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IN THE SUPREME COURT OF THE STATE OF DELAWARE

JOSEPH L. WASHINGTON, JAMES F. SOLIC, JAMES WASHINGTON, JR., LAURA M. ODELL and ARLENE BETH CLARKE, Plaintiffs-Below, Appellants, v. PREFERRED COMMUNICATION SYSTEMS, INC., Defendant-Below, Appellee.	No. 436, 2016 Appeal from Court of Chancery No. 10810-VCL

APPELLEE'S ANSWERING BRIEF

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Dated: November 9, 2016

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NATURE OF PROCEEDINGS

Plaintiffs/Appellants ("Plaintiffs" or "Noteholders") initiated this litigation by filing a civil action against Defendant/Appellee Preferred Communication Systems, Inc. ("Defendant" or "PCSI" or the "Company") in the State of Texas captioned *Joseph Washington, et al. v. Preferred Communication Systems, Inc., et al.*; Cause No. DC-13-15257, 68th Judicial District Court (the "Texas Litigation" or "Texas Action").

In that action, Plaintiffs brought claims for breach of contract, seeking repayment of principal and interest due on certain notes (the "Notes") issued by the Company. Following a mediation, PCSI agreed to fully repay Plaintiffs all principal and interest owed to them and also agreed to fully repay attorneys' fees Plaintiffs incurred in that action.

In addition to Plaintiffs' claim concerning non-payment of the Notes, Plaintiffs also alleged that they were due certain warrants of common stock in connection with a letter offer (the "Offer Letter") sent by the Company to the Noteholders at a time when the Notes came due, but the Company did not have funds to pay. The Plaintiffs were offered warrants on a monthly basis if they agreed to extend the maturity date of their Notes indefinitely (the "Extension Warrants"). During the Texas mediation, the parties agreed to transfer the dispute over the Extension Warrants to the Delaware Court of

Chancery, as the Delaware Court was familiar with the factual background of the Company and the legal defenses at issue, based on prior litigation before that Court.

Following the transfer, on June 4, 2015, the Court of Chancery entered partial summary judgment in favor of certain Plaintiffs, finding that there was no material issue of disputed fact as to whether they accepted the Company's Offer for Extension Warrants. Subsequently, based on newly-discovered evidence, on August 18, 2015, the Court granted PCSI's Motion to Modify Order Pursuant to Rule 54(b), vacating its earlier Partial Summary Judgment Order as to three of the Plaintiffs, while entering judgment in favor of one Plaintiff. On or about March 4, 2016, the remaining Plaintiffs voluntarily dismissed their claims with prejudice.

On June 21, 2016 the Noteholders filed a motion seeking their fees and expenses pursuant to Section 6.2 of the Notes, which was granted by Order dated July 12, 2016. PCSI then filed a Motion for Reargument Under Rule 59(f), or, Alternatively, for Relief from Clerical Error or Oversight Under Rule 60(a) (the "Motion for Reargument"), which the Court granted by Order dated July 26, 2016.

The Noteholders are presently seeking review of the Trial Court's Order granting PCSI's Motion for Reargument.

SUMMARY OF ARGUMENTS

1. Denied. (Response to Plaintiffs' Summary of Arguments).

2. Denied. (Response to Plaintiffs' Summary of Arguments).

3. Denied. (Response to Plaintiffs' Summary of Arguments).

4. Denied. (Response to Plaintiffs' Summary of Arguments).

5. Denied. (Response to Plaintiffs' Summary of Arguments).

6. Denied. (Response to Plaintiffs' Summary of Arguments).

7. Section 6.2 was only intended to permit fee-shifting in favor of noteholders in collection actions concerning the non-payment of principal and interest, and does not permit the recovery of fees and expenses incurred by Plaintiffs in connection with this action.

8. Section 6.2 is also inapplicable inasmuch as the Extension Warrants are not an indebtedness "evidenced by the Notes."

9. Plaintiffs failed to raise the doctrine of *contra proferentum* before the Trial Court, and it is therefore waived. In any event, it has no application here.

STATEMENT OF FACTS

The facts needed to analyze this narrow question of contract interpretation are few and undisputed.[1]

A. Austin's Offer to the Nine-Month Noteholders.

The genesis of this dispute began when, at the time the Notes entered default, former PCSI President Charles Austin ("Austin") sent a letter to the Noteholders, in which he offered them two options. (A86-87). The first option was to keep their debt in its then-current form (as debt), but receive 225 Class B Common stock warrants on a monthly basis with an exercise price of $5.00:

> • **Compensation for Delay in Repayment**: First, each Holder will receive 225 warrants (per $25,000 invested) for each month their note is overdue. These are Class B Common Stock warrants with an exercise price of $5.00 and an exercise period of five years. For example, you will be issued 4,306 warrants for your investment of $50,000 if your note is paid or converted on November 21, 2007.

(*Id.*).

In return, noteholders were required to agree to extend the maturity date of their note until "the Company determines it has sufficient cash to pay

[1] Plaintiffs devoted much space in their Opening Brief to discussing the history of the Company. However, the Company's history – which was well known to the Trial Court – has no bearing on the narrow legal questions at issue herein. We note that none of the Company's current management team had any role in the Company at or before the time the Extension Warrants were offered.

the Note." (*Id.*). Noteholders electing this option thus gave up their right to sue for the balance due on the note.

The second option offered by Austin was that noteholders could convert their debt into equity. (*Id.*). Along with such conversion, such noteholders would also receive Class B Common Stock warrants with an exercise price of $.01:

> • **Series B Stock Conversion Offer**: Second, Preferred is making a one-time offer to convert the amounts due under the Nine-Month Promissory Notes into Series B Preferred Stock at $7.50 per share. The Company will issue to you an additional 2,000 warrants for each $15,000 you convert. The warrants are convertible into Class B Common Stock and have an exercise price of one penny ($0.01) per share and an exercise period of ten years. This offer is only being made to Holders.

(*Id.*). In addition to the penny warrants referenced above, noteholders choosing to convert their equity to debt would also receive an amount of warrants promised to noteholders declining the conversion option the first option (i.e., 225 Class B Common stock warrants per month with an exercise price of $5.00). (*Id.*).

The Noteholders to this action claimed that they elected not to convert their debt into equity and instead elected to receive 225 Class B Common Stock warrants on a monthly basis until the notes were repaid (the "Extension Warrants").

B. PCSI Receives Substantial Funds.

In or around December 2013, the Company received approximately $60 million from Sprint Corporation in connection with a transaction, in which it essentially agreed to give up certain of its wireless assets. (A268).

C. The Texas Action.

As the Company now had funds to repay the Notes, the Noteholders brought suit seeking to compel their repayment. The Company ultimately agreed to fully repay those Notes in full during a mediation.[2] (A266). The Company also agreed to pay all attorneys' fees incurred by the Noteholders in that suit, which they did. (A162).

In addition to seeking repayment on their Notes, the Noteholders also asked the Texas Court to force the Company to issue the Extension Warrants. As part of the settlement of the Texas Action, the parties agreed to have that aspect of their suit (relating to the Extension Warrants) heard before the Delaware Court of Chancery, as that Court had extensive familiarity with the Company and the nature of certain defenses at issue.

[2] For its part, the Company initially had to work through numerous legal issues including whether Plaintiffs' claims were time-barred. The Company ultimately repaid all noteholders, and not just those who filed suit against the Company.

D. The Court of Chancery Awards Certain Extension Warrants.

On June 4, 2015, the Court of Chancery entered partial summary judgment in favor of certain Plaintiffs, finding that there was no material issue of disputed fact as to whether they accepted the Company's Offer for Extension Warrants. (D.I. 31). Subsequently, based on newly-discovered evidence, on September 10, 2015, the Court granted PCSI's Motion to Modify Order Pursuant to Rule 54(b), vacating its earlier Partial Summary Judgment Order as to three of the Plaintiffs, while entering judgment in favor of one Plaintiff. (D.I. 86). On or about March 4, 2016, the remaining Plaintiffs voluntarily dismissed their claims with prejudice. (D.I. 98).

E. The Noteholders Sought Recovery of Their Attorneys' Fees Pursuant to a Fee-Shifting Provision Contained in the Notes.

On June 21, 2016, the Noteholders filed a motion seeking their fees and expenses pursuant to Section 6.2 of the Notes, which was titled "Collection" and provided:

> Should any indebtedness evidenced by this Note be collected by action at law, or in bankruptcy, receivership, or other court proceedings, or should this Note be placed in the hands of attorneys for collection after default, Maker agrees to pay, upon demand by Holder, in addition to principal and interest and other sums, if any, due and payable hereon, court costs and reasonable attorneys' fees and other reasonable collection charges. Should Maker be required to bring any action to enforce its rights under this Note, it shall be entitled to an award of its court costs and reasonable attorneys' fees in such action.

(A78; D.I. 99).

In response to Plaintiffs' motion, PCSI argued, among other things, that the request for fees and expenses should be denied, as Section 6.2 only contemplated and provided for fee-shifting in collection actions for principal and interest, and not for actions such as the one at issue before the Trial Court for Extension Warrants created by an ancillary agreement. (D.I. 102).

By Order dated July 12, 2016, the Court granted the Noteholders' motion and awarded fees and expenses in the amount of $166,313.26. (D.I. 106). In so doing, the Trial Court held:

> Section 6.2, entitled "Collection," contains two sentences. The first deals with the indebtedness evidenced by the Note and the collection of that indebtedness. The second is broader. It states, "Should Maker be required to bring any action to enforce its rights under this Note, it shall be entitled to an award of its court costs and reasonable attorneys' fees in such action." The right to the Extension Warrants was a right that the Maker received under the Note. This action was brought to enforce that right. PCSI has a fair point that this enforcement action did not fall within the first sentence. Instead, it fell within the second sentence.

(*Id.*).

F. The Trial Court Subsequently Granted PCSI's Motion for Reargument.

PCSI moved for reargument on the basis that the second sentence of Section 6.2, upon which the Trial Court relied, only permitted fees in the

favor of the "Maker" of the Notes (i.e., PCSI). (D.I. 107). It provided no basis to award fees in Plaintiffs' favor.

In its motion, PCSI argued that, since the Trial Court agreed that the first sentence of Section 6.2 was only intended to permit fee-shifting in Plaintiffs' favor in collection actions where the Notes were unpaid, which was not the case here, the Trial Court's Order should be reversed.

The Trial Court ultimately agreed with PCSI by Order dated July 26, 2016, holding:

> The two sentences in Section 6.2 are worded differently. The second is broader, but it grants rights only to the Maker. The movant is correct that the Maker is the defendant, not the plaintiff. The plaintiff's fee-shifting rights extend only to collection efforts.

(D.I. 109).

ARGUMENT

I. THE TRIAL COURT PROPERLY HELD THAT SECTION 6.2 PROVIDES NO BASIS FOR FEE SHIFTING.

A. Question Presented

Whether the Trial Court correctly ruled that Section 6.2 of the Notes provides no basis for shifting fees and expenses in favor of the Noteholders following the Extension Warrant litigation.

B. Standard Of Review

This Court reviews a Trial Court's interpretation of contract *de novo*. *See Salamone v. Gorman*, 106 A.3d 354, 367 (Del. 2014).

C. Merits of the Argument

1. By its Terms, Section 6.2 Was Only Intended to Permit Fee-Shifting in Favor of Noteholders in Collection Actions for Non-Payment.

Plaintiffs sought attorneys' fees and expenses pursuant to Section 6.2 of the Notes. Section 6.2 contains two distinct fee-shifting provisions set forth in separate sentences. (A78). The first sentence governs fee awards to noteholders ("Sentence One"), while the second sentence governs fee awards to the Company ("Sentence Two"). (*Id.*).

Sentence One provides:

> Should any indebtedness evidenced by this Note be collected by action at law, or in bankruptcy, receivership, or other court proceedings, or should this Note be placed in the hands of attorneys for collection after default, Maker agrees to pay, upon

> demand by Holder, in addition to principal and interest and other sums, if any, due and payable hereon, court costs and reasonable attorneys' fees and other reasonable collection charges.

(*Id*.).

The Notes define PCSI as the Maker of the Notes, while each noteholder is defined as "Holder." (*Id*.). While Sentence One permits fee-shifting to the noteholders under certain circumstances, Sentence Two permits the reverse – fee-shifting from the noteholders to the Company:

> Should *Maker* [i.e. PCSI] be required to bring any action to enforce *its* rights under this Note, *it* shall be entitled to an award of *its* court costs and reasonable attorneys' fees in such action.

(*Id*.) (emphasis added).

In their Opening Brief on appeal, Plaintiffs argue that fee-shifting should have been permitted under Sentence One because the Company's failure to pay "Extension Warrants" constituted an "indebtedness evidenced by [the] Note[s]" that were "collected" in court proceedings. (Op. Br., p. 3). In the alternative, Plaintiffs argue that fee-shifting is required under Sentence One because the notes were "placed in the hands of attorneys after default." (*Id*.). Plaintiffs reject the notion that Sentence One was intended to restrict fee-shifting in favor of Plaintiffs to collection actions.

Plaintiffs' arguments are flawed for a number of reasons. First, Plaintiffs' attempt to parse out individual words and phrases, rather than

reading Section 6.2 as a whole, should be rejected. *See Kuhn Const., Inc. v. Diamond State Port Corp.*, 990 A.2d 393, 396-97 (Del. 2010) ("We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the contract mere surplusage.").

A fair reading of Section 6.2 as a whole makes it obvious that it was only intended to permit fee-shifting in collection actions where the company failed to pay principal and interest – which was not the case here. For example, Section 6.2 is titled "Collection" and permits the reimbursement of "court costs, reasonable attorneys' fees *and other reasonable collection charges*" in the event the Notes are "placed in the hands of attorneys for *collection* after *default*" or where "any *indebtedness* evidenced by [the Notes] be *collected* by action at law. . ." (A78) (emphasis added).

The only possible "default" envisioned by the parties was the Company's failure to pay back all owed principal and interest. Similarly, the only "collection" efforts would have been for the collection of principal and interest. This is true for a very simple reason. The Offer Letter (and Extension Warrants offered therein) *were not even in existence* at the time the Notes were drafted. The parties could not have envisioned fee-shifting for litigation involving warrants created by an ancillary agreement that were not yet in existence. *See Lorillard Tobacco Co. v. Am. Legacy Found.*, 903

A.2d 728, 739 (Del. 2006) ("When interpreting a contract, the role of a court is to effectuate the parties' intent.").

The Superior Court's decision in *Kuratle Contr., Inc. v. Linden Green Condo., Ass'n.*, 2014 Del. Super. LEXIS 556 (Oct. 22, 2014) is instructive. In *Kuratle*, the plaintiff, a company engaged in the business of management and maintenance of condominium complexes, entered into a series of contracts with the defendant, a condominium association. One of those documents, entitled "Landscaping and Maintenance Proposal" contained a fee-shifting provision, which stated: "Delinquent accounts may be referred to a collection agency and or attorney. Client agrees to payment of invoice amount, services charges, and any related legal expenses of balance on contract." *Kuratle*, 2014 Del. Super. LEXIS 556, at *31.

The *Kuratle* plaintiff argued that this provision reflected the parties' intent to provide for general fee-shifting in the event the plaintiff was required to initiate a legal proceeding relating in any way to the parties' agreement – even if the legal proceeding was not one to recover delinquent invoices. *Id.* In response, Defendant argued that, when read in context, this provision "does not in any way articulate an intent by the parties to shift attorneys' fees incurred in the course of litigation between the parties. It

simply governs the use of a collection agency or an attorney to collect delinquent invoices for certain additional lawn care services."

The *Kuratle* Court ultimately rejected the plaintiff's argument for reasons applicable here:

> It would be a mistake . . . to extend this narrow fee-shifting provision beyond its intended narrow scope. The Court finds that while there is a valid fee-shifting provision, it applies only to costs and fees specifically incurred in the collection of unpaid landscaping and maintenance invoices. The plain language of the provision indicates that it applies to 'delinquent accounts,' and authorizes fee-shifting for legal expenses incurred in the collection of these accounts. Second, the provision does not appear in the main body of the agreement (the document to which the signatures of the parties are affixed).

As in *Kuratle*, the fee-shifting provision contained in the Notes was only intended to govern collection efforts in the event the Company failed to repay the Notes. It was not intended to provide for general fee-shifting in the manner advanced by Plaintiffs. Also, as in *Kuratle*, there is no fee-shifting provision in the Offer Letter itself. Plaintiffs' fee request should be denied accordingly.

2. <u>There Is No "Indebtedness" Evidenced by the Notes</u>.

Even if we were to assume that the failure to pay Extension Warrants constituted an "indebtedness" under the Notes as Plaintiffs argue – notwithstanding the fact such warrants did not exist when the Notes were

executed – they are not an indebtedness "evidenced by the Notes." Page one of each Note sets forth the dollar amount and warrants owed. (*See, e.g.*, A77). The Extension Warrants promised in the Offer Letter are not set forth in the Notes, and thus would not be "evidenced" by the Notes, but by an ancillary agreement.

3. Plaintiffs Are Attempting to Transform Section 6.2 into One for General Fee-Shifting Regardless of the Nature of the Dispute Between the Parties.

As noted by the Trial Court, the second sentence of Section 6.2 is broadly worded and permits fee-shifting in favor of the Company any time it is required to "bring any action to enforce its rights under the Note." (*Id*.). Sentence One is different. It does not provide broad fee-shifting but instead, permits fee-shifting in favor of noteholders only after successfully prosecuting collection actions.

Notwithstanding the narrow language used in Sentence One, Plaintiffs assert in their Opening Brief that they are entitled to fees any time they file suit over an "event of a default," which they argue includes the failure to "observe, perform or comply with any covenant, agreement or provision of this Note." (Op. Br., p. 3.). Such an expansive interpretation of Section 6.2 would essentially mean that Plaintiffs would be entitled to their fees should they prevail in any suit against the Company.

This could not have been the intent of the parties. If the parties had intended both sides to have the exact same rights with respect to fee-shifting, they would have made that clear in their agreements. There would have been no need to have separate clauses for each party, with vastly differing language. Plaintiffs' interpretation of Section 6.2 should be rejected accordingly. *See Kuhn Const., Inc.*, 990 A.2d at 396-97 ("We will read a contract as a whole and we will give each provision and term effect, so as not to render any part of the contract mere surplusage.").

Plaintiffs' interpretation of Section 6.2 should also be rejected inasmuch as courts traditionally construe contractual fee-shifting provisions narrowly. *See ATP Tour v. Deutscher Tennis Bund*, 91 A.3d 554, 558 (Del. 2014) (citing *Mahani v. Edix Media Grp., Inc.*, 935 A.2d 242, 245 (Del. 2007)) ("Delaware follows the American Rule, under which parties to litigation generally must pay their own attorneys' fees and costs."); *Castro v. Lintz*, 338 P.3d 1063, 1067 (Colo. App. 2014) (quoting *Crandall v. City & Cty. Of Denver*, 238 P.3d 659, 662 (Colo. 2010) ("'We narrowly construe limitations of the American Rule and should not construe a fee-shifting provision as mandatory unless the directive is specific and clear on that score.'"); *In re Latshaw Drilling, LLC*, 481 B.R. 765, 795 (Bankr. N.D. Okla. 2012) ("fee-shifting provisions in contracts are narrowly construed,

and a party is permitted to recover its fees from the other party to the contract only when the language is "unmistakably clear" that the parties intended the provision to apply to the fees at issue."); *BKCAP, LLC v. Captec Franchise Trust 2000-1*, 701 F. Supp. 2d 1030, 1039 (N.D. Ind. 2010) ("To summarize, the American rules long-standing presumption that parties bear their own costs of litigation demands that fee shifting agreements be narrowly construed.").[3]

[3] *See also BKCAP, LLC*, 701 F. Supp. 2d 1030, 1036 n.6 ("Courts across the nation have frequently followed the 'narrow construction' model of interpreting attorney fee provisions.") (citing *Oscar Gruss & Son, Inc.*, 337 F.3d 186, 199 (2d. Cir. 2003) ("Accordingly, while parties may agree that attorneys' fees should be included as another form of damages, such contracts must be strictly construed to avoid inferring duties that the parties did not intend to create."); *Kim v. Kang*, 154 F.3d 996, 1001 (9th Cir. 1998) (denying fees because contract only allowed them when complaint "instituted to collect sum due Broker."); *Sholkoff v. Boca Raton Cmty. Hosp., Inc.*, 693 So.2d 1114, 1118 (Fla. Dist. Ct. App. 1997) ("[I]f an agreement for one party to pay another party's attorney's fees is to be enforced it must unambiguously state that intention and clearly identify the matter in which the attorney's fees are recoverable."); *McGuire v. City of Jersey City*, 125 N.J. 310, 593 A.2d 309, 317 (N.J. 1991) (narrowly construing contract's fee shifting provision); *Vacation Vill. Homeowners' Ass'n, Inc. v. Mordkofsky*, 254 A.D.2d 650, 679 N.Y.S.2d 435, 437 (N.Y. App. Div. 1998) (holding that fee shifting provision must be narrowly construed); *4447 Assocs. v. First Sec. Fin.*, 973 P.2d 992, 998, 1999 UT App 13 (Utah Ct. App. 1999) (allowing fees "only in accordance with the explicit terms of the contract and only to the extent permitted by the contract").

4. Plaintiffs Were Already Paid Their Attorneys' Fees in Connection with the Texas Action.

Plaintiffs argue that even if fee-shifting under Section 6.2 is only permitted upon collection actions brought by noteholders for the recovery of principal and interest, Plaintiffs filed such an action in the State of Texas, and thus, should get their fees here. (Op. Br., p. 4).

Plaintiffs incredibly failed to acknowledge, however, that, as part of the settlement of the Texas Action, the parties expressly agreed that all of Plaintiffs' attorneys' fees incurred in connection with that Action were considered to be paid. (*See* Settlement Agreement, A162) ("All attorneys' fees, legal expenses and court costs incurred up to the EFFECTIVE DATE [of the release] shall be paid by the party incurring same and, for the purposes of the NOTES shall be deemed paid as part of the SETTLMENT FUNDS.") (emphasis in original).

As a result, the fact that Plaintiffs originally brought suit for non-payment of the Notes has zero bearing here.

5. Plaintiffs Failed to Raise the Doctrine of *Contra Proferentum* Before the Trial Court, and in Any Event, It is Inapplicable.

Plaintiffs argue for the first time on appeal that any ambiguities in the Notes should be construed against PCSI as the drafter of the Notes pursuant to the doctrine of *contra proferentem*. However, Plaintiffs did not present

this argument below to the Trial Court, and it should not be considered on appeal unless the plain error doctrine applies. *Smith v. Delaware State University*, 47 A.3d 472, 479 (Del. 2012). Delaware Supreme Court Rule 8 provides that: "Only questions fairly presented to the trial court may be presented for review; provided, however, that when the interests of justice so require, the Court may consider and determine any question not so presented."

This Court has interpreted Rule 8 to excuse waiver of an argument only "if it finds that the trial court committed plain error requiring review in the interests of justice." *Turner v. State*, 5 A.3d 612, 615 (Del. 2010) (quoting *Monroe v. State*, 652 A.2d 560, 563 (Del. 1995)). To constitute plain error, "the error complained of must be so clearly prejudicial to substantial rights as to jeopardize the fairness and integrity of the trial process." *Wainright v. State*, 504 A.2d 1096, 1100 (Del. 1986).

This Court recently stated that it applies "the exceptions to Supreme Court Rule 8 parsimoniously, and only where a trial court's failure to confront an issue is basic, serious and fundamental in character and clearly results in manifest injustice." *Sabree Environmental & Construction, Inc. v. Summit Dredging, LLC*, 2016 WL 5930270, at *1 (Del. Oct. 12, 2016) (quoting *Cassidy v. Cassidy*, 689 A.2d 1182, 1184 (Del. 1997)). The failure

of a litigant to make a legal argument before the trial court rarely meets this rigorous standard.

Plaintiffs' failure to raise the doctrine of *contra proferentum* can hardly be considered plain error and the failure of this Court to consider said argument would not be "manifestly unjust." For these reasons, this argument should be rejected.

Even if this Court were to consider this argument, it has no application here. Section 6.2 is not ambiguous and plainly limits fee-shifting in the Noteholders' favor only in connection with collection actions for principal and interest.

CONCLUSION

For the foregoing reasons, PCSI respectfully requests that this Court affirm the Trial Court's decision in its entirety.

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