EFiled: Jun 12 2014 05:15PM EDT
Filing ID 55586471
Case Number 204,2014

IN THE SUPREME COURT OF THE STATE OF DELAWARE

TEXTRON INC., Plaintiff Below, Appellant, v. ACUMENT GLOBAL TECHNOLOGIES, INC., Defendant Below, Appellee.	:	No. 204, 2014 Appeal from the March 25, 2014 Decision After Trial Verdict For Defendant of the Superior Court of the State of Delaware in and for New Castle County in C.A. No. N10C-07-103 JRJ CCLD

OPENING BRIEF OF APPELLANT TEXTRON INC.

Of Counsel:

John A. Tarantino
ADLER POLLOCK & SHEEHAN P.C.
One Citizens Plaza, 8th Floor
Providence, RI 02903-1345
(401) 274-7200

Denise S. Kraft (I.D. No. 2778)
Laura D. Hatcher (I.D. No. 5098)
Brian A. Biggs (I.D. No. 5591)
DLA PIPER LLP (US)
1201 North Market Street, Suite 2100
Wilmington, DE 19801
(320) 468-5700

Donald J. Wolfe, Jr. (I.D. No. 285)
Arthur L. Dent (I.D. No. 2491)
POTTER ANDERSON & CORROON LLP
1313 North Market Street, 6th Floor
Wilmington, DE 19801
(302) 984-6000

Attorneys for Plaintiff Below-Appellant Textron Inc.

Dated: June 12, 2014

TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

PRELIMINARY STATEMENT

This appeal involves the construction and application of certain indemnity provisions under a Purchase and Sale Agreement (the "PSA") pursuant to which Appellant Textron Inc. ("Textron") sold certain of its fastening systems businesses to TFS Acquisition Corp. ("TFS") (the "Transaction"). TFS was indirectly owned by the private equity firm Platinum Equity ("PE"), and later became Appellee Acument Global Technologies, Inc. ("Acument").

Under the PSA provision at issue, Section 6.1(d)(iii)(C) (the "Tax Benefit Reduction" provision), Textron is entitled to reduce its indemnity obligations for assumed pre-closing contingent liabilities if Acument receives a "Tax Benefit" from that indemnity. Read in conjunction with the PSA's definition of "Tax Benefit," Acument agreed to reduce Textron's indemnity obligations by the amount of any tax savings that Acument had a right to receive. Although for the first two years following the Transaction Acument agreed with Textron's construction of the operative provisions, it later changed course, insisting that it did not actually receive any tax savings and forcing Textron to file suit to enforce Acument's compliance with the PSA's indemnity provisions.

At trial, Textron established — and Acument conceded — that the Tax Benefit Reduction was triggered by Acument's *right* to a tax reduction, *regardless of whether Acument was in a position to utilize that reduction*. Textron further

proved that, under established federal tax law, Acument has a right to a tax benefit based on the increase in its tax basis that it enjoyed by reason of Textron's indemnity payment for any pre-closing contingent liability assumed by Acument under the PSA. Thus, Textron should have prevailed below.

The Superior Court erred by ignoring Textron's assertion, consistent with established principles of federal tax law, that any tax basis increase resulting from Textron's payment of an assumed pre-closing contingent liability obligation would constitute a "Tax Benefit," triggering a Tax Benefit Reduction. Although the issue was fully briefed by the parties, and acknowledged by the Superior Court in a footnote to its Decision After Trial Verdict For Defendant (the "Opinion"), *see* Ex. A at 39, n.198, the Court failed to resolve, or even address, this potentially dispositive issue. Indeed, Textron submits that, had it done so, the Court could only have concluded that the increase in Acument's tax basis from the indemnity payment entitled Textron to a Tax Benefit Reduction in accordance with the terms of the PSA.

In addition, the Superior Court erred in construing the term "reduction," as used in the definition of Tax Benefit in Section 8.1 of the PSA, in a manner contrary to the position espoused by *either* party. In its post-trial briefing, Acument conceded that it did not need to receive a "deduction" in order to trigger a Tax Benefit Reduction. The Court nevertheless held that "reduction" in fact meant

"deduction," thereby effectively rewriting the operative provision of the PSA so as to substantially narrow the circumstances under which the Tax Benefit Reduction could be triggered. Because these terms have different meanings, in this case importantly so, this ruling was clear error.

Corporate and commercial practice in Delaware relies heavily on the State Courts' proper application of federal tax principles and the proper construction and interpretation of tax-related indemnity provisions. Thus, these issues are of significant importance. Accordingly, Textron respectfully submits that the decision of the Superior Court must be reversed.

NATURE OF THE PROCEEDINGS

On July 13, 2010, Textron filed suit against Acument in the Superior Court seeking to enforce its contractual right to the Tax Benefit Reduction under the PSA. Acument asserted mirror-image counterclaims against Textron. After two years of extensive discovery, the parties proceeded to a four-day bench trial on April 24-26 and May 30, 2013. The trial focused on the construction of the PSA and the application of federal tax law demonstrating that Acument had a right to a Tax Benefit, thereby triggering a Tax Benefit Reduction in favor of Textron.

On March 25, 2014, the Superior Court issued its Opinion. Although the Court specifically noted that the case was "difficult and close," it held that Textron failed to prove its case by a preponderance of the evidence, and ruled in favor of Acument. Ex. A at 3. The Court concluded that "[t]he Tax Benefit [Reduction] applies only when Acument is entitled to a Tax *deduction* based on Textron's indemnification payments," Ex. A at 64-65 (emphasis added), thereby rewriting a critical provision of the PSA. The Court did not address Textron's argument that, under applicable federal tax law, Acument had a right to receive a tax benefit from the payment of any assumed and indemnifiable pre-closing contingent liability, thereby triggering the Tax Benefit Reduction provision.

Textron filed its Notice of Appeal on April 24, 2014. This is Textron's Opening Brief in support of its appeal.

SUMMARY OF ARGUMENT

1. Under governing federal tax law principles, Acument receives an increase in its tax basis in the acquired assets when an assumed pre-closing contingent liability fixes. That tax basis increase constitutes a Tax Benefit under the PSA, as it confers upon Acument a right to a tax savings. Although the Superior Court acknowledged Textron's case-determinative argument in a footnote, it failed to address it. Had it done so, it could only have concluded that Acument's right to a "reduction" in its taxes is a Tax Benefit, thereby requiring a reduction in Textron's indemnity obligation under the terms of the PSA.

2. Interpreting the definition of "Tax Benefit," the Superior Court further erred in construing the term "reduction" to mean "deduction," a term that has a much narrower meaning under tax law. That conclusion was contrary to the express and stated understanding of *both* Textron *and* Acument. As used in the PSA, the word "reduction" defines the circumstances under which Textron may reduce its indemnification payments to Acument: Textron may do so if Acument has a right to receive a "refund, credit **or reduction**" in its otherwise required tax payments. A142 (PSA § 8.1 (definition of Tax Benefit)) (emphasis added). The term "reduction" is broader: a "deduction" is but one way by which one may secure a "reduction" in its tax obligations. Rejecting the position that it had advanced previously on this point, Acument ultimately conceded at trial and in its

post-trial briefing and argument that the broader standard — the right to a "reduction" in taxes — is in fact the controlling concept for purposes of the Tax Benefit Reduction. Thus, the parties are in agreement that, if Acument is eligible to receive a *reduction* in its taxes, by deduction *or otherwise*, Textron is entitled to a reduction of its indemnification payments to Acument. In concluding that "[t]he Tax Benefit offset applies only where Acument is entitled to a tax deduction," Ex. A at 48-49, the Court below contradicted the expressed understanding of both parties with respect to this provision, and substantially and improperly narrowed the circumstances under which the Tax Benefit Reduction could be triggered so as to exclude from it the basis for Textron's claim in this litigation.

STATEMENT OF FACTS

A. Textron Sells Assets and Liabilities to Acument Subject to Textron's Indemnity.

This dispute stems from the PSA, entered into on May 31, 2006, through which Textron sold certain fastening systems businesses to TFS. A114-154. PE, a private equity firm and the ultimate parent of TFS, negotiated the PSA on behalf of TFS. Ex. A at 5. TFS became Acument following the Transaction. A095 (Stip. Fact 19). PE is engaged in the business of buying and selling businesses, and at all times intended to "flip" the Acument businesses for a profit. Ex. A, 49-50 ("the parties were aware that PE intended to 'flip' TFS."); A219 (Trial Tr. Day III 125:16-20) (Dan Krasner, PE's principal negotiator of the PSA) ("[t]he whole purpose that [PE] bought these particular businesses is [to] flip them.").

Under the PSA, Acument purchased both the assets **and the liabilities** of the Textron fastening businesses, including contingent environmental and litigation liabilities. *See* A119 at § 1.4, A121-122 (Textron's indemnification of Acument's assumed liabilities); A152-A153 (transferred subsidiaries assumed assets and liabilities); A155-157 at ¶ 1 ("[a]ssignee … hereby assumes, all of the Seller's duties, liabilities and obligations."); *see also* A161 (Yassinger Dep. Tr. 233:16-21 (Marc Yassinger, PE's tax specialist admitting that "for legal purposes," the liabilities were assumed by Acument)). In addition, for purposes of federal tax law, all of the U.S. entities were "deemed asset sales," as a consequence of which

Acument was deemed to have purchased both the liabilities and the assets. A095 (Stip. Fact 18); A191 (Trial Tr. Day II 178:20-179:19 (Gertzman)).[1]

As part of the Transaction, Textron agreed to indemnify Acument for certain of the pre-closing contingent liabilities that Acument assumed under the PSA. A121-A122 (PSA § 6.1(b)). Textron and PE, each experienced in mergers and acquisitions and sophisticated with respect to tax matters, exchanged several drafts of the PSA and heavily negotiated the indemnity and tax-related provisions. Ex. A at 17. PE's first proposed revision to the draft PSA struck the Tax Benefit Reduction provision that Textron had proposed in its entirety. A110; A094 (Stip. Fact 9); A185 (Trial Tr. Day I 27:1-7 (Jack Curran, Textron's Vice President of Mergers and Acquisitions, who was in charge of the Acument sale)); A213 (Trial Tr. Day III 14:9-15:1 (Yassinger)). It subsequently proposed to replace the definition of "Tax Benefit" to focus exclusively on "actual tax savings." A186 (Trial Tr. Day I 30:13-31:4 (Curran)); A213 (Trial Tr. Day III 16:3-20 (Yassinger)); *see also* A112-A113; A094 (Stip. Fact 10). Textron rejected those proposed changes, and PE ultimately accepted the language proposed by Textron in the original draft of the PSA. A095 (Stip. Fact 16).

[1] Despite the plain language of the PSA, the relevant tax law, and Acument's own admission, Acument's tax expert, Robert Wellen ("Wellen"), opined that, for tax purposes, Acument never assumed the liability. Acument's argument is addressed and refuted in Section I.C.1.b, *infra*.

B. Under the PSA, Textron's Indemnity Obligation Was to Be Reduced By Any Tax Benefit to Acument.

Under the Tax Benefit Reduction provision as ultimately agreed to, any Textron indemnity obligation was to be reduced by, among other things, "any Tax Benefit" accruing to Acument:

> Each Loss (including Losses for which indemnification is required pursuant to Section 4.6) shall be reduced by … (C) any Tax Benefit of the Indemnified Party or any of its Affiliates attributable to such Loss.

A123 (§ 6.1(d)(iii)(C)). The PSA's definition of Tax Benefit makes clear that the Tax Benefit Reduction provision was designed to reduce Textron's indemnity obligation by the amount of "any refund, credit or **reduction**" in Acument's otherwise required tax payments even if, by reason of circumstances specific to Acument, it was not able to take advantage of it:

> "Tax Benefit" shall mean the present value of any refund, credit or **reduction** in otherwise required Tax payments, including interest payable thereon, which present value shall be computed as of the Closing Date or the first date on which the right to the refund, credit or other Tax **reduction arises or otherwise becomes available to be utilized**, whichever is later (i) using the Tax rate applicable to the highest level of income with respect to such Tax, (ii) using the interest rate on such date imposed on corporate deficiencies paid within thirty (30) days of notice of proposed deficiency under the Code, and (iii) **assuming that** such refund, credit or **reduction shall be recognized or received in the earliest possible taxable period** (without regard to any other losses, deductions, refunds, credits, **reductions** or other Tax items available to such party.[)]

A142 (§ 8.1 (definition of Tax Benefit) (emphasis added)).

C. Although Acument Initially Applies the Tax Benefit Reduction, Acument Later Changes Course and Textron Files Suit.

During the first two years after the Transaction, Acument recognized and satisfied its indemnity obligations by remitting to Textron funds reflecting the Tax Benefit Reduction in connection with Textron's indemnity payments for assumed contingent liabilities. A095-A096 (Stip. Facts 21, 25-27). Thereafter, Acument abandoned compliance, and refused to continue to reduce indemnity obligations in the U.S. (A103), claiming that it was not eligible for a tax benefit in the U.S.; that the Tax Benefit Reduction did not apply; and that its previous remittances pursuant to the Tax Benefit Reduction in the U.S. were the result of a mistake on its part. A096 (Stip. Fact 27); Ex. A at 34. Acument argued that the Tax Benefit Reduction provision of the PSA did not apply unless it was entitled to an actual tax savings on the payment of contingent liabilities in the U.S. A103. The parties were unable to resolve the dispute, and Textron filed suit on July 13, 2010. Ex. A at 37.

D. The Superior Court Denies Textron's Motion for Judgment on the Pleadings.

Textron initially moved for judgment on the pleadings. A004. The entirety of the parties' briefing with respect to that motion was focused on whether the Tax Benefit Reduction provision was triggered by an assumed tax benefit to Acument. A055-A059. In particular, Textron argued that the Tax Benefit Reduction provision was premised on an assumed or "hypothetical" tax benefit to Acument

resulting from the fixing of an assumed pre-closing contingent liability, and that Textron's indemnity payments would therefore be reduced in an amount commensurate with the highest applicable tax rate for the jurisdiction in question.[2] Acument argued instead that the Tax Benefit Reduction was not triggered by Textron's indemnity payment, but required that Acument have "a right to a refund, credit or tax reduction." A057. The Court determined that both of these interpretations were reasonable and, finding that the "provisions in controversy" were ambiguous, denied Textron's motion. A058.[3] As a result, in denying the motion for judgment on the pleadings, the Court below did not take up the meaning

[2] As set forth in the PSA, the amount of a Tax Benefit (and corresponding reduction to Textron's indemnity payment) is calculated using the highest tax rate available in the applicable jurisdiction. Specifically, the PSA provides that a "Tax Benefit" shall be calculated as "the present value of any refund, credit or reduction in otherwise required Tax payments . . . which present value shall be computed . . . (i) using the Tax rate applicable to the highest level of income with respect to such Tax." A142. As the Superior Court confirmed, the parties agreed that "the Tax Benefit [Reduction] was calculated by the highest income level percentage within the jurisdiction that the liability arose." Ex. A at 29. As to this point, the parties only disagreed at trial as to whether the Tax Benefit Reduction was triggered by a "hypothetical" benefit, or one that Acument had a right to receive.

[3] Acument has never seriously disputed that, outside of the U.S., Textron's indemnity is subject to the Tax Benefit Reduction, regardless of whether Acument has a right to tax savings or can actually use the tax reduction in question. For example, despite the fact that in Brazil Acument could not use the tax deductions that it was entitled to as a consequence of the existence of substantial Net Operating Losses ("NOLs"), Acument's own Dan Krasner (who negotiated the deal for Acument) conceded that Textron was entitled to a reduction in its indemnity payments. A216-A217 (Trial Tr. Day III 116:17-117:2 ("I did think they had the better side of that argument there.")); A100-A102. Indeed, from the inception of the PSA and even presently, Acument has not contested Textron's ability to reduce its indemnification payments where Acument had a *right* to a reduction in taxes in the form of a tax deduction but an inability to use that reduction. *Id.*; A274 (A. Post-Trial Op. Br. at 4).

of the term "reduction" as employed in the phrase "refund, credit or reduction" within the Tax Benefit definition.

E. At Trial, Textron Advances Arguments Based in Tax Law and in Contract to Support Its Entitlement to a Tax Benefit Reduction.

Textron presented two theories at trial in support of its claim that it was entitled to a Tax Benefit Reduction. *First*, as it had in its motion for judgment on the pleadings, Textron argued that the Tax Benefit Reduction was based upon an assumed tax benefit to Acument.[4] A244-A260 (T. Post-Trial Op. Br. at 7-23).

Second, Textron argued, and indeed demonstrated as a matter of federal tax law, that Acument has the right to tax savings whenever Textron makes an indemnity payment on a pre-closing contingent liability assumed in the transaction. A242-A244 (T. Post-Trial Op. Br. at 5-7). Textron maintained at trial that federal tax law requires this conclusion by reason of the step-up in Acument's tax basis on the acquired assets resulting from Textron's indemnity payments. *Id.*

F. Acument Concedes that the Tax Benefit Reduction Is Triggered When Acument Is Entitled to a Reduction in Its Otherwise Required Tax Payments.

Heading into trial, Acument argued that a right to an actual tax "deduction" was required under the PSA in order to trigger the Tax Benefit Reduction. A083 (A. Pre-trial Br. at 19) ("Textron Will Not Be Able to Prove that the Losses Are

[4] Following trial, the Superior Court rejected Textron's argument that the Tax Benefit Reduction provision required only a "hypothetical" tax benefit that could simply be assumed. Ex. A at 48-49. Textron does not appeal that aspect of the Superior Court's ruling.

Deductible by Acument.") (emphasis added). At trial, however, Acument's witnesses repeatedly conceded that Acument would receive a Tax Benefit whether through tax deductions or tax reductions whenever Textron indemnified the losses in any part. A214 (Trial Tr. Day III 50:4-51:7) (Marc Yassinger, PE's tax specialist, agreeing); A223 (Trial Tr. Day IV 85:5-19) (Don Modrycki, Acument's tax specialist, agreeing); A228-A229 (Trial Tr. Day IV 112:2-113:10) (Wellen, Acument's expert, agreeing). The following exchange with Don Modrycki, Acument's in-house tax expert, is illustrative:

> Q. Sure, let's use facts close to our case. [A] preclosing contingent liability [] becomes fixed. It's worth $100,000. Textron pays 60% of that liability at $60,000. Acument pays 40% at $40,000. Acument gets an increase to its basis of $40,000, right?
>
> A. That's correct.
>
> Q. Upon, say, sale of the company, assuming there's a gain on the sale of the company, Acument would get a tax benefit; right, because of that increase in basis?
>
> A. It would have an increase in basis, that's correct.
>
> Q. And that would result in a tax benefit?
>
> A. Yes, it would.

A223 (Trial Tr. Day IV 85:5-19). Consistent with that testimony, Acument changed its position and *agreed* that, under the plain language of the PSA, a right to a "reduction" in taxes, and not the more narrow right to a tax "deduction," was sufficient to trigger a Tax Benefit Reduction. A240-A242 (T. Post-Trial Op. Br. at

3-5); A345 (A. Post-Trial Reply Br. at 16). In its Post-Trial Reply Brief, Acument unequivocally and explicitly so conceded, agreeing with Textron that the Tax Benefit Reduction is triggered upon Acument's right to a "reduction," and not only upon a "deduction" (and in the process denying that it had ever argued to the contrary):

> Acument *does not dispute* that the Tax Benefit Offset applies when Acument 'would have a *re*duction in its otherwise required tax payments.' … *Acument has never contended that an Offset does not apply if Acument is entitled to a Tax reduction other than a reduction produced by a deduction. Acument has used the term 'deduction' simply as shorthand. Textron has done the same*.

A345 (A. Post-Trial Reply Br. at 16) (emphasis added).

Thus, by the close of trial, the parties were in agreement that the controlling concept in determining whether Acument receives a Tax Benefit triggering a Tax Benefit Reduction is whether Acument would have a right to a refund, credit or ***re***duction in its otherwise required tax payments, not whether — as the Court below nonetheless held in its Opinion — Acument had the right to a refund, credit or ***de***duction.

G. Textron Presents a Separate Treatment Tax Analysis Demonstrating that Acument Has a Right to a Tax Benefit for Every Contingent Liability Indemnified by Textron.

At trial, Textron presented an analysis demonstrating that Textron was entitled to the Tax Benefit Reduction by reason of well-established federal tax law principles. As Stephen Gertzman, a preeminent tax scholar, explained, a buyer in a

deemed asset sale (such as the Transaction)[5] has a right to deductions or other tax reductions whenever the seller indemnifies (in whole or in part) the buyer for a pre-closing, contingent liability (as occurred here). A197, A199-A200 (Trial Tr. Day II 203:2-204:10, 212:17-213:3). Relying on the federal tax code and seminal case precedent, Gertzman explained that, when a pre-closing contingent liability fixes[6] in connection with purchased assets, the buyer's tax basis in the purchased assets increases, resulting in deductions for the buyer either immediately or over time, or a reduction in taxes upon a sale of those assets. A199 (Trial Tr. Day II 212:17-23 (Gertzman)); A230 (Trial Tr. Day IV 117:6-118:3 (Wellen agreeing)); *see also* A193-A198 (Trial Tr. Day II 185:1-197:19, 203:2-205:14) (Gertzman's tax treatment examples). The buyer retains the right to these tax reductions when the seller of the assets indemnifies these losses, whether partially or in full. A198 (Trial Tr. Day II 206:16-207:6 (Gertzman)).

As Gertzman explained, in a deemed asset sale, the relevant inquiry involves a "separate treatment tax analysis," under which the liability and indemnification

[5] Under federal tax law, all of the U.S. entities purchased by Acument were "deemed asset sales," meaning that they were either sold as single member LLCs (treated as disregarded entities) or as corporations for which the parties made an election under § 338(h)(10) of the U.S. tax code. Ex. A at 16. As a consequence, Acument purchased the liabilities along with the assets.

[6] Under the "all events test" a contingent liability "fixes" for tax purposes upon the occurrence of three events: (1) all the events have occurred which establish the liability giving rise to the deduction; (2) the amount of the liability can be determined with reasonable accuracy; and (3) economic performance has occurred. *See Gillis v. U.S.*, 402 F.2d 501, 506 (5th Cir. 1968); *see also* A191 (Trial Tr. Day II 177:14-178:7 (Gertzman)).

issues are analyzed as two *separate* and *independent* steps: step 1 is the increase in basis when the liability fixes; step 2 is the decrease in basis (if any) resulting from an indemnity payment. Under this separate treatment tax analysis, when an assumed liability fixes, the buyer will *always* receive an increase in tax basis, which *always* gives rise to the right to deductions either immediately or over time, or reductions upon the sale of the assets. A199 (Trial Tr. Day II 212:19-23 (Gertzman)).

Acument's own tax experts supported Gertzman's separate treatment tax analysis. Acument's pre-litigation outside tax counsel, David Anderson, agreed that one must consider the increase in basis separately and independently from the decrease in basis. A168-A169 (Anderson Dep. Tr. 124:24-125:14) ("you have to consider the possibility that you have to go through that two-step basis, basis up, basis down net zero result"). Acument's trial tax expert, Wellen, acknowledged the validity of the separate treatment tax analysis and, importantly, that it is, in fact, supported by the IRS. A227 (Trial Tr. Day IV 106:8-16 (Wellen)) (Q: In your opinion is the analysis used by Mr. Gertzman wrong? A. No, *I wouldn't say that it's wrong. In fact, there is an IRS field service advice that walks through the analysis pretty much the way Mr. Gertzman does.*") (emphasis added)).

H. The Superior Court Fails to Address Textron's Argument that the Increase in Acument's Tax Basis Results in a Tax Benefit to Acument, Triggering a Right to a Tax Benefit Reduction.

Following trial, the Superior Court ruled in Acument's favor on all claims. Ex. A at 64-65. The Superior Court specifically acknowledged, in a footnote, Textron's separate and independent federal tax law analysis, noting as follows: "Textron essentially argues that the Court does not need to determine whether the Tax Benefit [Reduction] is hypothetical because, either way, Acument receives an increase in basis, resulting in a tax benefit." Ex. A at 39, n.198. Inexplicably, the Court failed to consider the separate treatment tax analysis, or apply it to determine whether Acument has a right to a reduction and thus, a Tax Benefit.

As Textron's expert established, Textron would be entitled to a Tax Benefit Reduction because, under federal tax law, Acument has a right to a Tax Benefit through a reduction in its taxes either immediately (as a deduction) or over time, or through an increase to its tax basis that can lead to eventual reductions in its tax liability. Thus, had the Superior Court reached the issue, it should have concluded that Acument received a Tax Benefit as a consequence of each indemnity payment, entitling Textron to a Tax Benefit Reduction.

I. The Superior Court Construes Tax "Reduction" to Mean Tax "Deduction."

In interpreting the operative provisions of the PSA, the Court improperly construed the term "reduction" in the Tax Benefit definition to mean "deduction,"

without acknowledging Acument's concession on this issue and the parties' express agreement during trial. Ex. A at 49, 64. The Superior Court rejected the difference between "reduction" and "deduction" as follows:

> The Court notes that despite Textron's 'deduction' and 'reduction' argument, the PSA does not contain the words 'hypothetical' or 'automatic.' And, after carefully considering all the documentary evidence, the parties' positions during negotiations, and the parties' conduct after executing the PSA and Letter Agreement, *the Court concludes that the Tax Benefit Offset applies only if Acument is entitled to a 'deduction*'….

Ex. A at 49 (emphasis added). The Superior Court further explained:

> Despite Textron's argument that the PSA utilizes a broader term of 'reduction,' as will be discussed, the parties tacitly agreed reduction meant deduction as exhibited in their pre-litigation conduct. Because the Court previously ruled that the PSA and Letter Agreement are ambiguous, it is not limited to determining their meaning by a third party standard. *See Wilmington Firefighters Ass'n, Local 1590 v. City of Wilmington*, 2002 WL 418032, at *6 n. 33 (Del. Ch. Mar. 12, 2002).

Id. at 49, n.249. The Superior Court thus disregarded Textron's *and* Acument's stated understanding of the term (and Acument's important concession), and ignored that there no longer was any dispute between the parties as to its meaning. The Superior Court then substituted a narrower term — "deduction" — in place of the agreed-upon term "reduction." As a result of this construction, the Superior Court held that Acument only obtained a Tax Benefit for purposes of the Tax Benefit Reduction provision when it had a right to a tax *deduction*.

ARGUMENT

I. UNDER SETTLED AND CONTROLLING FEDERAL TAX LAW PRINCIPLES, ACUMENT HAS A RIGHT TO A TAX BENEFIT AS A RESULT OF AN INCREASE IN ITS TAX BASIS.

A. Question Presented

Whether the Superior Court erred when it failed to consider and analyze tax law and found, contrary to the law, that Acument is not entitled to a tax deduction (or reduction) triggering a Tax Benefit Reduction? This issue was preserved for appeal in the parties' post-trial papers, A242-A244 (T. Post-Trial Op. Br. at 5-7) and A320-A321 (T. Post-Trial Reply Br. at 17-18), and at oral argument, A353-A354 (6:19-7:19).

B. Scope of Review

Whether the Superior Court erred as a matter of law in formulating or applying legal precepts constitutes a question of law, and questions of law are reviewed *de novo*. *Grand Ventures, Inc. v. Whaley*, 632 A.2d 63, 66 (Del. 1993). Where, as here, the trial court did not decide an issue raised by the parties, this Court may review the issue *de novo*. *See Riverbend Cmty., LLC v. Green Stone Eng'g, LLC,* 55 A.3d 330, 333 n.7 (Del. 2012) (determining that a contract interpretation issue was fairly presented to the trial judge and, thus, could be ruled upon by the Supreme Court, and applying the normal *de novo* review standard to the contract interpretation issue); *Telxon Corp. v. Meyerson,* 802 A.2d 257, 263

(Del. 2002) ("[T]his Court may rule on an issue fairly presented to the trial court, even if it was not addressed by the court below."); *Zirn v. VLI Corp.,* 621 A.2d 773, 783 n.6 (Del. 1993) (noting that, although the trial court did not expressly address certain arguments, the issues could appropriately be considered on appeal because they were fairly presented to the trial court); *Cannelongo v. Fid. Am. Small Bus. Inv. Co.,* 540 A.2d 435, 440 n.5 (Del. 1988) (determining that, although the trial court declined to address a point, the Supreme Court nonetheless could consider it because it was fairly presented to the trial court).

C. Merits of the Argument

Under well-settled principles of federal tax law, Acument has a right to a reduction in its otherwise required tax payments, and thus a right to receive a Tax Benefit, when a pre-closing contingent liability that Acument assumed fixes. In holding for Acument, the Superior Court failed to consider, or engage in any analysis of, controlling and settled tax law. As a consequence, the Court arrived at an erroneous result.

1. Textron Is Entitled to a Tax Benefit Reduction Because Acument Has a Right to a Tax Reduction as a Result of Its Increased Tax Basis in the Acquired Assets.

Under applicable federal tax law, Textron is entitled to a Tax Benefit Reduction because Acument receives a tax basis increase when an assumed, pre-closing contingent liability fixes. A242-A244 (T. Post-Trial Op. Br. at 5-7). The

increase in basis creates a right to a Tax Benefit, which triggers the Tax Benefit Reduction, whether or not Acument is immediately able to obtain an actual reduction in its taxes. *Id*.

a. Textron's Tax Analysis Is Correct and, Although Ignored Below, Should Be Adopted by this Court.

As Textron expert Gertzman explained at trial, applicable tax law requires a "separate treatment tax analysis" to determine whether Acument has a right to receive a tax savings. A196 (Trial Tr. Day II 199:10-200:6 (Gertzman)). The separate treatment tax analysis requires analyzing the tax consequences of Textron's indemnity payments in two *separate* and *independent* steps. First, when an assumed, pre-closing contingent liability fixes (satisfies the "all events test"), Acument's basis increases by an amount equal to the value of the contingent liability, and Acument considers the tax consequences. A199 (Trial Tr. Day II 212:8-16 (Gertzman)). Second, Acument's basis decreases by the amount (if any) of Textron's indemnity payment, and Acument considers those tax consequences. A196 (Trial Tr. Day II 199:10-200:6 (Gertzman)) ("[T]he tax law is fairly clear that you have to take the separate steps into account separately, the increase and the decrease."); *see also David R. Webb Co. v. Comm'r*, 77 T.C. 1134, 1137 (1981), *aff'd*, 708 F.2d 1254 (7th Cir. 2004).

Acument's basis in the acquired assets increases upon the fixing of an assumed contingent liability. This is undisputed by the parties, and is supported by

well-established case law. A193-A198 (Trial Tr. Day II 185:1-197:19, 203:2-205:15) (Gertzman's tax examples)); *see also* A173-A179; *Pacific Transport Co . v. Comm'r*, 483 F.2d 209, 214 (9th Cir. 1973) (finding that contingent liabilities should be added to the tax basis as a payment of the purchase price), *cert. denied*, 415 U.S. 948 (1974); *Webb*, 77 T.C. at 1137 (1981) (finding the payment of a contingent liability is a "capital expenditure which becomes part of the cost basis of the acquired property"); *Illinois Tool Works, Inc. v. Comm'r*, 355 F.3d 997, 1001 (7th Cir. 2004). It is also undisputed that when Textron makes an indemnity payment, Acument's tax basis is reduced. A197 (Trial Tr. Day II 203:2-19) (Gertzman)); A168-A169 (Anderson Dep. Tr. 124:24-125:14).

To properly assess the tax consequences related to the *fixing of* and *economic performance on* the liability, however, one must examine and treat the two events separately. *See, e.g.*, A173-A182 (citing, *e.g.*, Martin D. Ginsburg & Jack S. Levin, MERGERS, ACQUISITIONS, AND BUYOUTS, ¶¶ 304.2, 304.5 (2009)).

The separate treatment tax analysis establishes that, when Acument's tax basis in the acquired assets increases (step 1), Acument has a right to a reduction in taxes, whether through a deduction (depreciation, immediately or over time), or a reduction in gain on a subsequent sale (as Acument intended when it acquired the assets). Ex. A at 49-50 ("PE intended to 'flip' TFS."); A173-A179 (citing I.R.C. §§ 167, 168, 446); A199 (Trial Tr. Day II 212:19-23) (Gertzman) ("The increase in

the purchase price *always* results in an increase in tax basis. The increase in tax basis *always* gives rise to either immediate deductions, deductions over time, or deductions when the property is sold, or otherwise disposed of.") (emphasis added)). The increase in Acument's tax basis satisfies Acument's own acknowledged trigger to the Tax Benefit Reduction — it permits Acument a *right* to a tax benefit even if such benefit does not *actually* occur.[7] *See* A333 (A. Post-Trial Reply Br. at 4) ("Acument Must Have A Right to A Deduction or Other Tax Reduction…"). Any corresponding decrease in tax basis (in step 2) as a result of Textron's indemnity payment is irrelevant, as that decrease is a distinct and independent event under the tax law, the effect of which is analyzed separately. A196 (Trial Tr. Day II 199:10-200:6 (Gertzman)).

The separate treatment tax analysis is further supported by the language of the PSA and testimony and documents from Acument's own tax experts. Under the PSA, the definition of Tax Benefit applies the increase as though the benefit were available immediately, and it does so *without regard to the actual tax position of Acument.* A142. Moreover, Acument's pre-litigation outside tax counsel, David Anderson, agreed that one must consider the increase in basis separately and independently from the decrease in basis. A168-A169 (Anderson

[7] Because Acument has conceded that mere eligibility to reduce taxes (like an increase in basis) is enough to trigger the Tax Benefit Reduction (*i.e.*, Acument may not actually realize any tax savings), the increase in basis in and of itself triggers the Tax Benefit Reduction.

Dep. Tr. 124:24-125:14) ("you have to consider the possibility that you have to go through that two-step basis, basis up, basis down net zero result").

Thus, applying the separate treatment tax analysis, the Tax Benefit Reduction is triggered by the fixing of an assumed pre-closing contingent liability because Acument's tax basis increases. When Acument's basis increases, it has a right to a tax savings through a reduction in its otherwise required tax payments. As Acument has agreed, whether Acument ultimately receives the tax savings is beside the point; the "right" to that tax savings is sufficient to trigger the Tax Benefit Reduction. A345 (A. Post-Trial Reply Br. at 16).

b. Acument's Expert Could Not Disagree With Textron's Analysis.

Acument's expert, Wellen, did not rebut the separate treatment tax analysis. In fact, Wellen admitted that the separate treatment tax analysis was not incorrect, and he confirmed that it was supported by the IRS. A227 (Trial Tr. Day IV 106:8-16 (Wellen)).

Unable to refute the separate treatment tax analysis, Wellen offered something he referred to as the "no assumption" analysis. A226-A227 (Trial Tr. Day IV 104:19-105:10). Under that analysis, Wellen opined that the purchaser in a deemed asset sale *never* assumes the pre-closing contingent liabilities and, thus, the purchaser can have no adjustments to its basis. A226 (Trial Tr. Day IV 104:5-10). Wellen's opinion, however, is unsupported by any salient authority, and is

inconsistent with critical facts not in dispute. Indeed, Acument *did* assume the pre-closing contingent liabilities, as specifically reflected in the PSA and acknowledged by Acument's own witnesses. *See* Statement of Facts § A, *supra*.

As Wellen's theory proceeds upon the notion that Acument did not assume any pre-closing liabilities, it ignores the express provision of the PSA and the testimony of Acument's witnesses, as well as the unambiguous language of the Treasury Regulations that require the purchaser to assume liabilities in a deemed asset sale. Controlling tax regulations provide that, in a §338(h)(10) sale, the "new target is treated as acquiring all of its assets from an unrelated person *in exchange for consideration that includes the assumption of those liabilities.*" 26 C.F.R. § 1.338-1(a)(1) (emphasis added); *see also* A192 (Trial Tr. Day II 181:13-182:2 (Gertzman opining that the buyer in a 338(h)(10) and DRE sale assumes assets and liabilities)); Rev. Rul. 2004-88, 2004-2 C.B. 165 (DREs are legal entities separate from owner) (citing 26 C.F.R. § 301.7701-3 (discussing and providing examples in which assets and liabilities are transferred to DREs)). Thus, as a matter of law, Acument assumed the pre-closing contingent liabilities. Indeed, because Textron agreed to indemnify Acument for these contingent liabilities, Acument must have assumed them.

Moreover, unlike the well-supported and legally-recognized separate treatment tax analysis, Wellen's theory is premised on an inapplicable section of

the code, cited only for "policy," and two cases, *Rogers v. Comm'r*, 5 T.C. 818 (1945), and *Columbus & Greenfield Ry. Co. v. Comm'r*, 42 T.C. 834 (1964),[8] that are inapposite to the situation presented here, as they relate neither to deemed asset sales nor sales involving indemnification.[9] Accordingly, the Tax Court in those cases did not — and could not — comment on the proper tax treatment for indemnified contingent liabilities and its effect on a party's tax basis. The cases are not applicable, and provide no support for Wellen's theory.

Wellen cited no additional authority in support of his theory. Textron submits that Wellen's "no assumption" analysis ignores tax regulations and lacks supporting case law, and that, as a result, the Court below necessarily would have dismissed Wellen's analysis in favor of Textron's separate treatment tax analysis. Had the Superior Court addressed Textron's argument concerning the impact of federal tax laws, it would have concluded that Acument has a "right" to that tax savings, thus triggering the Tax Benefit Reduction.

Textron respectfully submits, based on the foregoing, that the decision below must be reversed, and the Superior Court directed to enter judgment for

---

[8] *See* A227 (Trial Tr. Day IV 105:13-19) (Wellen) ("There's a case called Rogers, which I think is very close to being on point. Another case called Greenfield and Columbus Railway, which has kind of odd ball facts, but I think also supports that view.").

[9] Gertzman confirmed this at trial. *See* A197 (Trial Tr. Day II 201:19-203:1 (Gertzman) (opining that *Rogers* and *Columbus* are irrelevant) ("But [the principal authorities cited by Mr. Wellen] were not dealing with DREs, or the 338 H10s where the law says that you're going to be treated as assuming the liabilities and you must remember the reason the law makes so much sense is the purchaser is buying the entity.")).

Textron. Alternatively, Textron urges the Court to remand the case with the Superior Court directed to consider the impact of the separate treatment tax analysis (which has important implications beyond this case) presented at trial but not addressed in the Opinion.

II. THE SUPERIOR COURT ERRED IN IGNORING THE EXPRESS AND UNEQUIVOCAL AGREEMENT OF THE PARTIES AS TO THE MEANING OF THE WORD "REDUCTION."

A. Question Presented

Whether the Superior Court's construction of the Tax Benefit Reduction provision of the PSA, which effectively replaced the word "reduction" with "deduction" in the definition of "Tax Benefit" and concluded that Acument was required to have a right to a "deduction" in order to trigger a Tax Benefit Reduction, is the product of an orderly or logical deductive process. This issue was raised and preserved in the Court's Opinion. Ex. A at 48-49.

B. Scope of Review

The Delaware Supreme Court accords deference to a trial court's contract construction if the decision is supported by the record evidence. *AT&T Corp. v. Lillis*, 970 A.2d 166, 170 (Del. 2009). This Court will reverse the trial court's construction, however, when the "findings are not supported by the record" or "the inferences drawn from those findings are not the product of an orderly or logical deductive process." *Motorola Inc. v. Amkor Technology, Inc.*, 958 A.2d 852, 859 (Del. 2008).

C. Merits of the Argument

In holding that the word "reduction" within the phrase "refund, credit or ***re***duction" meant "***de***duction," the Superior Court construed a term having

important tax implications in a manner inconsistent with the understanding of both parties. The Superior Court's construction effectively replaced the word "reduction" with the narrower term "deduction," thereby materially altering the contract and the parties' rights thereunder. Because the Superior Court *sua sponte* misinterpreted a contractual term that was no longer in dispute, the Superior Court's decision cannot be upheld as the product of an orderly or logical deductive process.

1. The Superior Court Erred by Ignoring the Parties' Express Agreement that "Reduction" Does Not Mean "Deduction."

The goal of contract interpretation is to ascertain the shared intent of the parties. *West Willow-Bay Court, LLC v. Robino-Bay Court Plaza, LLC*, 2007 WL 3317551, at *9 (Del. Ch. Nov. 2, 2007). Here, the parties' shared intent was unequivocally expressed to the Court through an important concession by Acument. The Superior Court nevertheless construed the term in a manner rejected by both parties. Justice requires that that interpretation be overturned.

There is no question that, by the end of trial, Acument agreed with Textron that only a right to a "reduction" in its taxes — and not the narrower "deduction" — was required to trigger a Tax Benefit Reduction. Indeed, resolving any lingering doubt, Acument made its agreement with Textron on this point crystal clear, stating: "Acument *does not dispute* that the Tax Benefit Offset applies when Acument 'would have a *re*duction in its otherwise required tax payments." A346

(A. Post-Trial Reply Br. at 17) (emphasis added). Thus, Acument agreed that a tax *de*duction, which is only one way of reducing one's taxes, is not required to trigger a Tax Benefit Reduction; rather, the trigger is a right to a *re*duction in taxes. To be sure, Acument had previously tried to limit "reduction" to mean "deduction." A083 (A. Pre-Trial Br. at 19 ("Textron Will Not Be Able to Prove that the Losses Are Deductible by Acument.")). Following the presentation of evidence at trial, however, Acument conceded that the term "reduction" is broader than "deduction" and that the parties used the word "deduction" merely as a shorthand reference for "reduction." A346 (A. Post-Trial Reply Br. at 17).

The Superior Court's *sua sponte* construction of "reduction" to require entitlement to a Tax Benefit Reduction — an interpretation of an important commercial provision that defied the parties' express understanding — constituted error.

2. The Court's Construction Also Violates Established Canons of Construction and Compels an Unreasonable Reading of the Provision.

The Superior Court's construction of the word "reduction" to mean "deduction" is unreasonable. It results in an impermissible rewrite of the applicable PSA provision, which carries different tax consequences, and renders important terms as mere surplusage.

Effectively, the Superior Court re-wrote section 6.1(d)(iii)(C) as follows:

> "Tax Benefit" shall mean the present value of any refund, credit or ~~reduction~~ deduction in otherwise required Tax payments, including interest payable thereon, which present value shall be computed as of the Closing Date or the first date on which the right to the refund, credit or other Tax ~~reduction~~ deduction arises or otherwise becomes available to be utilized, whichever is later … assuming that such refund, credit or ~~reduction~~ deduction shall be recognized or received in the earliest possible taxable period (without regard to any other losses, deductions, refunds, credits, ~~reduction~~ deduction or other Tax items available to such party.

The language of the Tax Benefit definition, as selected and agreed to by the parties, makes clear that a "refund, credit or *re*duction" in taxes, and not a "refund, credit or *de*duction," is what triggers the Tax Benefit Reduction. Notably, not once in the many drafts exchanged between the parties did either party propose using the term "deduction" in place of "reduction" within the definition of Tax Benefit. *Sassano v. CIBC World Markets Corp.*, 948 A.2d 453, 462 (Del. Ch. 2008) (noting that the language of a contract is the most objective indicia of the parties' intent). The fact that the parties chose the word "reduction" over "deduction" four separate times in the same provision should not be ignored.

Moreover, the Superior Court's construction improperly renders as mere surplusage the word "deduction," as the term *actually appears* in the text of the *very same clause* of the Tax Benefit definition. As revised by the Superior Court, the last clause of the Tax Benefit provides as follows:

> without regard to any other losses, **deductions**, refunds, credits, ~~reduction~~ deduction or other Tax items available to such party.

It is neither reasonable nor logical to conclude that the parties would have included the words "deduction" and "reduction" three words apart from each other in a list of different tax consequences if the parties intended "reduction" to mean "deduction." *See O'Brien v. Progressive Northern Ins. Co.*, 785 A.2d 281, 287 (Del. 2001) (recognizing that an interpretation that gives effect to each term is preferable to one that renders terms meaningless or uselessly repetitive).

The Superior Court's construction thus redefined the term "reduction" in a manner not intended by either of the parties and contrary to canons of contract construction. The Superior Court's construction has implications beyond this case. The construction was in error, and should be reversed by this Court.

CONCLUSION

For the foregoing reasons, Textron submits the decision below should be reversed and judgment for Acument on its counterclaims vacated, with the Superior Court directed to enter judgment in Textron's favor on its claims seeking enforcement of the Tax Benefit Reduction provision. In the alternative, and at a minimum, the case should be remanded for consideration of Textron's analysis under the federal tax law regarding the issue of whether Acument received a Tax Benefit.

DLA PIPER LLP (US)

By: */s/ Denise S. Kraft*
Denise S. Kraft (I.D. No. 2778)
Laura D. Hatcher (I.D. No. 5098)
Brian A. Biggs (I.D. No. 5591)
1201 North Market Street, Suite 2100
Wilmington, DE 19801
(320) 468-5700

POTTER ANDERSON & CORROON LLP

By: */s/ Donald J. Wolfe, Jr.*
Donald J. Wolfe, Jr. (I.D. No. 285)
Arthur L. Dent (I.D. No. 2491)
1313 North Market Street, 6th Floor
Wilmington, DE 19801
(302) 984-6000

Attorneys for Plaintiff Below-Appellant Textron Inc.

Of Counsel:

ADLER POLLOCK & SHEEHAN P.C.
John A. Tarantino
One Citizens Plaza, 8th Floor
Providence, RI 02903-1345
Telephone: (401) 274-7200

Dated: June 12, 2014