IN THE SUPREME COURT OF THE STATE OF DELAWARE

VIACOM INTERNATIONAL INC., Plaintiff/Counterclaim Defendant-Below, Appellant, v. WALTER A. WINSHALL, in his capacity as the Stockholders' Representative, Defendant/Counterclaim Plaintiff-Below, Appellee.	No. 513, 2012 On appeal from the Court of Chancery of the State of Delaware C.A. No. 7149-CS

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Dated: December 3, 2012

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NATURE OF THE PROCEEDINGS

This appeal is from an order granting summary judgment and confirming an arbitration award. The arbitration determined the Earn-Out Payment Amounts due under an Agreement and Plan of Merger ("Merger Agreement") by which Appellant Viacom International Inc. ("Viacom") acquired Harmonix Music Systems, Inc. ("Harmonix"). Appellee Walter A. Winshall, in his capacity as the Stockholders' Representative ("Winshall"), is the representative of the sellers under the Merger Agreement. Winshall and Viacom agreed that BDO USA, LLP ("BDO") would act as the Resolution Accountants selected under the alternative dispute resolution provisions of the Merger Agreement to render a final, binding, and conclusive resolution of the earn-out disputes.

The Resolution Accountants issued their Determination on December 19, 2011, finding the 2007 Earn-Out Payment Amount to be $234,130,148 and the 2008 Earn-Out Payment Amount to be $298,813,095. A557-58. Both sides agree that this Determination is an arbitration award governed by the Federal Arbitration Act ("FAA"). Only the amount due for 2008 remains in dispute.

Viacom brought this action to set aside the Resolution Accountants' Determination. Winshall filed a counterclaim for confirmation of the award and moved for summary judgment. Viacom filed a cross-motion for summary judgment. The Chancellor issued a Memorandum Opinion on August 9, 2012 ("Mem. Op.," Ex. A to Appellant's Opening Brief ("Op. Br.")), which granted Winshall's motion for summary judgment, confirmed the Determination, and denied Viacom's cross-motion. The Court entered the Final Order and Judgment on August 23, 2012. Ex. B to Op. Br. Viacom filed this appeal on September 17, 2012.

SUMMARY OF ARGUMENT

A. Denied. The Resolution Accountants did not "refus[e] to hear" evidence; all of Viacom's evidence bearing on the Inventory Write-Down was admitted. The Resolution Accountants concluded, based on the language of the Merger Agreement, that Viacom was not entitled to ask for an Inventory Write-Down because that deduction was not included in Viacom's Earn-Out Statement or Winshall's Summary of Issues. The Resolution Accountants' interpretation and application of the contract cannot be second-guessed under the FAA.

B. Denied. The Court of Chancery correctly held that the Resolution Accountants had authority to determine whether an Inventory Write-Down deduction was within the scope of the Earn-Out Statement and the Summary of Issues, and also correctly held that the Resolution Accountants' determination of that issue was subject to the FAA's strict limitations on judicial review.

1. Denied. The Resolution Accountants decided that Viacom's belated request for an Inventory Write-Down did not constitute an "Earn-Out Disagreement" under the terms of the Merger Agreement and therefore could not be submitted in the earn-out proceeding.

2. Denied. Viacom waived its "substantive arbitrability" argument. In any case, the determination by the Resolution Accountants that Viacom did not timely ask for an Inventory Write-Down deduction is a procedural arbitrability ruling subject to the FAA's strict limitations on judicial review.

C. Denied. Even if the Resolution Accountant's decision were reviewed *de novo*, the Chancellor correctly held that Viacom was not entitled to submit the Inventory Write Down in the earn-out proceeding. Viacom admits that its Earn-Out Statement did not request an Inventory Write-Down. Winshall's Summary of Issues did not mention an Inventory Write-Down. Both parties understood that the Inventory Write-Down was not an issue before the Resolution Accountants, which is why Viacom's opening submission did not argue for an Inventory Write-Down.

STATEMENT OF FACTS

A. The Merger Agreement

In 2006, Viacom acquired Harmonix pursuant to the Merger Agreement. A1-86. As part of the purchase price, Viacom agreed to make earn-out payments based on Harmonix's Gross Profit in 2007 and 2008. Section 2.4 of the Merger Agreement established a four-step procedure for resolving disputes about the earn-outs:

> (1) Viacom must deliver Earn-Out Statements to Winshall for both 2007 and 2008. Merger Agreement §§ 2.4(a) and (b), A16-17.
>
> (2) Within 20 days, Winshall must deliver a Summary of Issues describing each disagreement with the Earn-Out Statement. *Id.* Winshall "will not dispute any additional issues or amounts other than the 2007 [or 2008] Summary of Issues...." *Id.*
>
> (3) Winshall and Viacom then negotiate in good faith to resolve the disagreements in the Summary of Issues. *Id.* § 2.4(c), A17-18.
>
> (4) Either side may "submit the unresolved items in such Summary of Issues (the '<u>Earn-Out Disagreements</u>') to the Resolution Accountants…. The scope of the Resolution Accountants engagement (which shall not be an audit) shall be limited to those Earn-Out Disagreements." *Id.*, A17. "The resolution of the dispute by the Resolution Accountants will be a final, binding and conclusive resolution of the parties' dispute, shall be non-appealable, and shall not be subject to further review." *Id.*, A18.

B. Viacom's "Preliminary" Earn-Out Calculations

Before Viacom submitted the Earn-Out Statements required by the Merger Agreement, it provided Winshall with "preliminary"

earn-out calculations. The preliminary calculation for 2007 indicated an earn-out of $149,770,100. A92. In arriving at this sum, Viacom deducted only the costs of products that were sold during 2007; it did not deduct the costs of manufacturing the unsold products in inventory at year-end. A570. In September 2008, Viacom voluntarily paid $149,770,100 in earn-outs to the selling shareholders. *Id.*; Op. Br. at 8 n.2.

Viacom's preliminary calculation for 2008 likewise did not deduct the cost of unsold products in inventory at the end of 2008. It did, however, include a separate deduction of $54.6 million for "Inventory Write-Downs." B11.

C. Viacom's Earn-Out Statements and Winshall's Summary of Issues

In January 2010, Viacom delivered its 2007 Earn-Out Statement, which claimed that no earn-out was due – not even the $149,770,100 it had previously paid. A100. The biggest change (compared to Viacom's preliminary calculation) was that Viacom deducted $42 million as the cost of manufacturing its "Ending Inventory," *i.e.*, the cost of unsold goods. B16. Winshall's 2007 Summary of Issues objected to this deduction, stating: "The contract does not allow Viacom to deduct its year-end inventory when calculating the Gross Profit for the year." A111.

In March 2010, Viacom delivered its 2008 Earn-Out Statement, which claimed that no earn-out was due. A122. Unlike its preliminary calculation, Viacom's 2008 Earn-Out Statement deducted a total of $140 million in ending inventory, but made no mention of a deduction for "Inventory Write-Downs." B21, B26. In fact, Viacom's supporting schedule showed *zero* as the amount of "LCM [Lower of Cost or Market] Reserves." B26. Winshall's 2008 Summary of Issues objected that "the Merger Agreement does not allow Viacom to deduct inventory remaining unsold at the end of the year when calculating the Gross Profit for the year." A128.

D. The Proceeding Before the Resolution Accountants

The Merger Agreement does not specify all of the procedures to be used in Resolution Accountant proceedings, so the parties agreed on a set of procedures in the Engagement Letter with BDO. A137-150. The parties agreed that there would be no testimony, no depositions, no interviews, no affidavits, no experts, no documents introduced into evidence other than those produced by Viacom or publicly available, and no evidentiary hearing. A140. The parties' presentations were limited to two rounds of simultaneous written submissions, followed by a hearing to present arguments and answer questions. *Id*.

In its opening submission, Viacom did not argue for an Inventory Write-Down deduction. It merely alluded to this possibility in *a single sentence* of its 70-page submission, as follows:

> Whether the Earn-Out is determined by including the full variable cost of the unsold inventory as the Agreement provides, or by deducting the cost of writing-down the inventory to its net realizable value, the Earn-Out for 2008 would still be zero.

A182. As the Chancellor observed, "[t]hese cursory references were the whole of [Viacom's] comment about this issue." Mem. Op. at 15. Not until its reply submission (A385-389) did Viacom present an argument for an Inventory Write-Down. "Instead of the tossed-in statement approach it took in its initial submission, Viacom devoted several pages *of its reply* to the issue of the Inventory Write-Down...." Mem. Op. at 16 (court's emphasis).

The engagement letter authorized the Resolution Accountants to submit one set of written questions to the parties. A139. Invoking this authority, the Resolution Accountants sent a letter to both sides, which began by noting "that the Parties have changed their positions regarding certain Earn-Out Disagreements since the 2007 and 2008 Summaries of Issues...." A862. The letter identified (A) three areas in which Winshall had "proposed increases in the

disputed amounts originally presented in either the 2007 or the 2008 Summary of Issues," and (B) six areas in which Viacom had "proposed additional or alternative reductions to its calculation of Gross Profit as originally presented in the 2007 and 2008 Earn-Out Statements." These six items were referred to as "Viacom's Proposed Changes," and one of them was "The Cost of Writing Down the Inventory to its Net Realizable Value." A873-74. The letter then asked: "Have the Parties mutually agreed upon whether the Resolution Accountants may resolve these issues?" A872.

Viacom responded that all of Winshall's Proposed Changes were "untimely" and could not be considered.[1] Viacom told the Resolution Accountants that "under the terms of the Agreement, the SR agreed that he 'will ***not*** dispute any ***additional issues or amounts*** other than the ... Summar[ies] of Issues submitted to [Viacom].'" A888 (emphasis, brackets, and ellipses in original).

Winshall likewise objected to Viacom's six new deductions. With regard to the Inventory Write-Down, Winshall argued that "Viacom is barred on both procedural and substantive grounds.... No such claim is found in Viacom's 2008 Earn-Out Statement, which deducted the full amount of ending inventory rather than any sort of reserve or write-down." A898. On substantive grounds, Winshall explained why "the Merger Agreement does not provide for the deduction of charges taken to write down inventory." A899. Winshall also pointed out that the proposed $54.6 million write-down "was highly suspect, given that it was four times as high as the actual booked reserve at December 31, 2008...." *Id.*.

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[1] *See* A888 ("The SR's modification to the 2007 recoupable advances disagreement is untimely."), A893 ("The SR has no excuse for his untimely modification of the 2008 music advances disagreement."), A894 ("The SR should not be permitted to increase his price protection deduction.").

E. The Resolution Accountants' Determination

On December 19, 2011, the Resolution Accountants issued their Determination, which is 176 pages long. A528-707.

Viacom suggests that the Resolution Accountants relied on GAAP (Generally Accepted Accounting Principles) rather than the contract in deciding that Viacom could not deduct the cost of unsold goods.[2] That is not a fair reading of the Determination, which made clear that "the language of the Merger Agreement is the foundation for this determination regarding Peripheral Costs for Products in Inventory at the End of 2007 and 2008…." A582. The Resolution Accountants held as follows:

> Based on the Resolution Accountants' reading of the Merger Agreement, specifically the full section applicable to Contingent Consideration as well as the definitions of Earn-Out Payment Amounts, Gross Profit, Product Gross Profit, Net Revenue and Direct Variable Costs, the Resolution Accountants agree with the Stockholders' Representative that the language of the Merger Agreement requires the Earn-Out Payment Amounts to be based on Gross Profit which is the sum, for all relevant products, of Product Gross Profit derived from Net Revenue "covering all units of such product received by Customers during the relevant Fiscal Year" less the Direct Variable Costs associated with that Net Revenue. Thus, Peripheral Costs for Products in Inventory at the End of 2007 and 2008 are not appropriate deductions from Gross Profit in those years.

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[2] *See* Op. Br. at 11. In its Complaint, Viacom alleged that "the Resolution Accountants impermissibly substituted their own definitions for the Earn-Out formula and imposed 'accounting' concepts from outside the Merger Agreement rather than using the clear definitions stipulated in the Merger Agreement." B34.

A583. Only after construing the contract did the Resolution Accountants point out that their "reading of the language of the Merger Agreement – which is the foundation of this determination – is also consistent with the well-accepted usage of the term 'gross profit' in accounting and business…." *Id.*

The Resolution Accountants' Determination included a 10-page appendix entitled "Parties' Other Disagreements" (A697-706), which referred to the disputes *not* raised in the Summaries of Issues. The Resolution Accountants concluded that, in the absence of any agreement allowing them to consider additional issues, "only the 'unresolved items' from the 2007 or 2008 Summary of Issues can be the basis for Earn-Out Disagreements to be submitted to the Resolution Accountants." A703. They explained that this conclusion was based on the Merger Agreement's language:

> As the Stockholders' Representative is permitted only one opportunity to submit the 2007 and 2008 Summary of Issues, it follows that there can be only one Earn-Out Statement for each year upon which those Summaries of Issues can be based. As noted above, there is no mechanism evident to the Resolution Accountants for Viacom to submit additional or alternative reductions to Gross Profit once the Parties have identified the Earn-Out Disagreements.

Id.

The Resolution Accountants found that "the 2007 and 2008 Earn-Out Statements provided on January 4, 2010 and March 9, 2010 were clearly understood by Viacom to be the expected basis for the Earn-Out Disagreements." *Id*. As support for this conclusion, the Resolution Accountants cited three facts. First, Viacom had referred to these as the "final" Earn-Out Statements. A703-704. Second, the Engagement Letter, which was the "'the result of painstaking negotiations'.... makes no reference to the possibility that Viacom would amend the Earn-Out Statements for other additional or alternative reductions to Gross Profit...." A704. On the contrary, the Engagement Letter states that "the Parties specifically

do not submit to the Resolution Accountants ... [a]ny other issue not specified in the 2007 Summary of Issues or the 2008 Summary of Issues." A138. Third, in connection with a discovery dispute, Viacom had been able to avoid producing the documents underlying its preliminary earn-out calculations by stating that those calculations were not part of the proceeding. Viacom had stressed "the importance of distinguishing between any preliminary earn-out statements and the final 2007 and 2008 Earn-Out Statements." A704. The Resolution Accountants agreed with Viacom and denied discovery regarding Viacom's preliminary earn-out calculations. A705.

In the final paragraph of their decision, the Resolution Accountants stated that they were "prepared to resolve any or all of the Parties' Other Disagreements if ... it is adjudicated by a court that those disagreements may be asserted under the Merger Agreement and should be resolved by the Resolution Accountants." A706.

F. The Decision Below

The Chancellor rejected Viacom's challenge to the arbitration award under the FAA:

> Viacom argues that it was denied a fair hearing because the Resolution Accountants did not consider the Inventory Write-Down.
>
> Viacom's argument is undermined by the inescapable fact that it had the opportunity to propose the Inventory Write-Down, but chose not to include it as a reduction to Gross Profit in its final 2008 Earn-Out Statement.

Mem. Op. at 37. As a factual matter, the Chancellor found it undisputed that Viacom's Earn-Out Statement did not request an Inventory Write-Down deduction:

> Viacom made no suggestion in the final 2008 Earn-Out Statement or in any of the documents it offered in support of the final Earn-Out Statement that the Inventory Write-Down could be an alternative approach to deducting the costs of unsold products from Net Revenue. In fact, Viacom admitted at oral argument that no documents supporting the Inventory Write-Down were delivered with the final 2008 Earn-Out Statement. What's more, the supporting documents that Viacom provided with the Earn-Out Statement as required by the Merger Agreement were inconsistent with a write-down. An inventory schedule that Viacom provided to Winshall along with the final Earn-Out Statement clearly shows lower of cost or market, or "LCM," reserves of $0. If the inventory was impaired, then reserves equal to the difference between the inventory's cost and market value should have been shown on that schedule.

Id. at 12-13.

The Chancellor also rejected Viacom's argument that it had raised a question of "substantive arbitrability" that should be decided by a court rather than an arbitrator:

> Viacom's belated argument that the Resolution Accountants could not determine whether Viacom presented an issue in accordance with the Merger Agreement's terms ... is telling both in its tardiness and in its inconsistency with Viacom's position when it was before the Resolution Accountants.
>
> * * *
>
> The Resolution Accountants carefully examined which of the arguments were presented properly and which were not, and refused to consider any that they concluded were not presented consistent

> with the contractual procedures. I can find no rational argument why a court, rather than the Resolution Accountants, was required to address these issues. Apparently, Viacom could not conceive of one during the arbitration process itself, and its belated argument that it now recognizes that the Resolution Accountants were acting outside their domain of authority is unconvincing.

Id. at 30-31, 33-34.

Finally, the Chancellor held that if this issue were subject to *de novo* review, he agreed with the Resolution Accountants:

> In sum, by excluding arguments that Viacom and Winshall made that were not fairly raised in the Earn-Out Statement or the Summary of Issues, the Resolution Accountants read the Merger Agreement as I read it. Thus, even if Viacom were entitled to de novo judicial review, which it is not, there would be no basis to deny enforcement of the Resolution Accountants' award.

Id. at 43.

ARGUMENT

I. Viacom Has Not Asserted Valid Grounds for Vacating an Award under the Federal Arbitration Act.

A. Question Presented

Were the Resolution Accountants "guilty of misconduct ... in refusing to hear evidence pertinent and material to the controversy" under Section 10(a)(3) of the FAA?

B. Standard of Review

Winshall agrees with Viacom that this Court reviews *de novo* summary judgments of lower courts confirming arbitration awards. However, Viacom has not addressed the standard of judicial review for arbitration awards.

"The standards for judicial intervention in arbitration proceedings are always narrowly drawn." *Del. Transit Corp. v. Amalgamated Transit Union Local 842*, 34 A.3d 1064, 1067 (Del. 2011). So long as an "'arbitrator is even arguably construing or applying the contract and acting within the scope of his authority,' the fact that 'a court is convinced he committed serious error does not suffice to overturn his decision.'" *Major League Baseball Players Ass'n v. Garvey*, 532 U.S. 504, 509 (2001) (citation omitted). On matters of contract interpretation, an arbitration decision is subject to challenge only "where the arbitrator's reasoning is 'so palpably faulty that no judge, or group of judges, could ever conceivably have made such a ruling....'" *RBC Capital Mkts. Corp. v. Thomas Weisel Partners LLC*, 2010 WL 681669, at *8 (Del. Ch. Feb. 25, 2010) (citation omitted). Furthermore:

> "[A] court's review of an arbitration award is one of the narrowest standards of judicial review in all of American jurisprudence." When "an arbitration award rationally can be derived from either the agreement of the parties or the parties' submission to the arbitrator, it will be enforced."

TD Ameritrade, Inc. v. McLaughlin, Piven, Vogel Sec., Inc., 953 A.2d 726, 732 (Del. Ch. 2008) (citations omitted). *See* Mem. Op. at 25-26 & nn.81-88 for a more comprehensive discussion of the standard of review.

C. Merits

Viacom contends that it was treated unfairly because the Resolution Accountants failed to consider its request for an Inventory Write-Down deduction. But Viacom never explains why it omitted the Inventory Write-Down deduction from its Earn-Out Statement. Viacom was aware of the issue. It had included a separate deduction for "Inventory Write-Downs" in a *preliminary* calculation, but dropped the deduction from its final Earn-Out Statement. Perhaps Viacom concluded that the Write-Downs were not permitted under the Merger Agreement. Perhaps it lacked evidence to support taking that deduction during 2008 (the final earn-out year) rather than 2009 (when Viacom actually booked the Write-Down in its financial statements). Perhaps, having proposed an even bigger deduction, Viacom did not want to offer the Resolution Accountants a middle ground. Regardless of its reasons, the fact remains that Viacom made a conscious decision not to include an Inventory Write-Down deduction in the Earn-Out Statement it delivered pursuant to the Merger Agreement.

Viacom invokes Section 10(a)(3) of the FAA, which provides that a court may set aside an arbitration award "where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced." 9 U.S.C. § 10(a)(3).

Section 10(a)(3) deals with procedural irregularities, but there were none here. The Resolution Accountants did not "refus[e] to hear evidence." Viacom concedes that it "presented evidence of the cost of writing down the diminished value of the unsold inventory" and that the "Resolution Accountants acknowledged Viacom's evidence." Op. Br. at 1, 2. Viacom was afforded

a full opportunity to present its arguments. Indeed, the Resolution Accountants gave Viacom an extra opportunity when they requested additional submissions after observing "that the Parties have changed their positions regarding certain Earn-Out Disagreements since the 2007 and 2008 Summaries of Issues…." A862. Both sides were asked to explain their positions regarding the "significant areas of dispute between the Parties regarding the issues and amounts appropriately before the Resolution Accountants as Earn-Out Disagreements." A551.

Thus, Viacom's quarrel is not with an evidentiary ruling, but rather with the Resolution Accountants' determination of what issues the parties had timely and properly designated as "Earn-Out Disagreements" pursuant to the Merger Agreement. As the Chancellor explained, "the Resolution Accountants interpreted the Merger Agreement as limiting both the acquirer and the selling stockholders to the arguments raised in their Earn-Out Statement and Summary of Issues." Mem. Op. at 2.

Section 10(a)(3) is not a vehicle for reviewing an arbitrator's interpretation of the contract. By its terms, the statute applies to "misconduct" and "misbehavior" by an arbitrator that unfairly denies a party the opportunity to present evidence. For instance, Viacom cites *Teamsters Local 312 v. Matlack, Inc.*, 118 F.3d 985, 996 (3d Cir. 1997), where the arbitrator "decid[ed] the merits of the controversy after advising the parties that he would not do so until after he decided the procedural issues," thus depriving a party of the opportunity to present evidence; *Gulf Coast Indus. Workers Union v. Exxon Co., USA*, 70 F.3d 847, 850 (5th Cir. 1995), where the arbitrator "prevented Exxon from presenting additional evidence by misleading it into believing that [certain drug tests] had been admitted," and then "us[ing] Exxon's failure to present evidence that he told Exxon not to present as a predicate for ignoring the test results"; *Teamsters, Chauffeurs, Warehousemen & Helpers, Local Union No. 506 v. E.D. Clapp Corp.*, 551 F. Supp. 570, 578 (N.D.N.Y. 1982), where "the Union was not given an opportunity to complete its presentation of proof...."; and *Tempo Shain Corp. v. Bertek, Inc.*, 120 F.3d 16, 17-18 (2d Cir. 1997), where the arbitrators refused to keep the record open for the testimony of a

key witness, who was unavailable on the hearing date due to his wife's cancer diagnosis.

As Viacom's own cases recognize, § 10(a)(3) does not apply when arbitrators rule that particular issues are irrelevant under their view of the case, or subject to a procedural defense, and for that reason decide not to consider the evidence bearing on those issues. *See Century Indem. Co. v. Certain Underwriters at Lloyd's, London*, 584 F.3d 513, 559 (3d Cir. 2009) (confirming award where "the panel considered the evidence and concluded, after receiving written submissions regarding its substance and relevance, that it was irrelevant, a finding that was within its authority to make"); *Newark Stereotypers' Union No. 18 v. Newark Morning Ledger Co.*, 397 F.2d 594, 600 (3d Cir. 1968) (holding that arbitrators were not required to hold "an inquiry or investigation for the general purpose of exposing the misconduct of the company," which "was peripheral to the issue of fact ... before the arbitrators for decision"); *Grynberg v. BP Exploration Operating Co.*, 938 N.Y.S.2d 439, 440 (N.Y. App. Div. 2012) ("We reject petitioners' argument that the arbitrator was required to hear expert valuation evidence…; the arbitrator's findings of fact rendered such evidence moot.").

Viacom states that "Section 10(a)(3) of the FAA is designed to ensure the fundamental fairness of alternative dispute resolution proceedings and provide relief in cases of severe prejudice." Op. Br. at 14. But there was no unfairness here. Viacom is complaining of its own self-inflicted wound in failing to present its arguments at the proper time. It deliberately chose *not* to ask for an Inventory Write-Down in its Earn-Out Statement. It chose *not* to argue for an Inventory Write-Down in its opening submission, and merely alluded to that possibility in a single sentence. And it *successfully* urged the Resolution Accountants not to consider any disputes or amounts that Winshall failed to include in his Summary of Issues.

If Viacom had believed that its Inventory Write-Down deduction was one of the pending Earn-Out Disagreements, surely it would have made a serious argument on such a huge issue in its

opening submission. If, on the other hand, Viacom's strategy was to save the point for its reply submission, leaving Winshall unable to respond, the Resolution Accountants had no obligation to permit sandbagging, just as the courts of Delaware do not tolerate such tactics. *See, e.g.*, *Saudi Basic Indus. Corp. v. Mobil Yanbu Petrochemical Co.*, 866 A.2d 1, 20 (Del. 2005); *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213 (Del. 2012).

Viacom was not treated unfairly.

II. The Chancellor Correctly Deferred to the Resolution Accountants' Determination That the Inventory Write-Down Was Not an "Earn-Out Disagreement" under the Merger Agreement.

A. Questions Presented

Did the Resolution Accountants determine that the Inventory Write-Down was not an Earn-Out Disagreement under the Merger Agreement? Did Viacom waive its argument that this was a "substantive arbitrability" ruling? Did the Chancellor err in finding that this decision was a matter of "procedural arbitrability" entitled to judicial deference?

B. Standard of Review

Winshall agrees with Viacom that these questions are subject to *de novo* review.

C. Merits

1. The Resolution Accountants determined that the Inventory Write-Down was not an Earn-Out Disagreement under the Merger Agreement.

Viacom concedes that the Resolution Accountants had the authority under the Merger Agreement to make a final, binding decision of the Earn-Out Payment Amounts Due. The Resolution Accountants did indeed decide that issue, finding that the 2008 Total Earn-Out Payment Amount Due is $298,813,095. A533.

In reaching that decision, the Resolution Accountants needed to decide – and did decide – whether they could consider certain claims that (A) were raised by the parties in their written submissions but (B) were not "Earn-Out Disagreements" as defined in the Merger Agreement. Section 2.4(c) of the Agreement plainly states that "[t]he scope of the Resolution Accountants

engagement (which shall not be an audit) shall be limited to the resolution of the Earn-Out Disagreements…." A17-18.

The Resolution Accountants concluded that "the Merger Agreement defines 'Earn-Out Disagreements' as part of a process which has no mechanism evident to the Resolution Accountants for Viacom to make changes to the 2007 and 2008 Earn-Out Statements once the Parties have submitted the Earn-Out Disagreements to the Resolution Accountants." A702. The Resolution Accountants carefully explained why this decision followed from the language of the Merger Agreement. A702-03.

In addition, the Resolution Accountants made a factual finding that Viacom's 2008 Earn-Out Statement was "clearly understood by Viacom to be the expected basis for the Earn-Out Disagreements." A703. Viacom does not dispute that factual finding, which was based on a reading of Viacom's Earn-Out Statement, the terms of the Engagement Letter, and the position taken by Viacom in successfully opposing discovery regarding its preliminary earn-out calculations. A703-05*; see supra* Section E of the Statement of Facts.

Prior to the hearing, the Resolution Accountants identified a number of areas where one side or the other had sought to raise additional (or increased) items beyond those found in Viacom's Earn-Out Statements and Winshall's Summaries of Issues. "These disagreements, which are not considered part of the Earn-Out Disagreements, are collectively referred to as the 'Parties' Other Disagreements.'" A701. One of those items was "The Cost of Writing Down the Inventory to its Net Realizable Value." *Id.* The Resolution Accountants asked if both sides consented to the consideration of the Parties' Other Disagreements, and both sides said no. The Resolution Accountants therefore concluded that they had no authority to consider the Parties' Other Disagreements. "Neither the Merger Agreement nor the subsequently negotiated Engagement Letter provided for the … expansion of the scope of the Resolution Accountants." A705.

In the final paragraph of their decision, the Resolution Accountants recognized the possibility that a court might later disagree with their reading of the Merger Agreement, and thus stated that they "are prepared to resolve any or all of the Parties' Other Disagreements if: (1) the Parties subsequently agree to permit the Resolution Accountants to do so, or (2) it is adjudicated by a court that those disagreements may be asserted under the Merger Agreement and should be resolved by the Resolution Accountants." A706.

Contrary to Viacom's suggestion, this statement by the Resolution Accountants that they were available for additional assignments did not erase the preceding explanation of their ruling. As the Chancellor pointed out:

> The Resolution Accountants' offer to revisit these issues is merely an echo of their agreement in the Engagement Letter that they would only consider issues other than the Earn-Out Disagreement if the parties agreed to it or a court ordered them to do it. The fact that the Resolution Accountants included this language does not change the fact that they addressed the procedural question of what was properly before them, and decided that the Inventory Write-Down was outside the scope of those issues.

Mem. Op. at 40.

2. Viacom waived its "substantive arbitrability" argument.

Viacom has *doubly* waived its argument that the Resolution Accountants lacked authority to decide the "arbitrability" of the Inventory Write-Down – first, by the position Viacom took before the Resolution Accountants, then by not preserving it in the court below.

During the arbitration proceedings, Viacom never questioned the authority of the Resolution Accountants to decide the arbitrability of the Inventory Write-Down. At no point did Viacom contend that this issue had to be decided by a court. Although Viacom now says that it never agreed to let the Resolution Accountants decide arbitrability questions, when the issue arose it affirmatively *urged* the Resolution Accountants to make rulings on arbitrability – specifically, to rule that Winshall could not ask for increased disallowances beyond the amounts specified in his Summary of Issues. As the Chancellor noted:

> The inconsistency of Viacom's position is even more telling. Before the Resolution Accountants, Viacom argued that Winshall was stuck with the arguments he raised in this Summary of Issues, and that the Resolution Accountants could not consider arguments that Winshall made that were not within that Summary of Issues. Why? Because the Merger Agreement said that the Resolution Accountants were supposed to decide the Earn-Outs on the basis of the procedures in the Merger Agreement, and specifically on the basis of the dispute as framed by Viacom's Earn-Out Statement and Winshall's Summary of Issues in response to it. Viacom won before the Resolution Accountants on that argument.

Mem. Op. at 32.

By not raising the arbitrability issue before the Resolution Accountants, Viacom waived the point. *See Howard Univ. v. Metro. Campus Police Officer's Union*, 512 F.3d 716, 720 (D.C. Cir. 2008) ("[A] party that does not object to the arbitrator's jurisdiction during the arbitration may not later do so in court."); *United Indus. Workers v. Gov't of the V.I.*, 987 F.2d 162, 167-69 (3d Cir. 1993); *Jones Dairy Farm v. Local No. P-1236, United Food & Commercial Workers Int'l Union*, 760 F.2d 173, 175-76 (7th Cir. 1985); *see also DMS Properties-First, Inc. v. P.W. Scott*

Assocs., Inc., 748 A.2d 389, 392-93 (Del. 2000).[3] Furthermore, because it *successfully* urged the Resolution Accountants to decide arbitrability issues, Viacom is judicially estopped from arguing that the Resolution Accountants lacked such authority. Judicial estoppel "prevents a litigant from advancing an argument that contradicts a position previously taken that the court was persuaded to accept as the basis for its ruling." *Motorola Inc. v. Amkor Tech., Inc.*, 958 A.2d 852, 859 (Del. 2008). It is "widely held that a position taken in an arbitration can give rise to judicial estoppel." *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara*, 264 F. Supp. 2d 490, 498 n.9 (S.D. Tex. 2003); *accord Lydon v. Boston Sand & Gravel Co.*, 175 F.3d 6, 12-13 (1st Cir. 1999); *In re Cohn-Phillips, Ltd.*, 193 B.R. 757, 765 (Bankr. E.D. Va. 1996).

Viacom has tried to turn this issue around by arguing that Winshall did not object to the Inventory Write-Down until "the very last minute." Op. Br. at 2. But Viacom never argued for an Inventory Write-Down deduction until its *reply* submission. In any event, if Viacom had wanted to argue that Winshall waived his procedural objections to an Inventory Write-Down, it was required to present that argument to the Resolution Accountants. By failing to do so, Viacom has "waived waiver." *See Norwood v. Vance*, 591 F.3d 1062, 1068 (9th Cir. 2010), *cert. denied*, 131 S.Ct. 1465 (2011); *United States v. Boudreau*, 564 F.3d 431, 435 (6th Cir. 2009); *In re Brand Name Prescription Drugs Antitrust Litig.*, 186 F.3d 781, 790 (7th Cir. 1999); *United States v. Layeni*, 90 F.3d 514, 522 (D.C. Cir. 1996).

In addition to its waiver during the Resolution Accountant proceeding, Viacom waived the "substantive arbitrability" point in the court below because it made "only a passing and confusing

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[3] In *DMS*, this Court held that the appellant had preserved its right to challenge the panel's authority to decide substantive arbitrability because, when the issue arose during the proceeding, the appellant had "argued that the issue of arbitrability could not be decided by the arbitration panel." *Id*. at 392.

reference to this argument in its opening brief." Mem. Op. at 31. Viacom's opening brief did not contain a genuine argument about substantive arbitrability. *See* A992 & n.5. Indeed, it did not cite the *HDS*, *Nash*, or *Avnet* cases that are the centerpiece of Viacom's argument in this Court. *See* Op. Br. at 20-26. "The failure to raise a legal issue in the text of the opening brief generally constitutes a waiver of that claim on appeal." *Murphy v. State*, 632 A.2d 1150, 1152 (Del. 1993); *see also Emerald Partners v. Berlin*, 726 A.2d 1215, 1224 (Del. 1999).

3. The Resolution Accountants' finding that Viacom did not properly raise the Inventory Write-Down was a "procedural arbitrability" ruling entitled to deference.

The distinction between "substantive" and "procedural" arbitrability is important because an arbitrator's rulings on questions of procedural arbitrability are subject to the same high degree of deference, and the same limitations on judicial review under the FAA, as rulings on the merits. *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 943 (1995).

The U.S. Supreme Court has made it clear that the procedural category includes disputes about "whether prerequisites such as *time limits*, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met…." *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 85 (2002) (emphasis in original) (holding that an arbitrator, rather than a court, should decide timeliness of claim). "Once it is determined ... that the parties are obligated to submit the subject matter of a dispute to arbitration, 'procedural' questions which grow out of the dispute and bear on its final disposition should be left to the arbitrator." *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543, 557 (1964) (holding that an arbitrator, rather than a court, should decide whether the procedural prerequisites to arbitration were satisfied).

This Court has likewise recognized that, "[g]enerally, resolution of procedural questions, including whether the invocation of arbitration was proper or timely, commonly referred to as 'pro-

cedural arbitrability,' is left to the arbitrator." *SBC Interactive Inc. v. Corporate Media Partners*, 714 A.2d 758, 762 (Del. 1998). The issue in *SBC Interactive* was whether a party lost the right to arbitrate because it had not complied with the contractual requirement to submit a notice of arbitration within 10 days after the conclusion of negotiations. This Court upheld the lower court's ruling that the arbitrator should decide the point: "once arbitrability of the underlying dispute is determined, procedural defenses, including timeliness, also fall within the scope of the arbitration." *Id.* at 761-62.

Substantive arbitrability, by contrast, deals with the threshold questions of whether an arbitration clause is valid and whether it applies to a particular kind of dispute. *DMS Properties-First*, 748 A.2d at 391. As this Court explained in *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 79 (Del. 2006):

> Substantive arbitrability issues are gateway questions about the scope of an arbitration provision and its applicability to a given dispute. The court presumes that parties intended courts to decide issues of substantive arbitrability. The opposite presumption applies to procedural arbitrability issues, such as waiver, or satisfaction of conditions precedent to arbitration.

In the present case, both sides agree that the "underlying dispute" – *i.e.*, the Earn-Out Payment Amount – was for the Resolution Accountants to decide. Furthermore, both sides agree that *only* the Resolution Accountants, and not the court, had authority to decide the merits of an Inventory Write-Down deduction. Consequently, there is no question of substantive arbitrability here. The issue is purely procedural – whether Viacom's submission of its Inventory Write-Down claim was timely, proper, and in accordance with the contractual requirements. The authority to decide such questions is an inherent part of the Resolution Accountants' power to render a "final, binding and conclusive resolution of the parties' dispute" pursuant to § 2.4(c) of the Merger Agreement. A18.

Viacom's attempt to force the Resolution Accountants to consider new issues – raised outside the scheme established by the Merger Agreement – would create a procedural nightmare. According to Viacom, "nothing in … the Merger Agreement empowered the Resolution Accountants here to decide that Viacom's purported 'additional' or 'alternative' Earn-Out deduction could not be considered by them." Op. Br. at 21. But what were the Resolution Accountants supposed to do when Viacom asked for *six* new deductions not found in its Earn-Out Statements? Should they have adjourned the proceedings so that the issue could be litigated in the Court of Chancery, followed by *de novo* review in this Court? The Chancellor rightly condemned the specter of "running back and forth between the courts and arbitrator" (Mem. Op. at 33), for it would defeat "arbitration's essential virtue of resolving disputes straightaway." *Hall St. Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 588 (2008).

Viacom offers three arguments in support of its challenge to the Resolution Accountants' authority. First, it suggests that BDO should not have resolved "legal issues" because their "institutional competence … is as experts in examining accounting issues." Op. Br. at 24. Yet the specific issue raised by Viacom – whether an Inventory Write-Down is required by the same "GAAP-related accounting principles" that Winshall supposedly advocated (*id.* at 29) – is more appropriately decided by accountants than lawyers. But even if the issue were legal, "[s]ophisticated accounting firms like BDO – the Resolution Accountants here – have access to lawyers." Mem. Op. at 35-36. When Viacom agreed that the Resolution Accountants would decide the Earn-Out Payment Amount, it necessarily agreed that they would decide any legal issues that might arise. Indeed, the Court of Chancery has often upheld the authority of arbitrators to decide timeliness and other procedural questions even when the arbitrators were technical experts rather than traditional lawyer-arbitrators. *E.g., AHS New Mexico Holdings, Inc. v. Healthsource, Inc.*, 2007 WL 431051, at *7 (Del. Ch. Feb. 2, 2007) (accountant-arbitrator has "sufficient authority to consider whether Healthsource can demonstrate that its seemingly untimely adjustment meets the notice requirements"); *Mehiel v. Solo Cup Co.*, 2005 WL

3074723, at *3 (Del. Ch. Nov. 3, 2005) (Neutral Auditor's determination that proposed adjustments were untimely was found by the court to be "final, binding, and conclusive"); *SRG Global, Inc. v. Robert Family Holdings Inc.*, 2010 WL 4880654 (Del. Ch. Nov. 30, 2010) (Environmental Expert should decide whether seller had satisfied contractual requirements for disputing buyer's claim).

Next, Viacom contends that three Court of Chancery decisions – *HDS*, *Nash*, and *Avnet*[4] – stand for the principle "that whether an 'untimely' submission should be considered … is a matter of 'substantive arbitrability' to be decided by the court." Op. Br. at 22. As explained below, that is not a fair reading of those cases. Moreover, such a reading would place those cases squarely in conflict with this Court's decision in *SBC Interactive* and the U.S. Supreme Court's decision in *Howsam*, both of which treated timeliness as procedural. Indeed, a number of Court of Chancery cases recognize that the procedural category includes whether "prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met." *MESO Scale Diagnostics, LLC v. Roche Diagnostics GmbH*, 2011 WL 1348438, at *15 (Del. Ch. April 8, 2011); *accord Brown v. T-Ink, LLC*, 2007 WL 4302594, at *12 (Del. Ch. Dec. 4, 2007) (arbitrator should decide "whether the June 13 Letter provided adequate notice" under the arbitration clause).

HDS does not help Viacom because that was a case where *both sides* asked the court to decide whether the arbitrator could consider a late submission.[5] Nor is Viacom helped by *Nash* or

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[4] *HDS Inv. Holding Inc. v. Home Depot, Inc.*, 2008 WL 4606262 (Del. Ch. Oct. 17, 2008); *Nash v. Dayton Superior Corp.*, 728 A.2d 59 (Del. Ch. 1998); *Avnet, Inc. v. H.I.G. Source, Inc.*, 2010 WL 3787581 (Del. Ch. Sept. 29, 2010).

[5] "Both parties argue that this Court should decide the issue of whether the neutral auditor is permitted to consider the March 28, 2008 Revised Closing Statement that was submitted later than the allotted ninety days after the Closing Date." *HDS*, 2008 WL 4606262, at *7. "The most efficient way to proceed is for the

Avnet because those cases did not *decide* whether the timeliness issue should be submitted to the arbitrator; they merely deferred ruling on that point, finding that the issue could not be resolved on the pleadings.[6] Indeed, the author of the *Avnet* opinion (Vice Chancellor Parsons) has left no doubt that timeliness issues are normally matters of procedural arbitrability:

> Questions of procedural arbitrability deal with whether the parties have complied with the terms of the arbitration clause. For example, a contract might provide that to arbitrate a dispute a party must provide notice to another party within ten days of some event. Whether a party satisfied that requirement would pose a question of procedural arbitrability. There is a presumption that questions of procedural arbitrability will be handled by arbitrators and not by courts.

Carder v. Carl M. Freeman Cmtys., LLC, 2009 WL 106510, at *3 (Del. Ch. Jan. 5, 2009) (footnotes omitted).

Finally, Viacom argues that "rulings on arbitrability are not entitled to deference where the parties did not 'clearly agree' to arbitrate arbitrability." Op. Br. at 19, *quoting DMS Properties-First, Inc. v. P.W. Scott Assocs., Inc.*, 748 A.2d 389, 391 (Del. 2000). But the *DMS* opinion did not discuss *procedural* arbitrability. Rather, it held that rulings about "the validity of an arbitration agreement," which it classified as "substantive arbitrability,"

Court to decide the contractual issues before the parties proceed with arbitration." *Id.* at *9.

[6] *See Nash*, 728 A.2d at 63-64 ("There is, at least potentially, a factual question as to whether the parties intended the arbitration process to permit Dayton Superior to revise the Closing Balance Sheet…."); *Avnet*, 2010 WL 3787581, at *11 ("I cannot conclude on a motion for judgment on the pleadings that the underlying disputes simply involve matters of procedural arbitrability….").

should be reviewed *de novo*. *Id*. at 391. However, as the U.S. Supreme Court has pointed out, on procedural matters, "the strong pro-court presumption as to the parties' likely intent does not apply." *Howsam*, 537 U.S. at 86.

III. The Inventory Write-Down Was Not an "Earn-Out Disagreement" under the Merger Agreement, So the Resolution Accountants Correctly Did Not Include it in the Earn-Out Payment Amount.

A. Question Presented

Viacom framed its third Question Presented as follows: "Did the Court of Chancery err by holding that the Inventory Write-Down was not subject to arbitration under the Merger Agreement." That is not a correct formulation of the issue because it does not accurately describe the decision below. The correct formulation is: "Did the Court of Chancery err by holding that the Inventory Write-Down was not an Earn-Out Disagreement under the Merger Agreement?"

B. Standard of Review

The challenged decision of the Resolution Accountants is one of procedural arbitrability. If the Court agrees with Winshall on this point, then the Resolution Accountants' decision is subject to the same high degree of deference, and the same limitations on judicial review under the FAA, as their rulings on the underlying disputes. *See First Options*, 514 U.S. at 943.

This third Question Presented assumes, however, that the Court agrees with Viacom on the second Question Presented and holds that the Resolution Accountants decided an issue of substantive arbitrability. On the basis of that assumption, Winshall agrees with Viacom's statement of the standard of review.

C. Merits

Viacom contends that "the Inventory Write-Down was put at issue for resolution by Winshall's Summary of Issues." Op. Br. at 27. If that were true, why did Viacom fail to argue in its opening submission for an Inventory Write-Down worth $191 million? Surely Viacom would have pressed vigorously for the deduction in its opening submission if that really were one of the Earn-Out

Disagreements. Viacom, however, did not ask for an Inventory Write-Down because it recognized that this deduction – which it had deliberately omitted from its Earn-Out Statement – had *not* been submitted to the Resolution Accountants.

1. The Merger Agreement does not permit Viacom to claim deductions not found in its Earn-Out Statement.

Viacom offers no response to the Resolution Accountants' explanation of *why* the Merger Agreement does not allow Viacom to submit additional or alternative deductions beyond those found in its Earn-Out Statement: "the Merger Agreement and the Engagement Letter contemplated and defined a process set by the Parties which is time-bound, restricted with respect to inputs, narrow in scope and final." A705.

Every aspect of the process was keyed to Viacom's Earn-Out Statement, so it was critical that Viacom clearly specify what deductions it was claiming. The contract allowed Winshall only 20 days to submit his Summary of Issues, which had to contain "a written description of each such disagreement" with Viacom's Earn-Out Statement. *See* Merger Agreement § 2.4(b), A17. There was no leeway: "In connection with any dispute resolution regarding the 2008 Earn-Out Payment Amount, the Stockholders' Representative will not dispute any additional issues or amounts other than the 2008 Summary of Issues submitted to [Viacom] within the twenty (20) day-period…." *Id*.

In addition, document discovery was limited to "assess[ing] the accuracy of the 2008 Earn-Out Statement." *Id*. In fact, Viacom argued (and the Resolution Accountants ruled) that Winshall was not entitled to the documentation underlying Viacom's preliminary earn-out calculations because those were not part of the contractual Earn-Out Statement. A704-05.

Moreover, the specific disputes arising from the Earn-Out Statements were the basis for the parties' negotiations over the detailed arbitration procedures. In the Engagement Letter, the

parties agreed that there would be no depositions, no testimony, no third-party discovery, and no documents received into evidence other than those produced by Viacom or found in the public domain. A140. Winshall agreed to those limitations believing that the disputes did *not* include the fact-intensive issue of inventory valuation, which Viacom had plainly omitted from its Earn-Out Statement. Winshall would not have agreed to a procedure that deprived him of the opportunity to question Viacom's witnesses and present expert testimony if inventory valuation issues were part of the case, and if Viacom were asking for an Inventory Write-Down that was far larger than the write-down reflected in its own audited financial statements. As the Chancellor observed, "such a method raises many questions of reliability and integrity." Mem. Op. at 10.

Given these strict procedures, the Resolution Accountants concluded that the Merger Agreement required the Earn-Out Statement to list all the deductions Viacom wished to claim. If Viacom were permitted to seek additional items at a later date, Winshall would have no opportunity to submit objections, let alone obtain discovery:

> As the Stockholders' Representative is permitted only one opportunity to submit the 2007 and 2008 Summary of Issues, it follows that there can be only one Earn-Out Statement for each year upon which those Summaries of Issues can be based.

A703. This interpretation of the Merger Agreement is eminently sensible, and Viacom offers no response to the Resolution Accountants' reasoning.

2. Winshall's Summary of Issues did not "put at issue" an Inventory Write-Down deduction that Viacom never claimed.

Viacom mistakenly asserts that the Chancellor "never even addressed, let alone rejected," its argument that Winshall's Summary of Issues raised the Inventory Write-Down. Op. Br. at 27.

The Chancellor squarely found that "Winshall did not address writing down the inventory, presumably because Viacom had not included LCM [Lower of Cost or Market] reserves as part of its final Earn-Own Statement and thus there was no Inventory Write-Down for him to challenge." Mem. Op. at 13.

As noted above, Viacom conceded that its 2008 Earn-Out Statement failed to include an Inventory Write-Down deduction. Viacom also conceded that the schedule it submitted in support of the 2008 Earn-Out Statement "clearly shows lower of cost or market, or 'LCM,' reserves of $0." Mem. Op. at 12. As the Chancellor pointed out, Viacom's Earn-Out Statement and supporting schedules were "inconsistent with a write-down." *Id.* Thus, it would have been surprising – to say the least – if Winshall's 2008 Summary of Issues had "put at issue" an Inventory Write-Down deduction that Viacom never claimed. Rather, as is clear upon examination of the Earn-Out Statement and the Summary of Issues, both sides were in agreement that the earn-out calculations did not include any Inventory Write-Down.

Viacom contends that Winshall's Summary of Issues nevertheless raised the Inventory Write-Down because it (A) "advocated an accounting methodology" that "costs must be 'matched' with revenues," (B) "invoked the 'matching principle,'" and (C) "urg[ed] the Resolution Accountants to apply these GAAP-related accounting principles." Op. Br. at 5, 8, 9, 29.

That claim is utterly false. Winshall's Summaries of Issues never referred to accounting methodologies, never mentioned GAAP, and never used the words "matched" or "matching." Nor did Winshall's Summary of Issues mention a write-down of inventory or the inventory's value. Viacom cites a few passages in Winshall's subsequent written submissions to the Resolution Accountants (*see* Op. Br. at 28-29), but those are not the controlling documents. Under § 2.4(c) of the Merger Agreement, the "Earn-Out Disagreements" are defined as "the unresolved items in such Summary of Issues." A17.

Winshall's objection in the Summary of Issues was based strictly on the language of the contract, not accounting principles. Specifically, in the 2008 Summary of Issues, Winshall objected to Viacom's deduction of "Rock Band peripheral costs" to the extent that it included "inventory on hand at the end of 2008" because "the Merger Agreement does not allow Viacom to deduct inventory remaining unsold at the end of the year when calculating the Gross Profit for the year." A127-28. Winshall then referred to his 2007 Summary of Issues, where he explained how the contract should be interpreted:

> The deductibility of costs is governed by the definition of "Product Gross Profit." That definition makes it clear that *not all* Direct Variable Costs may be deducted in a particular year. "Product Gross Profit" is explicitly defined "with respect to any product ... in any Fiscal Year" as the "difference, between (i) Net Revenue attributable to such product and (ii) the sum of all Direct Variable Costs *attributable to such product."* Thus, in order to be deductible in 2007, the Direct Variable Costs must relate to the same products that generated the Net Revenue in 2007.

A112 (emphasis in original).

By raising this purely *contractual* issue, Winshall did not "put at issue" the *factual* question of whether the market value of Harmonix's inventory on December 31, 2008, was lower than its cost. Tellingly, the Resolution Accountants were able to resolve Winshall's objection without deciding any disputed issues of fact. Based solely on "the language of the Merger Agreement," the Resolution Accountants concluded that "Peripheral Costs for Products in Inventory at the End of 2007 and 2008 are not appropriate deductions from Gross Profit in those years." A583.

Viacom's argument is further undermined by the fact that an Inventory Write-Down is an *entirely different deduction* from the "Rock Band Peripheral Costs" deduction that was the subject

of Winshall's objection in the Summary of Issues. The difference can be seen in Viacom's "preliminary" calculation of the 2008 earn-out payment. B11. As shown in the excerpt below, this calculation included two separate deductions – one for "Rock Band Peripheral Costs" and another for "Inventory Write-Downs":

Preliminary 2008 Harmonix Earn-out Statement

Direct Variable Cost Detail

$ in millions	Royalty Statements RockBand	Guitar Hero	Adjustments	Earn-out
EA Statement Deductions				
EA Costs of Goods Sold	$ 131.5		$ 2.5	$ 134.0
Coop Advertising	17.0		4.6	21.7
Warehousing	10.5		2.2	12.6
Freight In / Duty Charges	57.7		0.6	58.3
Warranty Expense	10.9		(3.2)	7.7
Marketing / QA / Other	26.8		(26.8)	-
Subtotal EA Costs	$ 254.4	$ -	$ (20.1)	$ 234.3
Harmonix Costs				
Rock Band Peripheral Costs			$ 356.5	$ 356.5
Inventory Write-Downs			54.6	54.6
Warranty / Freight / Warehousing			8.4	8.4

Viacom's actual Earn-Out Statement, by contrast, "abandoned the Inventory Write-Down." Mem. Op. at 11. It deducted "Rock Band Peripheral Costs" but did not include any deduction of "Inventory Write-Downs." Thus, the fact that Winshall disputed a portion of Viacom's "Rock Band Peripheral Costs" deduction does not mean that he put at issue Viacom's abandoned "Inventory Write-Downs" deduction.

* * * * *

Viacom complains that it was forced into "an all-or-nothing baseball arbitration" in which "the Resolution Accountants were compelled to choose between Viacom's 100% deduction [of unsold inventory] and Winshall's zero deduction." Op. Br. at 32. But this situation was created by Viacom, not by Winshall or the Resolution Accountants. Viacom could have asked for an Inventory Write-Down in its Earn-Out Statement, either as its primary position or as an alternative back-up position. But it made a deliberate, strategic choice not to do so. It gambled on total victory,

and did not want to give the Resolution Accountants a way of "splitting the baby" – at least not until its reply submission, at a point that was much too late under the terms of the Merger Agreement.

CONCLUSION

The Memorandum Opinion and Judgment of the Court of Chancery should be affirmed.

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