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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,	)	No. 436, 2016
v.	)	Appeal from Court of Chancery
	)	C.A. No. 10810-VCL
PREFERRED COMMUNICATION SYSTEMS, INC.,	)	
Defendant Below, Appellee.	)	

REPLY BRIEF OF PLAINTIFFS BELOW/APPELLANTS

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PRELIMINARY STATEMENT

Appellants lent money to appellee Preferred Communications Systems, Inc. ("PCSI") in return for promissory notes (the "Notes") promising principal, interest, and warrants for stock in PCSI. The Notes included a fee-shifting provision ("Section 6.2"). PCSI delivered the warrants but due to financial difficulties was unable to pay principal and interest when the Notes came due. Rather, the Notes were amended by letter (the "Offer Letter") to promise more warrants ("Extension Warrants") in return for Appellants forbearing to sue until PCSI had the cash to pay the Notes.

When PCSI obtained cash but nevertheless refused to pay, Appellants sued in Texas for principal, interest, and the Extension Warrants. The parties settled the Texas action as to principal and interest but agreed that the issue of Extension Warrants be resolved in Delaware. The Court of Chancery granted Appellants' motion for summary judgment, ruling, "The contract at issue consists of the Notes as modified by the Offer Letter". A266 ¶ 3. Appellants therefore seek to recover their attorneys' fees and expenses in this appeal.

The fee-shifting provision contains two sentences, the first shifting fees in favor of Noteholders ("Section 6.2[1]"). Section 6.2[1] shifts fees in two circumstances.

First, fees are shifted if "any indebtedness evidenced by this Note" is "collected" in any "court proceedings". The trial court ruled that the Offer Letter amended the Notes to entitle Appellants to the Extension Warrants – a ruling PCSI did not appeal. Appellants' citations clearly show that "indebtedness" includes non-monetary things owed such as warrants. Because PCSI owed Appellants warrants which Appellants successfully obtained via the action below, PCSI must pay their fees.

Fees are also shifted if the Notes are placed in the hands of attorneys for collection after "default". As expressly defined in the Notes, the term "event of default" includes ***any failure to comply with the Agreement*** – including by not providing warrants, which even the original Notes promised. PCSI must pay Appellants' fees for this reason as well.

PCSI's arguments to the contrary in its Answering Brief are at best distinguishable and at worst factually wrong. The plain English meaning of the words in either of the two prongs of Section 6.2[1] alone resolve this matter in Appellants' favor. Even if PCSI's arguments had enough force to render the Notes ambiguous, they should be interpreted in Appellants' favor because PCSI solely drafted the Notes and the Offer Letter (an argument squarely presented to the trial court, contrary to PCSI's assertion).

This Court should therefore reverse the trial court and remand with an order to grant Appellants their reasonable attorneys' fees in this action.

ARGUMENT

I. FEES SHOULD BE SHIFTED BECAUSE PCSI WAS INDEBTED TO PROVIDE THE EXTENSION WARRANTS TO APPELLANTS.

Section 6.2[1] provides that PCSI must pay Appellants' attorneys' fees and expenses in two circumstances: (1) any "indebtedness" evidenced by the Notes is "collected" in any "court proceedings," or (2) the Notes are "placed in the hands of attorneys for collection after default."

Appellants are owed fees under the first prong because the lower court ruled PCSI indebted to Appellants to provide the Extension Warrants to them. The term "indebtedness" refers to nonmonetary as well as monetary debts. OB at 14. This action clearly was and is a "court proceeding". "Collect" is a common verb meaning to gather things together that can be used in plain English to refer to gathering anything, whether coffee cups, stock warrants, or money. OB at 16-17.

PCSI cites *Kuhn Construction, Inc. v. Diamond State Port Corp.*, 990 A.2d 393 (Del. 2010)[1] for the propositions that the Court will "read the contract as a whole" and "give each provision and term effect". *Id.* at 396-97 (cited in AB at 11-12). It is PCSI's proposed interpretation, however, that violates these

[1] In that case the Court held the provision at issue to be ambiguous and applied the "doctrine of *contra proferentem* and construe[d] ambiguous terms and provisions against the drafting party." *Id.* at 397. Even if PCSI's arguments render Section 6.2[1] ambiguous, *Kuhn* shows that Appellants should prevail as PCSI indisputably drafted the Notes and Offer Letter. OB at 21-22.

propositions, as it would ignore the commonsense, plain English interpretation of these words in favor of a narrow, technical definition.

PCSI is trying to rewrite the Notes to substitute the words "principal and interest" for the word "indebtedness." PCSI, however, knew how to separately refer to a failure to pay "principal and interest," treating such failures separately from other covenant defaults. A78 §§ 5(a) & (b). PCSI's deliberate use of the broad term "indebtedness" rather than the narrow terms "principal" or "interest" dooms its argument.

When confronted by the plain English meaning of the words in the first prong, PCSI cites to the second. AB at 12. PCSI's interpretation is contrary to the way PCSI itself drafted Section 6.2[1], however, as they are clearly set off by the disjunctive "or".

PCSI argues that the title of Section 6.2 means that it "was only intended to permit fee-shifting in collection actions where the company failed to pay principal and interest". AB at 12. The second sentence of Section 6.2 ("Section 6.2[2]"), however, entitles PCSI to fee-shifting if it must "bring any action to enforce its rights under this Note". PCSI could bring such an action whether or not it had failed to pay principal or interest, and thus this argument obviously fails.

Section 6.2[1] entitles Appellants to "reasonable attorneys' fees and other reasonable collection charges." PCSI cites the phrase "collection charges," AB at

12, but ignores the fact that "collection" modifies "charges," not "attorneys' fees". Attorneys' fees can be shifted so long as they are "reasonable," whether or not they are "collection charges".

II. FEES SHOULD ALSO BE SHIFTED BECAUSE PCSI WAS IN "DEFAULT" FOR NOT PROVIDING EXTENSION WARRANTS.

The second trigger for fee-shifting in favor of Appellants is if the Notes are "placed in the hands of attorneys for collection after default." The Notes define an event of "Default" broadly as non-compliance with ***any*** of their provisions. OB at 15. As amended by the Offer Letter, the Notes required PCSI to provide Appellants with Extension Warrants. PCSI's failure to do that constitutes a "default" under this second prong and also requires fee-shifting.

PCSI argues that the only "possible 'default' envisioned by the parties was the Company's failure to pay back all owed principal and interest." AB at 12. Even before being amended by the Offer Letter to promise Extension Warrants, however, the Notes entitled Appellants to warrants for shares of PCSI common stock. A81. PCSI's failure to comply with that promise would also have been an event of "default" triggering fee-shifting. Not only is PCSI incorrect that the Notes did not contemplate an event of default other than non-payment of principal or interest, ***they specifically contemplated PCSI's failure to issue warrants*** and called that an event of "Default".

Even if the Notes originally had not promised warrants, the facts remain that (1) they define "Default" to include violation of any provision; and (2) the Offer Letter amended the Notes to provide the Extension Warrants. If PCSI had wanted to exclude the Extension Warrants from Section 6.2[1], as sole drafter of the Offer Letter it could have done so unilaterally with one simple sentence (*e.g.*, "Notwithstanding any contrary provision in the Notes, a failure to provide Extension Warrants will not result in fee shifting.").

It did not do so, doubtlessly because PCSI was offering the Extension Warrants to avoid being sued after it had failed to pay the Notes upon maturity. Including such a provision, referring to the possibility that it might not comply with its promises even as it made them, could have caused Appellants to reject the proposed deal and sue. This Court should not save PCSI from the proper results of its own promises. *See Thompson v. Town of Henlopen Acres*, 1996 WL 117652, at *5 (Del. Ch. Mar. 7, 1996) (holding that a limited easement did not also permit a fence, asking "whether a majority of lot owners would have agreed to the easement at all without the prohibition against fences").

III. PCSI CANNOT AVOID THE PLAIN MEANING OF THE LANGUAGE IT DRAFTED.

PCSI attempts to distract from the fact that its proposed reading runs contrary to the plain meaning of Section 6.2[1] by arguing that Appellants seek to change it to "provide for general fee-shifting". AB at 14. There are, however,

potential disputes between PCSI and Appellants indisputably not covered by Section 6.2[1].[2] Litigation that did not collect "indebtedness" or did not follow a "default" would not be covered: for example, a successful declaratory judgment action. Section 6.2[1] is not a general fee-shifting provision between the parties or even as to the Notes, only one that happens to apply to this action.

Kuratle Contracting, Inc. v. Linden Green Condominium, Ass'n., 2014 WL 5391291 (Del. Super. Ct. Oct. 22, 2014), cited by PCSI, is inapposite. In that lawsuit by a building management company against a condominium association, an attachment to one of the contracts was at issue. In the attachment defendant promised to pay – on delinquent landscaping and maintenance accounts – invoice amount, services charges, and "any related legal expenses of balance on contract". *Id.* at *10. The court ruled the provision limited to landscaping and maintenance and declined to shift fees because the action did not materially involve such issues. *Id.* at *11. By contrast, Section 6.2[1] appears in the body of the main contract at issue (the Notes), and refers broadly to all "indebtedness" and any "default" rather than to specific defaults.

[2] Appellants have certainly never argued that it shifts fees in any of the other disputes between them and PCSI unrelated to their Notes, which would of course not involve any indebtedness evidenced by or default on those Notes. *See, e.g.*, *Agar v. Judy*, 2015 WL 7288933 (Del. Ch. Nov. 17, 2015) (litigation brought by plaintiffs including Appellants James Washington and Arlene Clarke regarding stock or other warrants for stock in PCSI and alleged fiduciary wrongdoings of directors and prior officers).

PCSI characterizes Appellants' interpretation of Section 6.2[1] as giving both parties "the exact same rights" to fee-shifting under [1] and [2]. PCSI then argues that if it had intended to give both sides the same rights Section 6.2 would have one sentence, not two. AB at 16.

First, Section 6.2[1] as properly interpreted does not provide the "exact same rights" as Section 6.2[2]. While Appellants may recover fees only if an "indebtedness" is collected or a "default" has occurred, PCSI may collect fees if it must "bring any action to enforce its rights under this Note". There are disputes that could conceivably be covered if PCSI sued that would not be covered if Appellants did, for example a declaratory judgment action as whether PCSI had certain obligations under the Notes.

Also, it is likely that Section 6.2[1] came first as it deals with the more likely scenario of a creditor suing. If PCSI wanted its own fee-shifting provision it would therefore have had to add one dealing with the different circumstances that might cause a debtor to sue. Having done so, it would have been easier to keep two sentences than it would have been to draft one sentence to properly shift fees for both creditor and debtor (and, as set forth above, they are triggered in different circumstances). Separate provisions for creditor and debtor is an ordinary consequence of the circumstances and does not support PCSI's argument.

In any event, Delaware courts interpret provisions as they were drafted, not as they allegedly should have been drafted. *Seidensticker v. Gasparilla Inn, Inc.*, 2007 WL 4054473, at *3 (Del. Ch. Nov. 8, 2007) (rejecting interpretation that made "rational sense" but was not "***reasonable*** in light of the indisputably clear language of the contract") (emphasis in original).

IV. PCSI CANNOT AVOID THE OFFER LETTER'S AMENDMENT OF THE NOTES TO PROMISE EXTENSION WARRANTS.

PCSI attempts to avoid the plain meaning of Section 6.2[1] by arguing without elaboration or citation that the Extension Warrants are not indebtedness "evidenced by the Note" because they were promised in the Offer Letter. AB at 14-15.

This argument, however, fails given the trial court's summary judgment ruling. In ruling that Appellants were entitled to the Extension Warrants, the trial court expressly held that "the contract at issue consists of the Notes as modified by the Offer Letter." A266 ¶ 3. This ruling has not been appealed by PCSI and is therefore binding on it. *See Mann v. Oppenheimer & Co.*, 517 A.2d 1056, 1060 (Del. 1986) ("[A]bsent a cross-appeal, the appellee may not attack the judgment of the court below with a view to enlarging its own rights or lessening the rights of its adversary.").

PCSI could have, but did not, draft the Offer Letter to amend Section 6.2. Rather, it promised to pay attorneys' fees if it had to be forced by lawsuit to pay

indebtedness "evidenced by this Note," then offered to amend those Notes to indebt itself to provide the Extension Warrants. Because it had to be sued to force it to provide them, fees must be shifted.

It is well settled that a written agreement may be modified by a subsequent written or oral agreement.[3] *E.g.*, *Moeller v. Wilmington Sav. Fund Soc.*, 723 A.2d 1177, 1179 & n.7 (Del. 1999). There is no evidence that Section 6.2[1] meant to exclude fee-shifting if the Notes were amended.

V. FEES WOULD BE SHIFTED EVEN IF THE NOTES ONLY CONCERNED LITIGATION OVER PRINCIPAL OR INTEREST.

PCSI argues in vain that Section 6.2[1], which refers to "indebtedness" and "default," should be read as if it referred only to "principal" or "interest". Even if it had been drafted that way (it was not), however, fees would still properly be shifted.

PCSI argued below that it need not provide the Extension Warrants because it had already paid interest. The trial court rejected this argument in its summary judgment ruling, holding that "PCSI ***promised warrant coverage as a component of the plaintiffs' return*** and is now obligated to provide it." A275 ¶ 15 (emphasis

[3] PCSI's argument, when carefully considered, violates this principle and leads to absurdity. Suppose the parties had agreed to amend the Notes in other respects, such as to pay a different principal or interest amount. Would a successful suit to enforce the Notes as amended be subject to full fee-shifting, partial fee-shifting, or none at all? These odd questions are all avoided by the simple and commonsense assumption that Section 6.2[1] applies to the Notes however they are amended.

added). PCSI did not appeal this holding and thus is bound by it. *Mann*, 517 A.2d at 1060. Even if Section 6.2[1] limited fee-shifting to non-payment of "principal and interest", Appellants' fees would still properly be shifted because the Extension Warrants were in reality a component of the interest due to Appellants.

Furthermore, this litigation stems from litigation in Texas to recover principal and interest. Indeed, the very first page of the Answering Brief acknowledges the genesis of the claim for Extension Warrants in the Texas litigation. AB at 1-2 (Appellants "initiated this litigation by filing a civil action against [PCSI] in the State of Texas", and parties "agreed to transfer the dispute over the Extension Warrants to the Delaware Court of Chancery"). Even if Section 6.2[1] applied only upon being placed in the hands of attorneys after a failure to pay principal or interest, that is what happened, and the fee-shifting provision thereafter grants all "reasonable attorneys' fees."

In responding to this argument, PCSI notes that there was a settlement in the Texas action and asserts that therefore "the fact that Plaintiffs originally brought suit for non-payment of the Notes has zero bearing here." AB at 18. That settlement in no way precludes fee-shifting in this action as the release is limited as to costs and attorneys' fees incurred "up to the EFFECTIVE DATE" of the release. A162.

VI. EVEN IF AMBIGUOUS, THE FEE-SHIFTING PROVISION MUST BE CONSTRUED IN APPELLANTS' FAVOR.

As set forth above, the plain language of Section 6.2[1] grants Appellants fees for having prevailed in this action. At worst, PCSI's arguments give rise to an ambiguity. That ambiguity must be construed against PCSI, because it and it alone drafted both the Notes and the Offer Letter that amended those Notes.[4] OB at 21-22.

PCSI asserts that "Plaintiffs did not present this argument below to the Trial Court," and relies on it almost exclusively in opposing this ground for reversal. AB at 19-20.[5] PCSI is simply mistaken. In Appellants' opposition to PCSI's

[4] PCSI argues that "the Company's history" has "no bearing on the narrow legal questions at issue here." AB at 4 n.1. It is wrong because the *contra proferentem* doctrine in event of ambiguity looks to whether one side drafted the relevant contracts (PCSI does not deny it was the drafter). It is also wrong because a general understanding of the circumstances can assist this Court in understanding Section 6.2. *U.S. W., Inc. v. Time Warner Inc.*, 1996 WL 307445, at *10 n.10 (Del. Ch. June 6, 1996) (Allen, C.) ("In some cases, determining whether a contract is susceptible to more than one interpretation requires an understanding of the context and business circumstances under which the language was negotiated"). For instance, because PCSI was trying to avoid being sued by Appellants, it had no leverage to tell them they would not be repaid their legal fees if they had to sue to get their Extension Warrants, the interpretation PCSI advances in this appeal. *Supra* pp. 6-7.

[5] Ironically, PCSI itself argues for the first time on appeal that "courts traditionally construe contractual fee-shifting provisions narrowly." AB at 16-17 & n.3. Only two of the cases PCSI cites are from Delaware, however, and those merely stand for the more general and irrelevant proposition that fee-shifting provisions are an exception to the American Rule. Delaware courts have no such rule of construction. Even if they did, the Court should still construe Section 6.2 against

motion for reargument,[6] Appellants argued, "To the extent the contract is ambiguous, Plaintiffs' interpretation is supported by the contractual canon of interpreting a contract against the drafter." A356. Appellants cited *Bank of New York Mellon v. Commerzbank Capital Funding Trust II*, 65 A.3d 539, 551 (Del. 2013), the same case they cited in their Opening Brief to this Court. OB at 21.

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the drafter because it would be inequitable to allow PCSI to create an ambiguous fee-shifting provision, then benefit from that ambiguity.

[6] The trial court ruling at issue here is the one it rendered on PCSI's motion for reargument, as it originally granted Appellants' motion for attorneys' fees.

CONCLUSION

Appellants respectfully request that this Court reverse the lower court with instructions to grant Appellants' motion for attorneys' fees.

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