as a component of fair value determination in certain transactions, while claiming – *albeit incorrectly* – that Dell is the party seeking bright-line rules for appraisal proceedings. Petitioners' brief ignores precedent holding that the merger price is a strong indicator of fair value where there has been a vigorous transaction process providing for a real world market check, which is exactly what happened here. It defends the trial court's erroneous conclusion that the merger price should be disregarded even following an exemplary process if the court finds that it is not the

"most reliable" indicator of value, if it cannot ascertain with exactitude any sales process mispricing, or if the transaction is structured as an MBO transaction.

Petitioners' continued assault on the market's assessment of Dell's future also extends to their defense of modeling errors in the trial court's DCF analysis, including the trial court's decision to (i) deduct only $650 million for Dell's FIN 48 liability even though the court found, and Dell's audited financials confirm, that the Company determined its probable FIN 48 liability to be $3.01 billion at the merger date; (ii) exclude residual tax liabilities on foreign earnings while simultaneously including those earnings in free cash flow calculations (if foreign earnings are not repatriated, they are unavailable to stockholders); and (iii) select a terminal tax rate which is inconsistent with legal precedent. Petitioners do not dispute that correcting these three errors in the trial court's model results in a fair value determination consistent with the merger price even after assuming all of the trial court's other assumptions and inputs.

Finally, Petitioners contend in their cross-appeal that the trial court abused its discretion by not determining an even *higher* valuation. They reach this incorrect conclusion by challenging well-supported findings concerning the projections used by the trial court in its model and in its determination of required cash.

Dell was not massively undervalued at the time of the merger. A fair reading of the record in this case demonstrates that the merger price represents a valuation ceiling that is consistent with the valuation produced by a properly constructed DCF calculation. Accordingly, this 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 its determinations as to the modeling errors in the trial court's valuation analysis.

SUMMARY OF ARGUMENT ON CROSS-APPEAL[1]

3. Denied. The trial court did not abuse its discretion in determining the appropriate projections to use in its discounted cash flow analysis or the level of cash that Dell required to operate its business at the merger date. Contemporaneous documents and unrebutted trial testimony support the trial court's findings on each of these valuation inputs. *See, infra*, at 34-41.

---

[1] This Summary only addresses arguments in support of Petitioners' Cross-Appeal.

ARGUMENT

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

The trial court committed both legal error and an abuse of discretion by failing to place any weight on the merger price in its valuation determination. *See* Appellant's Opening Brief ("AOB") at 14-42. In their Answering Brief, Petitioners claim that Dell is seeking both a "mandatory rule requiring the trial court to weight the deal price in determining fair value" and a "bright-line rule that so long as the record evidence does not establish that a company's directors breached their fiduciary duties with respect to a sale process, the trial court *must* integrate the deal price into whatever mathematical formula it develops to determine fair value." Petitioners' Answering Brief ("PAB") at 38-39. Dell is not so ambitious: it simply seeks an application of the appraisal statute and this Court's precedent to the facts presented, with real-world evidence taking priority over academic theories that align with the trial court's own views as to how sale processes should be structured and executed.

A. The Trial Court Committed Legal Error By Adopting A Heightened Standard For Consideration Of The Merger Price In Certain Transactions.

This Court reviews *de novo* the trial court's "interpretation and application of the mandates in Section 262." *M.G. Bancorporation, Inc. v. Le Beau*, 737 A.2d

RLF1 17339899v.1

513, 524 (Del. 1999).[2] Nonetheless, Petitioners argue that only the abuse of discretion standard applies. PAB at 36. They claim the conclusion is supported "by even a cursory review of the Memorandum Opinion, which devoted in excess of *fifty pages* to evaluating the reliability of the deal price as an indication of fair value and to explaining the myriad reasons why it was not under the facts here." *Id.* at 37.

To the contrary, the trial court's decision readily reveals the legal error below. 8 *Del. C.* § 262(h) states: "[i]n determining such fair value, the Court shall take into account all relevant factors." When discussing the merger price, the trial court purported to qualify the statutory mandate that all relevant factors be taken into account: "[i]n this case, the final Merger Consideration is certainly a relevant factor, but it is not the best evidence of the Company's fair value." Op. 46. Based, in part, on that finding, the trial court accorded no weight to the merger price in

---

[2] *See also Rapid-American Corp. v. Harris*, 603 A.2d 796, 804 (Del. 1992) (reviewing *de novo* the trial court's finding that adding a control premium in a valuation violated Section 262); *Cede & Co. v. Technicolor, Inc.*, 684 A.2d 289, 300 (Del. 1996) (reviewing *de novo* the trial court's refusal to include in the valuation calculus certain business plans and strategies that were found not to be speculative); *Gonsalves v. Straight Arrow Publishers, Inc.*, 701 A.2d 357, 361 (Del. 1997) (reviewing *de novo* whether the trial court "may adopt an expert's valuation views under a previously announced 'hook, line and sinker' rationale . . . ."); *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 554 (Del. 2000) (reviewing *de novo* the trial court's reliance upon the "net asset value" as the sole criterion for determining fair value); *Golden Telecom, Inc. v. Glob. GT LP*, 11 A.3d 214, 216-17 (Del. 2010) (reviewing *de novo* whether or not the trial court should defer conclusively or presumptively to the merger price).

determining fair value. As set forth in Dell's opening brief, the trial court erred, as a matter of law, by engrafting onto the statutory relevant factors language a "best evidence" requirement that has no basis in Delaware law. AOB at 16-17. The same is true as to the trial court's holding that "[b]ecause it is impossible to quantify the exact degree of the sale price mispricing, this decision does not give weight to the final Merger Consideration." Op. 114.[3]

A merger price that results from an open and fair process is a reliable and widely accepted valuation metric. AOB at 18-19. Thus, the trial court's use of a heightened standard strayed from *Weinberger v. UOP, Inc.*'s teaching that fair value determinations "must include proof of value by any techniques or methods which are generally considered acceptable in the financial community and otherwise admissible in court." 457 A.2d 701, 713 (Del. 1983). This too amounted to legal error.

---

[3] Petitioners' attempt to elide *de novo* review by relying on *In re Appraisal of Shell Oil Co.*, 607 A.2d 1213 (Del. 1992), and *M.P.M. Enterprises, Inc. v. Gilbert*, 731 A.2d 790 (Del. 1999), fails. In neither case did the trial court hold one valuation method to a higher standard of reliability than others. Indeed, in *Shell Oil*, the trial court found that one "seriously flawed" valuation analysis "must be given considerable weight," while another "substantially flawed" analysis was one of "the two most creditable methodologies presented." 607 A.2d at 1219.

1. This Court Has Never Endorsed A *Per Se* Rule Limiting Valuation Determinations To A Single Methodology.

The trial court committed legal error by creating a rule that the merger price should be accorded no weight if it is not the "most reliable" or "best" evidence of fair value. AOB at 15-20. This Court has never endorsed a *per se* rule limiting fair value determinations to a single valuation methodology. Nor has the Court ever decreed that indicators of value should be ignored if they are not the "most reliable" or "best" evidence of fair value. In fact, the Chancellor recently observed that Delaware 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).

Petitioners' response to this straightforward legal error essentially is to ignore it. Instead, they state that "*Shell Oil* makes clear that the trial court does not violate Section 262 simply by failing to accord mathematical weight to a valuation methodology that it considered, but deemed less reliable than the one it did use." PAB at 40. But that is not what the trial court did in this case. The court never considered the weight to be assigned to the merger price because it preempted that analysis based on its conclusion that the merger price was "not the best evidence of

the Company's fair value." Op. 46.[4] Because the deal price supposedly "functioned imperfectly as a price discovery tool," Op. 113, it was excluded from consideration, as opposed to being comparatively assessed along with other price discovery tools, each of which also undoubtedly functions imperfectly. The legal error by the trial court resulted from application of an incorrect legal standard; namely, that a key indicator of value – the merger price – should be disregarded unless it is the single best or most reliable indicator of value. That standard is contrary to Delaware law.

2. The Trial Court Applied A Different Standard For The Merger Price Than It Did For Other Methodologies.

The trial court next committed legal error by according no weight to the merger price "[b]ecause it is impossible to quantify the exact degree of the sale process mispricing" embedded in the merger price. Op. 114. The trial court created a presumption against the merger price that could be employed in virtually every case against every deal price – indeed, against every valuation methodology. The "merger price resulting from arms-length negotiations where there are no claims of collusion is a very strong indication of fair value." *M.P.M. Enters.*, 731 A.2d at 797. Being able to quantify exactly the difference between the merger

[4] *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").

price and fair value has never been the standard for deciding whether to give weight to the merger price in determining fair value. Engrafting an exactitude requirement onto valuation decisions for purposes of Section 262 is fundamentally misguided and constitutes legal error. AOB at 20-24.

Petitioners never address this argument. Nor do they have any response to the trial court's application of a much more forgiving standard of precision to its preferred DCF methodology, which incorporated thousands of subjective, imprecise assumptions about the Company's future performance at a time when the Company (i) was undergoing a significant transformation during a period of well-documented industry upheaval; and (ii) had fallen short of consensus analysts' forecasts in six of the seven quarters immediately prior to the announcement of the proposed merger. Op. 2, 16, 75, 100-02; A3261; A3327.[5] There is nothing whatsoever exact about a DCF analysis.

The trial court's hostility to a market-derived price is particularly troubling given that the projections incorporated into the trial court's valuation model were rooted in the market's collective assessment of Dell's future – the same market that the court assumed for *years* could not properly value the Company. The trial court

[5] *See also Union Ill. 1995 Inv. Ltd. P'ship v. Union Fin. Grp., Ltd.*, 847 A.2d 340, 359 (Del. Ch. 2004) ("[i]n 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").

erred by insisting on exactitude for the negotiated deal price while relying exclusively on another very inexact indicator of value.

3. The Trial Court Created A Presumption Against The Reliability Of The Merger Price In MBO Transactions.

The trial court also committed legal error by effectively holding that the merger price should be accorded no weight if it results from an MBO transaction. AOB at 25-27. The trial court's approach in substance, if not in words, embodies a presumption that the transaction price represents less than "fair value" if the transaction is an LBO, and especially if it is an MBO.[6] That is an improper application of *Golden Telecom*, where this Court declined only to "adopt a standard requiring conclusive or, in the alternative, presumptive deference to the merger price in an appraisal proceeding." *Golden Telecom*, 11 A.3d at 216.[7] It also conflicts with what Petitioners describe as this Court's aversion to "formulaic methods of determining fair value." PAB at 41.

---

6 Such presumption may have the effect of undermining any price certainty in MBO transactions generally.

7 *See also Huff Fund Inv. P'ship v. CKx, Inc.*, 2013 WL 5878807, at *12 (Del. Ch. Nov. 1, 2013) ("The Petitioner's position here, that I should *ignore* the merger price in appraising CKx, is in my view directly at odds with the holding and rationale of *Golden Telecom,* which is that the Court of Chancery has an obligation to consider all relevant factors, and that no per se rule should presumptively or conclusively exclude any of those factors from consideration."), *aff'd*, 2015 WL 631586 (Del. Feb. 12, 2015).

B. The Trial Court Abused Its Discretion By Failing To Place Any Weight On The Merger Price.

The trial court also abused its discretion in this case by disregarding the merger price as an indicator of fair value. AOB at 27-42.

1. The Trial Court's Critical Assumptions And Findings Are Not Supported By The Record.

No evidence supports the trial court's critical assumption that a gap existed for years between Dell's market and intrinsic values. AOB at 27-30. Petitioners point to differences between the market price and valuations tied to management forecasts, but they do not identify any information disparity that would allow the trial court to conclude that those management-driven valuations more accurately reflected Dell's intrinsic value – and the court specifically rejected any argument that Mr. Dell and his management team "sought to create [a] valuation disconnect so that they could take advantage of it." Op. 74-75.

The lynchpin of the court's "valuation gap" theory is a factual finding that cannot withstand even the slightest scrutiny. The trial court stated that a "valuation gap existed because Dell's stockholders were focused on the short-term." Op. 75. How could any court purport to know what motivated the investment decisions of the hundreds of thousands of investors in one of the world's most widely held and actively traded stocks? Indeed, the analyst reports quoted by the trial court itself expressly reflect that those analysts were focused on the long-term and did not buy

into management's optimism about its ability to transform Dell.[8] It is hard to imagine a court ever having an evidentiary basis to find that investors in a widely held company were focused on short-term results, as opposed to long-term prospects, but there certainly is no basis for such a finding here.

As the trial court found, Michael Dell's team "tried to convince the market that the Company was worth more." Op. 75. The difference between the value assigned by the market and the value at which members of Dell's management believed the stock should trade constitutes a difference of opinion, not evidence that management was correct and the dozens of analysts and masses of investors were all wrong. The trial court abused its discretion by rejecting the merger price as a reliable indicator of value based on the factually unsupported assumption that a gap existed for years between Dell's market and intrinsic values.[9]

The trial court further abused its discretion by disregarding the merger price on the basis that the pre-signing phase only included private equity bidders. A

---

[8] *See, e.g.*, Op. 7-8 ("Dell's turnaround strategy is fundamentally flawed [and] the fundamentals are bad. Dell may have responded too late to save itself."), 10 ("55% of all analysts had a hold or sell rating on Dell, . . . the 'technicals [are] ugly,' and . . . investors' concerns included '(1) over half of operating profits still come from deteriorating PC business, and (2) skepticism that Dell can become a successful enterprise player.'").

[9] *See* Tim Koller et al., *Valuation* 370 (5th ed. 2010) ("Scrutiny of the evidence shows that significant deviations from intrinsic value are in fact rare . . . ."); Burton Malkiel, *Reflections on the Efficient Market Hypothesis: 30 Years Later*, 40 FIN. REV. 2 (2005) ("the strongest evidence suggesting that markets are generally quite efficient is that professional investors do not beat the market").

requirement that a pre-signing process must include strategic bidders has no basis in Delaware law and, indeed, conflicts with this Court's instruction that "there is no single blueprint that a board must follow to fulfill its duties." *C&J Energy Servs., Inc. v. City of Miami Gen. Emps.' & Sanitation Emps.' Ret. Trust*, 107 A.3d 1049, 1067 (Del. 2014) (quoting *Barkan v. Amsted Indus., Inc.*, 567 A.2d 1279, 1286 (Del. 1989). Although the trial court speculated about a "lack of meaningful price competition during the pre-signing phase," Op. 78, 82,[10] it ultimately conceded that "it is the presence or realistic threat of competition during this period that drives up the price." Op. 81. In fact, there was such pre-signing competition.[11] Potential purchasers in this transaction also knew that their bids were going to be subject to further market scrutiny and price discipline during a post-signing go-shop.

Finally, there is no evidence to support the trial court's erroneous assumption that the Silver Lake LBO model (or LBO models generally)

---

[10]

[11] The Special Committee did invite bidders into the process during a pre-signing market canvass in which Mr. Dell "encouraged all the bidders to bid as high as they possibly could." AOB at 8-9. After KKR withdrew from the process because it "could not get [its] arms around the risks of the PC business" (Op. 17; A1635), the Special Committee sought out another source of pre-signing competition for Silver Lake, and contacted TPG. Op. 19. Ultimately, TPG also 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." *Id.*; A314-15; A595-96.

necessarily produces a valuation outcome meaningfully different from fair value. Op. 65; A547. Both models assess value based on estimates of future cash flows and costs of debt and equity capital. As such, similar assumptions about cash flows and costs of capital will yield similar valuation conclusions. There is no reason to assume that a bid price prepared using an LBO model will be a less reliable assessment of the present value of the future cash flows than an equity value derived from a DCF model.[12]

Petitioners defend the trial court's analysis by pointing to an October 2012 illustrative presentation prepared by J.P. Morgan that purports to reflect different valuation outputs between the two models. As Dell demonstrated in its opening brief, had the same assumptions been used in the two models, the output range would have been *higher* in the LBO model ($14.13) than in the DCF model ($11.76-$13.21). AOB at 32-33. In other words, the trial court's conclusion that the merger price should be disregarded because the LBO model necessarily produces a lower value than the DCF model is exactly backwards in this case. The fact that two models employing different assumptions produced different

[12] In fact, the Bank Case projections that Petitioners and the trial court champion were based on Silver Lake's LBO model.

valuations is not surprising, nor is it a sound basis for disregarding the merger price as a reliable indicator of value.[13]

2. The Trial Court's Determination Of Fair Value Was Not The Product Of An Orderly And Logical Deductive Process.

The trial court also abused its discretion by failing to engage in an orderly and logical deductive process.[14] The trial court appropriately recognized that " [i]f the merger giving rise to appraisal rights 'resulted from an arm's-length process between two independent parties, and if no structural impediments existed that might materially distort the "crucible of objective market reality,"' then 'a reviewing court should give substantial evidentiary weight to the merger price as an indicator of fair value.'" Op. 47-48 (collecting cases). The trial court then sought to avoid this result by prioritizing theoretical concerns and academic commentary concerning go-shops over record evidence and real world inputs.

Petitioners speculate that Dell's go-shop was insufficient to support reliance on the merger price because "[f]aced with a tight 45 day window in which to diligence a $25 billion deal that had been in the works for months, a rational third-

---

[13] There is no evidence to support Petitioners' companion assumption that access to leverage constrained private equity bidders in this transaction. *See* AOB at 34.

[14] *See Rapid-American Corp.*, 603 A.2d at 802 ("A court abuses its discretion in an appraisal proceeding when its factual findings do not have record support and its valuation is not the result of an orderly and logical deductive process."); *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972).

party bidder *might* see no path to success and simply decide not to start down the path in the first place, even if it thought Dell was worth much more than Silver Lake was willing to pay." PAB at 19 (emphasis added).[15] They advance three arguments in support of that contention, all of which lack merit.

First, Petitioners argue that Michael Dell's status as a "net buyer" impacted the reliability of the merger price because he would be motivated to depress the pricing of bids and discourage topping bids. PAB at 19. The "net buyer" theory is directly contradicted by the trial court's own factual findings. The trial court found that Mr. Dell actively encouraged pre-signing bidders to increase the amounts of their bids. Op. 15. It also found that Mr. Dell cooperated fully with Blackstone during the go-shop in its efforts to present a topping bid, spending more time with Blackstone than any other potential bidder. Op. 31. The trial court concluded that

[15] Petitioners' predicate assumption that bidders confronted a 45-day window in which to complete diligence is factually incorrect. All that was required for a bidder to become an "Excluded Party" was to submit a general outline of the structure of the transaction so that the Special Committee could determine if it "could reasonably be expected to result in a Superior Proposal." Op. 90; A1831; A519-20; A531. An Excluded Party then had months to complete due diligence, arrange committed financing, and negotiate the terms of a definitive agreement. Hiltz testified that no interested party ever suggested that the length of the go-shop was problematic. A525. Indeed, two parties – Blackstone and Icahn – obtained Excluded Party status.

Mr. Dell was not an "insuperable" impediment to a topping bid, as he "was willing to work with other buyout groups." Op. 97-98; A1050.[16]

Second, Petitioners argue that a single match right impacted the reliability of the merger price because it "served as a deterrent to prospective bidders." PAB at 20. A match right is "a common contractual feature that, when assented to by a board fulfilling its fundamental duties of loyalty and care for the proper purpose of securing a high value bid for the stockholders, has legal legitimacy." *In re Toys "R" Us, Inc., S'holder Litig.*, 877 A.2d 975, 1017 (Del. Ch. 2005). If matching rights really raise "a reasonable concern that any material higher bid would be economically irrational, then that suggests that the board got close to the Company's maximum economic value, when measured by fundamental measures of its earning power." *Id.* at 1021.

---

[16] Petitioners continue to take liberties with the record in suggesting that management's decisions to accelerate the transformation from a PC business to an enterprise business had the collateral effect of depressing the Company's stock price. Petitioners do not show that Mr. Dell took any intentional action to drive down Dell's stock price (of which he was the largest individual stockholder), nor do they show that the Company's transformation strategy was not known to the market. Instead, they misleadingly seize upon Mr. Dell's retrospective conclusion that the market did not reward the Company's efforts to enhance stockholder value by accelerating Dell's transformation. A585-86 ("Q. And what was your reaction to the fact that, as the company pursued its transformation, the stock price went down? A. It was frustrating. It was disappointing. It was demoralizing.").

Third, Petitioners' argument further fails because there is no credible evidence to support a finding that structural impediments actually existed in this case and impacted the reliability of the merger price.[17] The real world showed that the academic theory relied on by the trial court was simply wrong. Neither structural impediments nor the size of Dell prevented Blackstone, an ultra-sophisticated investment firm, from making a massive effort to present a topping bid; as it disclosed in a letter to the SEC, the fundamental weakness of Dell's business prevented such a bid. Op. 32; A2161; A2148; A538-39. As to the alleged "winner's curse," Blackstone had no reason to fear that it would outbid the more knowledgeable insider because Michael Dell was willing to join forces with Blackstone. Op. 97. Moreover, as with match rights, any fear of bidding too much with an incrementally higher bid demonstrates the fairness, not the inadequacy, of the merger price. *See Toys "R" Us*, 877 A.2d at 1021 (rejecting winner's curse argument as applied to match rights). Who would be afraid of topping a deal price if the deal actually was, as the trial court concluded, severely underpriced?

[17] Petitioners make much of Subramanian's testimony. A1049. Any reliance on Subramanian's statement or testimony must be tempered by his admission that (i) he never "assessed whether there was a disconnect between the market price and the intrinsic value" of Dell (A979); (ii) he did not form an opinion as to the impact that his concerns had on the merger price (A981); and (iii) the go-shop in this case was "robust" (A1035) and has "some probative weight" as to Dell's value (A1050). In short, Subramanian was unwilling to say that his academic theories supported Petitioners' assertion that Dell was significantly undervalued in the merger.

More troubling, 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 the LBO pricing model (Op. 63-64); and (iii) strategic buyers passed on $4 billion in potential synergies and allowed for the Company to be sold for $7 billion less than its fair value because of "integration risk[s]." (Op. 82, 113). In other words, according to the trial court's theoretical paradigm, nobody in the real world was willing to pay an amount even close to Dell's purported fair value. Elevating theoretical and academic concerns over such real world considerations, as well as over record evidence, was an abuse of discretion.

3. The Trial Court's Decision To Place No Weight On The Merger Price In This Case Is Clearly Wrong.

The trial court's decision to place no weight on the merger price should also be overturned because it is "clearly wrong and justice so requires." *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 48 (Del. 2006).

The median divergence between the merger price and the fair value determined by the Court of Chancery in public company appraisal cases decided over the last twenty years is approximately 9%. AOB at 24 n.11. Those few cases that have resulted in appraisal awards at or above the premium awarded in this case have almost always involved controlling stockholders, no-shops, or significant process defects, none of which is present here. *Id.*

Dell does not contend that a fair process will always result in a fair value determination, nor does it contend that the merger price will always reflect fair value. It does not need to in order to prevail here. Dell does submit, however, that on the adjudicated facts of this case, it was error to accord no weight to the merger price. *See 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"); *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 . . . is viewed as strong evidence that the price is fair.").

Here, the sale process was extensive and arm's-length, and there were no claims or evidence of any collusion. *See* AOB at 7-11. The pre- and post-signing process involved multiple bidders and meaningful price competition. *Id.* There was no evidence of "managerial sloth, incompetence, pressure, or collusion" that could have led to a price not reflective of fair value. *See generally* Charles Korsmo & Minor Myers, *Reforming Modern Appraisal Litigation*, 41 DEL. J. CORP. L. 279, 322 (2017). In light of these circumstances, the trial court's decision to apply no weight to the merger price was "clearly wrong." *M.P.M. Enters.*, 731 A.2d at 797 (merger price relevant when "accompanied by evidence tending to

show that it represents the going concern value of the company rather than just the value of the company to one specific buyer”).[18]

C. Petitioners Minimize The Policy Implications Resulting From The Trial Court’s Decision.

The trial court’s decision presents troubling questions for directors and their advisors with potential fiduciary liability implications. *See* AOB at 40-42. Petitioners dismiss those concerns with general statements concerning the benefits of appraisal that do not provide appropriate guidance or clarity to directors, advisors, or the Court of Chancery.

Applying the trial court’s reasoning, Dell’s Special Committee and Board faced an intractable fiduciary problem. On the one hand, according to the trial court, investors suffered from collective cognitive biases that led them to undervalue the stock substantially, strategic bidders were scared off by integration risk, and financial bidders were unable to pay fair value due to the purported constraints of the LBO model.[19] On the other hand, Dell’s directors believed,

---

[18] *See also Union Ill.*, 847 A.2d at 359 (“[f]or 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”); *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); AOB at 19 n.6 (collecting cases).

[19] Petitioners’ experts testified to *none* of this. There was no expert testimony quantifying even generally the degree to which the stock market allegedly underpriced one of the most widely held and broadly traded stocks in the world, nor even any rebuttal to testimony that Dell traded in an efficient market.

based on an extensive transaction process and the advice of two respected investment banks, that the $13.75 per share offer for the Company was better for the stockholders than the entity continuing as a public company where it had been trading at less than $10 per share. Op. 61; AOB at 7-11.

The trial court's analysis thus places directors in a dilemma: If they believe their companies are undervalued in the market (whether because of undue pessimism, uncertainty about future cash flows, short-termism, integration risk, or any other reason); if they cannot find, or elect for good reason not to seek, strategic bidders; and if they consider a leveraged buyout offer for a price they believe (on the basis of thorough process and expert advice) to be fair, advisable, and better than the status quo, should they take the course they believe to be in the stockholders' best interests, or should they deprive the stockholders of that opportunity because a private equity bid, by definition in the trial court's view, represents less than the fair value of the corporation?

It is no answer to say, as Petitioners do, that directors should think harder about the economics of such a transaction. PAB at 45.[20] Appraisal arbitrage is a

---

Petitioners' experts did not opine as to why Hewlett Packard or other strategic parties elected not to bid for Dell. They did not even attack the price generated through an LBO model as intrinsically unrepresentative of a corporation's fair value.

[20] Petitioners' reference to *Technicolor* makes little sense. PAB at 45 & n.172. The award there exceeded the deal price in large measure because this Court

growing phenomenon, and Petitioners' promise that only the worst of deals will draw appraisal litigation rings hollow.[21]

The interests of the former public stockholders of Dell were represented in the transaction by independent fiduciaries. The trial court found that those directors complied with their fiduciary duties in all respects. The disinterested stockholders of Dell then approved the transaction on an informed basis. More than ninety-eight percent of those stockholders received the merger consideration. And yet, notwithstanding the actions of fiduciaries deemed faithful by the trial court and the vote of informed stockholders, those stockholders now have been told by the very same court that they were dramatically short-changed and should have received more – not a little more, but much, much more. This Court should not validate the injustice created by the appraisal award in this case.

held that the trial court was required to value the subject corporation on the basis of a new operating plan implemented by the acquirer after taking control via a tender offer but before the effective time of the merger. *Cede & Co. v. Technicolor, Inc.*, 884 A.2d 26, 32-34 (Del. 2005) (detailing procedural history). In other words, there was a significant intervening circumstance that made a deal that was entirely fair when the board approved it (and so found after a 47-day trial) become less than fair *before* the merger closed. No such circumstance exists here.

[21] *See generally* Gaurav Jetley and Xinyu Ji, *Appraisal Arbitrage - Is There a Delaware Advantage?*, 71 BUS. LAW. 427, 428-33 (Spring 2016) (noting increase in appraisal actions and discussing economic incentives for appraisal arbitrageurs).

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

The trial court abused its discretion by relying on 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. AOB at 43-52. Petitioners fail to meaningfully address the substantive errors in the trial court's model.

A. Petitioners Continue To Incorrectly Describe The Accounting Of Dell's FIN 48 Contingent Liability Reserve.

The trial court erred in accounting for Dell's FIN 48 contingent liability reserve. *See* AOB at 44-46. The parties stipulated that this liability – *which was reflected in Dell's audited financial statements (before and after the transaction) and in its ASC 805 Valuation Analysis* – was $3.01 billion. A98. The trial court appropriately recognized that it "is reasonable to subtract [the FIN 48 reserve] as a non-operating liability," but then inexplicably deducted only $650 million of that liability on the theory that subtracting the full amount "would imply that this court better understands the merits of the Company's tax positions than the Company does . . . ." Op. 111-12.

Petitioners advance three poorly grounded arguments in defense of the trial court's erroneous conclusion. They first assert that a deduction for this liability is

not appropriate because "[n]o valuation textbook or other authoritative source supports deducting 'contingent tax liabilities' that may never be paid from the value derived via a DCF." PAB at 53. That is not correct. *See* Aswath Damodaran, *Investment Valuation* 441 (3d ed. 2012) (contingent liabilities are "claims on the firm that do not show up in debt that you should subtract from firm value"); Shannon Pratt & Roger Grabowski, *Cost of Capital: Applications and Examples* 542 (5th ed. 2014) ("Liabilities for either current or prior period issues, such as potential judgments or settlements for ongoing litigation, ***proposed or potential adjustments to prior period income taxes*** and environmental cleanup costs, are real liabilities that should be subtracted from the overall business valuation as of the valuation date but are not considered part of the ongoing capital structure of the subject entity.") (emphasis added); Koller, *Valuation*, at 279-80.[22]

Petitioners next argue that the full amount of the FIN 48 liability is "highly uncertain" and, therefore, that the trial court's "decision not to deduct such speculative, contingent 'liabilities' from Dell's net cash is mandated by Delaware law." PAB at 54. Petitioners continue to misconstrue or misunderstand what a FIN 48 reserve represents. As set forth in Dell's opening brief (AOB at 45-46), the FIN 48 reserve reflects management's best judgment as to the aggregate amount of

[22] In its ASC 805 valuation, Ernst & Young followed FASB standards and also recognized that Dell's FIN 48 liability impacts value. A3121.

taxes and interest that Dell expects to pay to resolve disputes with various taxing authorities. 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; A469, A807-08; A1091-92; A3393-95. It does not reflect, as the trial court incorrectly assumed, a maximum liability risk for past tax positions, but rather a "best estimate" of the amount that Dell actually will pay to resolve its disputes with the various taxing authorities. A452-53; A469; A4364; A808.[23]

Petitioners last argue that Dell should not hazard an "unsubstantiated guess about what the trial court 'might have' been thinking" when it erroneously inserted the wrong amount of Dell's FIN 48 reserve into its DCF calculation. PAB at 55. That is exactly the point: the trial court's decision is inconsistent with the evidentiary record and the applicable statute concerning that liability. Accordingly, it does not reflect an orderly and logical deductive process, but rather an abuse of discretion.

---

[23] In a recent study examining confidential proprietary IRS audit settlement data to compare against publicly reported FIN 48 reserves, the authors concluded that FIN 48 reserves "have a dollar-for-dollar relation with the sum of future income tax cash outflows." William Ciconte et al., *Predictable Uncertainty: The Relation Between Unrecognized Tax Benefits and Future Income Tax Cash Outflows* 33 (Sept. 2016). That is not surprising, as the FIN 48 reserve is reviewed annually by the Company's auditors. A446-47; A456; A2737.

B. Petitioners Continue To Ignore The Liabilities Associated With Dell's Foreign Earnings.

The trial court erred in its fair value determination by failing to account for the Company's residual U.S. tax liability resulting from its foreign earnings. *See* AOB at 47-48. The parties stipulated that the amount of taxes due on those foreign earnings equaled $6.3 billion at the merger date and would continue to increase during any periods in which Dell paid less than the marginal rate. A100; A4343; A3395; A812; A1073-74. Hubbard accounted for this accrued and certain liability by spreading it over twenty-five years commencing at the terminal date. A794-96. The trial court erred by not accounting for this liability *at all* in its valuation determination, while still including the untaxed foreign earnings in its cash flow calculation.

Petitioners present scattershot arguments to defend the trial court's omission of this liability, none of which are well grounded. PAB at 55-58. Petitioners first assert that there is "no support in the academic literature for deducting deferred taxes in converting enterprise value to equity value." PAB at 56. Not so. Damodaran included a specific example spreading deferred tax obligations over ten years beginning at the terminal date. *See* Damodaran, *Investment Valuation*, at 254.[24] Petitioners quibble with Hubbard's decision to spread this liability over

[24] *See also id.* at 441 ("The most sensible way of dealing with this item is to consider it an obligation, but one that will come due only when the firm's

twenty-five years beginning in 2023. PAB at 57. By spreading deferred tax payments over 25 years starting at the terminal date, Dell adopted a more petitioner-friendly approach than if Hubbard had discounted the full accrued tax liability all at once in 2023 or spread it over 10 years beginning at the terminal date as suggested by Damodaran. A4343; A3457.

Petitioners next assert that there is no basis to deduct deferred tax liabilities because "Dell had no plans to repatriate its offshore earnings at the time of the MBO." PAB at 56. Petitioners miss the point. As Dell explained in its opening brief, that argument only makes sense if you also *exclude* the earnings associated with those liabilities in the DCF analysis. AOB at 48. The trial court erred by crediting foreign earnings in its free cash flow calculation while completely omitting offsetting taxes attendant to those earnings. *See Merion Capital LP v. BMC Software, Inc.*, 2015 WL 6164771, at *13 (Del. Ch. Oct. 21, 2015) ("I find it appropriate to include a reasonable offset for the tax associated with repatriating those funds.").[25]

---

growth rate moderates. Thus, if you expect your firm to be in stable growth in 10 years, you would discount the deferred tax liability back 10 years and deduct this amount from firm value to get to equity value.").

[25] The fact that such earnings could be invested overseas does not change the fact that those investments will have no value if their earnings stream can never be returned to stockholders – and that requires that U.S. taxes be paid on this money. A236-38; A816; A1079.

Petitioners assert that "Dell had never in its entire history repatriated offshore earnings and profits at the federal marginal rate." PAB at 57. Again, this statement misses the point.[26] For purposes of modeling, some assumption must be made as to the tax rate. Rather than speculating as to future tax changes and potential tax holidays, the proper approach is to use the appropriate rates existing as of the merger date. At the time of the merger, that rate was 35.8%. A1139-40; A1188-89.

Finally, Petitioners assert that "deferred taxes are included in Dell's effective tax rate." PAB at 57. They are wrong. The testimony and evidence established that deferred taxes associated with the unrepatriated foreign profits are not included in the Company's effective tax rate. A814. To ignore repatriation taxes on foreign earnings while simultaneously counting the benefits of those profits would overestimate the value of Dell and "lead to a value that no rational investor would be willing to pay." *Del. Open MRI Radiology Assocs., P.A. v. Kessler*, 898 A.2d 290, 329 (Del. Ch. 2006).

C. The Trial Court Erred By Failing To Apply The Marginal Tax Rate In The Terminal Period.

The trial court erred in modeling the tax rate used in the terminal period in its DCF calculation. *See* AOB at 49-52. Dell previously noted that the finance and

---

[26] Petitioners overstate this point. The evidence only established that Dell repatriated funds at less than the marginal rate during a one-time tax holiday authorized by the government in 2004. A288; A485; A1131.

academic literature overwhelmingly supports use of the marginal tax rate during the terminal period. *Id*. at 50-51. Dell further observed that the Court of Chancery recently reached this same conclusion in an appraisal case, holding that it is "overly speculative to apply the current tax rate in perpetuity" because of the "transitory nature of tax deductions and credits." *Ancestry.com*, 2015 WL 399726, at *20 (quoting *Henke v. Trilithic Inc.*, 2005 WL 2899677, at *9 (Del. Ch. Oct. 28, 2005)).

Rather than confront, or even mention, these authorities, Petitioners ignore them. *First*, they argue that because Dell's effective tax rate was 21% at the time of the merger, a properly constructed DCF must use that same rate in the terminal period. Petitioners cite no authority for the proposition that the projection and terminal tax rate must be identical, nor do they respond to the contrary authority cited in Dell's opening brief. AOB at 50 n.28. As Damodaran explains in his leading valuation treatise:

> 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.[27]

Petitioners' position also fundamentally misconstrues the nature of the terminal period calculation. A discounted cash flow analysis derives its output by summing the present value of a company's cash flows into perpetuity. The incremental cash flows for the projection and any transition period are summed, and then a simplifying convention is used for the remaining period to "predict the company's cash flow into perpetuity." *Global GT LP v. Golden Telecom, Inc.*, 993 A.2d 497, 511 (Del. Ch. 2010); Damodaran, *Investment Valuation*, at 304 ("Since you cannot estimate cash flows forever, you generally impose closure in discounted cash flow valuation by stopping your cash flows sometime in the future and then computing a terminal value that reflects the value of the firm at that point."). In order to use this simplifying convention, cash flows must be "normalized." *In re Appraisal of Orchard Enters.*, 2012 WL 2923305, at *15 (Del. Ch. July 18, 2012), *aff'd*, 2013 WL 1282001 (Del. Mar. 28, 2013). In other words, it is not sufficient to use a model that "unrealistically extrapolates [respondent's] short run

---

[27] Even if it were appropriate to employ a single, unitary tax rate across all periods as the trial court did in this case, the trial court had no rational basis to model a 21% tax rate to perpetuity since the unrebutted evidence established that Dell's "significant tax holidays expire in whole or in part during Fiscal 2016 through Fiscal 2022." A2013; A438-39; A1191. More credibly, any such unitary rate logically should fall between the Company's twenty-five year historical rate of 28.1% and the U.S. marginal rate of 35.8%. A795-96; A3372-74; A4209.

circumstances into perpetuity." *Kleinwort Benson Ltd. v. Silgan Corp.*, 1995 WL 376911, at *8 (Del. Ch. June 15, 1995).

Second, Petitioners' assertion that there is "no reason to assume that all of a sudden, for some unknown reason and beginning precisely in 2023, all of Dell's global income would begin immediately, and into perpetuity, being taxed at the highest marginal tax rate" does not help their argument. PAB at 60. The trial court considered the evidence and concluded that a "three-stage model better captured the operative reality of the Company and the likely schedule for the transformation plan to generate results."[28] Op. 102. Petitioners present no evidence that the trial court abused its discretion in making that determination. The sole issue at that point is the appropriate tax rate to apply in the terminal period. And, on that score, Dell presented compelling, credible, and on-point finance and legal authorities demonstrating that the marginal rate is the proper tax rate to apply in the terminal period. AOB at 50-51.

---

[28] The trial court had sound reasons for reaching this conclusion. The 2023 date allowed for completion of Dell's transformation and normalization of its cash flows. The date also reflected the changing tax landscape resulting from the fact that the Company's "significant tax holidays expire in whole or in part during Fiscal 2016 through Fiscal 2022." A2013; A438-39; A1191.

III. THE TRIAL COURT DID NOT ABUSE ITS DISCRETION IN DETERMINING THE PROJECTIONS AND OPERATING CASH THAT SHOULD BE USED IN ITS DISCOUNTED CASH FLOW MODEL.

A. Question Presented

Whether the trial court abused its discretion in selecting projections and operating cash amounts from the evidence in the record.

B. Scope of Review

The trial court's determination of the appropriate projections to use in its model and the level of required operating cash are reviewed for abuse of discretion. PAB at 61.

C. Merits of Argument

Petitioners ask this Court to increase the fair value determination of Dell to $21.33 – a staggering figure 55% higher than the merger price and more than 100% above Dell's unaffected market price. The trial court did not abuse its discretion in selecting the appropriate projections to use in its model and the level of cash that Dell required to operate its business.

1. The Trial Court Did Not Abuse Its Discretion In Selecting The Projections Used In Its DCF.

The trial court averaged two sets of projections: one derived from projections prepared by the Boston Consulting Group ("BCG") and one based on projections prepared by the acquirer Silver Lake. Op. 100-04. Petitioners contend that the trial court's selection of the former was "not the result of an orderly and

logical deductive process" and was therefore an abuse of discretion. They are wrong.

BCG prepared projections for the Special Committee in January 2013 after being asked to provide an independent and objective view as to the Company's likely future performance if it were to remain a public company. Op. 19. BCG developed and refined a detailed forecast model based on the Company's then-current business mix and geographical distribution. The forecast was predicated on delivering financial performance "given market forces, given the company's position, and if the company continued to perform and continued to execute the strategy that they were in . . . ." A644-45. The trial court found that the "forecasts comported with the evidence presented at trial, in that they projected declining margins for the end-user computing business and increasing margins for the enterprise service and solutions business." Op. 100.

The trial court found that the January 2013 BCG projections were never updated before the merger closed on October 29, 2013. Op. 101. The court also found that the PC market continued to deteriorate over the next ten months before the merger date.[29] These adverse developments required that the experts either

[29] *See* Op. 31 ("On April 10, 2013, [industry analyst] IDC published a report stating that worldwide PC shipments had declined 13.9% year over year and 13.2% quarter over quarter."); 33 ("On May 16, 2013, the Company released its results for the first quarter of FY 2014. . . . GAAP earnings per share fell 81% year over year, and non-GAAP earnings fell 51%."); 37 ("When Evercore

bring the BCG projections forward to the merger date in a manner that preserved the integrity of the BCG model or abandon the BCG model altogether. Hubbard chose the former by updating the IDC market data in the BCG model; the trial court found that his adjustments were "persuasively" supported by the record. Op. 102-03.

Petitioners suggest that a cost-savings program implemented by Dell rendered the BCG projections unreliable. Op. 62. Petitioners leave out the fact that the evidence demonstrated that any cost-savings did not translate into increased cash flow due to eroding margins from price competition. Op. 34; AR263.

Petitioners next claim that adjustments to the January 2013 BCG model were inappropriate since Hubbard "lacked the expertise to understand how a change in industry data for one segment of the Company's business would affect the Company's overall cash flows." PAB at 62-63. The trial court correctly determined otherwise: "Hubbard used current IDC data and maintained the

---

valued the Company in February, it relied on a forecast projecting annual operating income for FY 2014 of $3.7 billion. . . . The first six months of FY 2014 resulted in annualized operating income of $2.2 billion. As a result, Evercore 'had no confidence in' the projections . . . ."); 38 (On August 16, 2013, "IDC issued a public report in which it lowered its five-year forecast for PC shipments to negative 8%."); 101 ("The Company's actual operating income for FY 2014 was more than 36% below the BCG 25% Case.").

dynamic model's mechanics, formula, and internal assumptions." Op. 101; A757; A764. That was not an abuse of discretion.

Petitioners next argue that "it was not possible to simply 'pull out' BCG's PC industry inputs and 'plug in' the August 2013 IDC numbers." PAB at 29. In reaching this conclusion, Petitioners overstate testimony from Lutao Ning of BCG as to whether BCG just inserted the August 2012 IDC forecast when preparing its model in January 2013. Ning's unsurprising acknowledgement that BCG did not just 'plug and play' that stale 2012 data into its January 2013 model does not allow Petitioners to leap the chasm and conclude that the substitution of current IDC data at the merger date was somehow improper. Hubbard did not make adjustments beyond what the IDC data indicated and observed that "BCG actually has a very detailed model to map that in." A758-60.

Petitioners next argue that the January 2013 BCG model "already incorporated a decline in PC sales at a level commensurate with the August 2013 IDC report." PAB 64. Petitioners again confuse the record. BCG was never asked to update its projections after January 2013. Op. 101; A661; A681. When BCG was asked in early May 2013 whether the release of the February 2013 IDC data required an adjustment to the January 2013 BCG forecast, it determined that no adjustment was required because the BCG model anticipated the decline reflected in the quarterly IDC data that was about to be released. Petitioners end

their story there and never account for the further deterioration in the PC market that was reflected in the late-May and August 2013 IDC reports. As the trial court correctly determined, Op. 101, this later data confirmed the continued deterioration in the PC market.

Finally, Petitioners assert that the trial court abused its discretion by adopting attachment rates that were provided by management. Once again, Petitioners' quibble is with the fact that the trial court did not accept their version of the evidence, rather than the fact that such evidence does not exist in the record. Hubbard used the same attachment rate provided to BCG and utilized in Dell's prior management models. Op. 101; A3450-51. The trial court did not abuse its discretion in crediting that evidence and testimony.

2. The Trial Court Did Not Abuse Its Discretion In Determining The Appropriate Amount of Required Operating Cash.

Petitioners challenge the trial court's finding that Dell required $4.2 billion in cash at the time of the merger for working capital and restricted cash. PAB at 66-68.

The trial court was well within its discretion to accept the record evidence concerning Dell's required cash needs. Dell's CFO (Tom Sweet) testified and contemporaneous documents reflect that Dell required at least $5 billion in cash to

support its operations.[30] A431-33; AR48 ("Estimate $5 billion minimum cash balance (including $2 billion restricted cash) is adequate to support operating needs"); AR85 ($5.167 billion required working capital/restricted cash); AR99 ($5.0B "minimum cash balance"); AR3 ($5.0 billion "Cash to Keep"). The trial court also fairly took note that Silver Lake, the party with an incentive to reduce leverage by drawing down cash, left $5.665 billion in cash on the balance sheet immediately after the closing. Op. 109-10; A433; A806-07; AR136.

In pressing their counter-factual position that "there was no reason for the Chancery Court to make any deduction from Dell's cash balance in order to account for the Company's working capital requirements" (PAB at 67), Petitioners advance the same misplaced arguments:

- Petitioners assert that Dell "typically generated sufficient free cash flow from operations to fund its working capital needs." PAB at 67. The trial court did not abuse its discretion in crediting Sweet's testimony that Dell required cash to address mismatches between disbursements and receipts related to (a) the "seasonality" associated with the business, and (b) "geographical friction." A432-33.
- Petitioners assert that "Dell's working capital needs were baked into the

[30] The trial court reduced this amount to $4.2 billion to account for $0.8 billion in restricted cash that Dell was able to access just prior to the merger closing. Op. 110.

Company's own cash flow projections." PAB at 67. The trial court did not abuse its discretion in crediting Hubbard's testimony that "there is sometimes a confusion that if you generate additional cash for working capital in the future, that somehow you don't need cash for your base of working capital. That's just not true." A805-06.

- Petitioners assert that Dell "had access to a line of credit that it used to smooth cash flow fluctuations." PAB at 67. The trial court did not abuse its discretion in crediting Hubbard's testimony that Petitioners' position would be "like canceling your checking account and just using your Visa card. You would typically think of a line of credit as being contingent financing, not your base of working capital." A807.
- Petitioners assert that *post*-merger changes as a private company allowed Dell to reduce its required working capital. PAB at 68. The trial court did not abuse its discretion in crediting Sweet's testimony that those post-closing actions were unappealing in a public company setting because Dell was "concerned from a perception with our investors and analysts around what we called our negative cash conversion cycle." A434-36.

"Delaware law requires that in an appraisal action, a corporation 'must be valued as a going concern based on the "operative reality" of the company as of the time of the merger.'" *Montgomery Cellular Hldg. Co.*

v. Dobler, 880 A.2d 206, 222 (Del. 2005) (quoting *M.G. Bancorporation*, 737 A.2d at 525)).

In the end, Petitioners fail to show that the trial court abused its discretion in finding that Dell required at least $4.2 billion in cash to support its operations.

CONCLUSION

For the foregoing reasons and the reasons set forth in Dell's opening brief, the merger price represents a valuation ceiling under the facts presented in this case. 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. The arguments presented on the cross-appeal should be rejected.

/s/ Gregory P. Williams

Gregory P. Williams (No. 2168)
John D. Hendershot (No. 4178)
Susan M. Hannigan (No. 5342)
Andrew J. Peach (No. 5789)
RICHARDS, LAYTON & FINGER, P.A.
One Rodney Square
920 North King Street
Wilmington, Delaware 19801
Tel.: (302) 651-7700

Attorneys for Appellant Dell Inc.

OF COUNSEL:

ALSTON & BIRD LLP
John L. Latham
Susan E. Hurd
1201 West Peachtree Street
Atlanta, Georgia 30309
Tel.: (404) 881-7000

-and-

ALSTON & BIRD LLP
Gidon M. Caine
1950 University Avenue, 5th Floor
East Palo Alto, California 94303
Tel.: (650) 838-2000

-and-

ALSTON & BIRD LLP
Charles W. Cox
333 South Hope Street, 16th Floor
Los Angeles, California 90071
Tel.: (213) 576-1000

Dated: April 3, 2017