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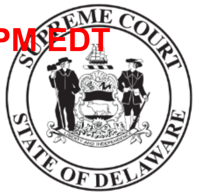

# IN THE SUPREME COURT OF THE STATE OF DELAWARE

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| DSG ENTERTAINMENT SERVICES INC. (f/k/a Deluxe Entertainment Services Inc.), | ) | No. 185, 2021 |
| Plaintiff Below-Appellant, | ) | |
| v. | ) | Court Below: Court of Chancery of the State of Delaware, C.A. No. 2020-0618-MTZ |
| DLX ACQUISITION CORPORATION and DELUXE MEDIA INC. | ) | Public Redacted Version Filed: August 18, 2021 |
| Defendants Below-Appellees. | ) | |

## AMENDED APPELLANT'S OPENING BRIEF

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Dated: July 30, 2021

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## NATURE OF PROCEEDINGS

DSG Entertainment Services Inc. (f/k/a Deluxe Entertainment Services Inc.) ("Seller") sold its distribution subsidiary, Deluxe Media, Inc. ("Target"), to DLX Acquisition Corporation ("Buyer"), an affiliate of the private equity firm Platinum Equity ("Platinum"), pursuant to a Purchase Agreement among Seller, Target and Buyer dated as of June 30, 2020, in a sign and close transaction that closed on the same day. All of the contemporaneous communications between the parties showed that the parties understood the deal was to be "cash-free, debt-free." But that is not what happened. When Seller tried to get Target to upstream the cash that was in Target's accounts at closing, Target, now under control of Platinum, refused. As a result, Buyer received around a [redacted] windfall.

Seller tried to resolve the issue with Platinum, but Platinum refused. So, on July 24, 2020, Seller filed an action in the Court of Chancery asserting, among other things, claims for breach of contract, breach of the implied covenant of good faith and fair dealing, and reformation. After the Court of Chancery summarily denied Seller's motion to expedite without a hearing, the parties agreed to brief a motion for judgment on the pleadings to be filed by Buyer and Target (collectively, "Defendants").

On March 29, 2021, the Court of Chancery issued a letter decision granting Defendants' Motion for Judgment on the Pleadings (the "Opinion").[1] On April 7, 2021, Seller filed a Motion for Reargument. A496-A502. On May 19, 2021, the Court of Chancery denied the Motion for Reargument.[2] Seller filed its Notice of Appeal on June 8, 2021. This is Seller's Opening Brief on Appeal.

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[1] The Opinion is attached hereto as Exhibit A and will be cited herein as "Op."

[2] The decision denying Seller's motion for reargument is attached hereto as Exhibit B.

## SUMMARY OF ARGUMENT

1. The Court of Chancery erred in granting Defendants judgment on Seller's breach of contract claim. First, the calculation of Net Working Capital, which excludes Target's cash as a "definitional" adjustment and was incorporated into the Purchase Agreement as an exhibit, definitively shows that Buyer was not entitled to receive any cash in Target's accounts at closing. The Court of Chancery's decision allowing Buyer to keep this cash upends the economic agreement the parties reached. Second, the Court erred in assuming that the defined term Company Assets included Target's cash. The Court raised this issue *sua sponte* during oral argument, and Seller advised the Court that Target's cash is not a Company Asset, as defined by the Purchase Agreement, because the cash in Target's accounts was not used "solely or primarily … by the Company Group in the conduct of its business."

2. The Court of Chancery erred in granting Defendants judgment on the pleadings on Seller's claim for breach of the implied covenant of good faith and fair dealing. If, as the Court found, the Purchase Agreement did not specifically address the treatment of Target's cash at closing, and Seller made an "operational mistake" by failing to sweep Target's cash before closing, there still was no contractual provision that addressed how much, if any of Target's cash would remain at closing. As such, only the implied covenant of good faith and fair dealing applies to prevent the Buyer from receiving the windfall for which it did not bargain. The Court erred

in citing the wrong-pocket provisions of the Purchase Agreement as evidence that the parties contracted for the possibility of misplaced assets. Those provisions, rather, address unintended transfers. To the contrary here, it is the failure of a transfer at issue, so the cash was never put into a wrong pocket.

3. The Court of Chancery erred in granting Defendants judgment on the pleadings on Seller's reformation claim. First, the Court below erred in concluding that the parties did not reach a definite agreement that Target's cash would not be included as part of the transaction. All of the contemporaneous evidence pleaded in the Complaint showed that the parties understood Target's cash would not be included. Second, the Court erred in concluding that the "mistake" was an operational mistake by Seller in failing to sweep cash before closing, and not a failure to memorialize properly the parties' agreement. Among other things, that conclusion cannot be squared with the Court's conclusion that Buyer is entitled to keep Target's cash under the Purchase Agreement because, under the Court's interpretation, it would have then been a breach of contract if Seller had swept Target's cash prior to closing, despite both Buyer and the Court of Chancery conceding Seller was entirely permitted to sweep the Target's cash prior to closing.

## STATEMENT OF FACTS

### A. Seller Markets its Distribution Business

Seller was, at one time, the world's leading video creation to distribution company, offering global, end-to-end services and technology in 38 key media markets worldwide. A10 at ¶ 4. Seller ran its distribution business through Target. A10 at ¶ 6. The distribution business permits Target's clients to deliver content to any window, screen or destination. *Id.*

In November 2019 Seller emerged from bankruptcy with a mandate from its owners to maximize the value of the company. To satisfy this mandate, Seller retained Moelis & Company LLC ("Moelis") to run the sale process for Seller's distribution business.

Moelis prepared the customary documentation to market the distribution business and in February 2020 sent letters to the entities who showed interest inviting them to submit an indication of interest by March 5, 202 (the "Initial Process Letter"). A11 at ¶ 9. In the Initial Process Letter, Moelis requested that the indication of interest should "indicate the cash purchase price in U.S. dollars you are proposing to pay for 100 percent of Deluxe Distribution on a cash-free, debt-free basis (the "Enterprise Value")." *Id.*

Platinum Equity ("Platinum") submitted an indication of interest on March 5, 2020 (the "Initial IOI"). A11 at ¶ 10. In the Initial IOI, Platinum estimated the

"enterprise value" of Target to be between [redacted] A11-A12 at ¶ 10. Platinum did not object to, or otherwise correct, the definition of Enterprise Value in the Initial Process Letter. *Id.* On May 1, 2020, Moelis sent a second process letter to the potential buyers selected to participate in the second round of the sale process (the "Second Round Process Letter"). A12 at ¶ 11. In the Second Round Process Letter, Moelis again invited participants to submit proposals to acquire 100% of Deluxe Distribution "on a cash-free, debt-free basis (the "Enterprise Value")." *Id.*

The Second Round Process Letter also invited participants to, among other things, review information in a data room and meet with members of management to discuss the distribution business. A12 at ¶ 12. As part of Platinum's due diligence process, the parties traded various documents. On May 12, 2020, Moelis placed in the virtual data room an illustrative example of Net Working Capital. During a subsequent three-hour call to discuss the Net Working Capital, Platinum agreed with excluding cash from the Net Working Capital calculation. *Id.*

As part of Platinum's due diligence process, the parties also traded versions of a due diligence tracker. A12 at ¶ 13. The May 13, 2020 version of the due diligence tracker showed that Seller had rejected certain due diligence requests borrowing base certificates of Target because the transaction was a "cash free/debt free deal." Platinum did not object to this response or the reason for it. *Id.*

On May 22, 2020, Platinum submitted an indication of interest that again referenced an "enterprise value" for the distribution business of (the "Second IOI"). A13 at ¶ 14. The Second IOI did not object to, or otherwise correct, the definition of Enterprise Value in the Second Round Process Letter. *Id*. In response to the Second IOI, Seller informed Platinum that Seller needed to receive net value (after giving effect to an initial Net Working Capital adjustment at closing) of no less than to do a deal. A13 at ¶ 15. In response, Platinum ultimately agreed to a enterprise value with a Net Working Capital goal. Because both parties knew that closing Net Working Capital under the proposed calculation was expected to be around each side understood that the actual cash exchanged at closing would be approximately less than the or *Id*. Given the clear mandate on net proceeds that Seller needed to receive, it is inconceivable that Platinum could have had a reasonable belief that it would get to effectively reduce Seller's proceeds even further by retaining cash of the Target for which Platinum did not pay. *Id*.

**B. The Parties Negotiate a Cash-Free, Debt-Free Transaction**

Having reached an understanding on the price of Seller's distribution business and structure of the transaction, the parties heavily negotiated the terms of their agreement throughout the month of June 2020, with the goal of a closing no later than June 30, 2020. A13-A14 at ¶ 16. Platinum had promised a June 30, 2020

closing as a key part of its winning bid in the very competitive process to buy the distribution business. As part of the negotiations, the parties exchanged several documents addressing the net working capital that the Target would have at closing, all of which showed that cash was excluded from the calculation of net working capital. *Id.* For example, on June 9, 2020, Brett Reinhart of Platinum sent Moelis a spreadsheet prepared by Platinum Equity entitled "AM – Project Rocket – Supporting Schedules_6.4.20.xlsx" that showed the deduction of cash from Reported Net Working Capital as a "Definitional Adjustment" to arrive at "Definitional Net Working Capital." A444; A13-A14 at ¶ 16.

On June 25, 2020, Moelis sent an email to several lawyers representing Platinum in the transaction containing, among other things, the projected closing balance sheet for Target and the projected Net Working Capital calculation, both assuming a closing on June 30, 2020. A14 at ¶ 17. The projected balance sheet expressly showed that the Target would have no cash at closing. The projected Net Working Capital again treated the elimination of cash as a definitional adjustment from Reported Net Working Capital to arrive at Definitional Net Working Capital, just like the spreadsheet prepared by Platinum earlier in June. A444; A14 at ¶ 17.

On or around June 26 and 27, 2020, Platinum urgently and repeatedly requested certain "must-have" information from Seller with respect to the funding needs that Target would have from and after closing. A14-A15 at ¶ 18. Specifically,

Platinum requested a "Consolidated and by-region 13-week (or at least 30-day) cash flow forecast for Distribution with exact dates and amounts that need to be funded in the 2 weeks immediately following the closing (along w/bank account info)." *Id.* On June 28, 2020, Alix Partners ("Alix"), Seller's liquidity consultant, sent to Platinum and Palmtree, Platinum's liquidity expert, various documents and information addressing these "must have" requests Platinum made regarding Target's "day 1" cash flow needs. A15 at ¶ 19. All of these materials expressly showed zero as the starting cash balance for the Target. Among these documents were a file titled "Project Rocket – Closing Balance Sheet Forecast for 6.30" which showed cash (both on a consolidated basis and on a country by country basis) as zero. A15 at ¶ 19. Alix also provided a spreadsheet titled "Project Rocket – CF Forecast_PalmTree (202000628 2135).xlsx" containing, among other things, the projected cash flow for Target post-closing, including "payroll build up/expected payment timing." A446-447; A15 at ¶ 19. None of these files contemplated that the Target would have any cash following closing. *Id*.

Not once during any of the parties' negotiations or discussions of the calculation of net working capital, projected balance sheets, or "day 1" funding needs did Platinum or its liquidity expert question why starting cash was shown as zero in all of the documents provided. A15 at ¶ 20. On June 28, 2020, as part of negotiating the Net Working Capital figure to be used to determine the amount paid

at closing, Platinum sent a spreadsheet to Moelis with Platinum's "annotations/edits." A15-A16 at ¶ 21. The spreadsheet contained many tabs, two of which were labeled, "Exhibit A – NWC_PE View" and "Exhibit A – NWC_seller view." Both tabs again expressly exclude cash "definitionally" from the calculation of net working capital. *Id.*

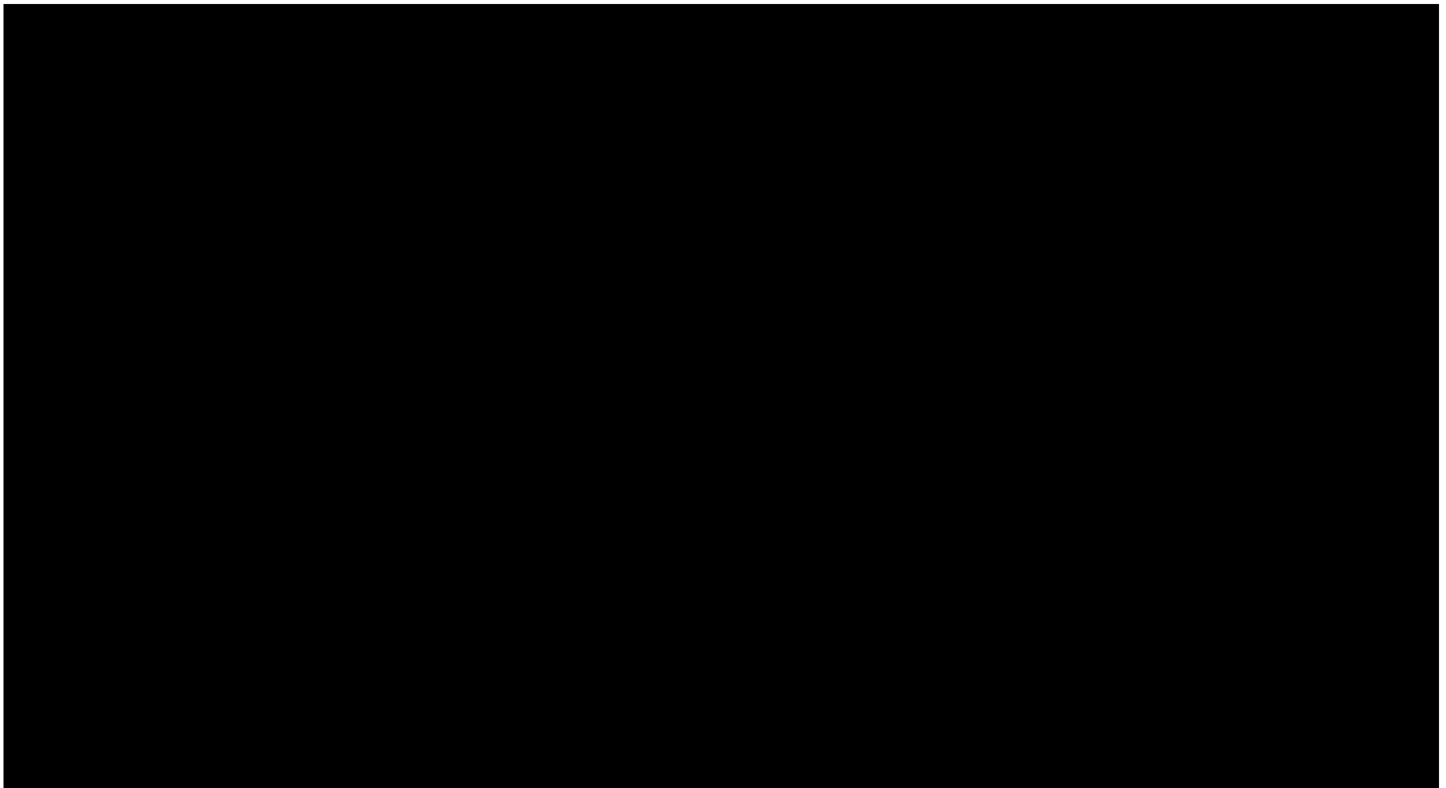
### C. The Relevant Terms of the Purchase Agreement

Consistent with the parties' understanding of the transaction, the Purchase Agreement was drafted in a manner to remove cash as an asset being transferred at closing. Specifically, the definition of Net Working Capital in the Purchase Agreement, excerpted below, deferred entirely and expressly to the line items and adjustments on Schedule 2.4 to the agreement (an illustrative example of the Net Working Capital calculation) to determine which "assets" are included or excluded in calculating Net Working Capital:

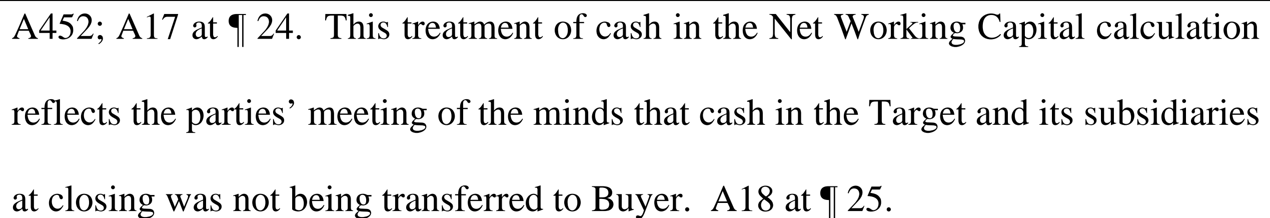
> (a) the sum of current assets of the Company Group set forth on the line items and subject to the adjustments set forth on Schedule 2.4; *minus* (b) the sum of the current liabilities of the Company Group set forth on the line items and subject to the adjustments set forth on Schedule 2.4 (which schedule shall not include any Transaction Bonuses), in each case, calculated in accordance with the Accounting Principles. An illustrative example of the calculation of Net Working Capital is set forth on Schedule 2.4.

A16 at ¶ 22; A45.

Schedule 2.4, in turn, expressly refers to a number of "Definitional Adjustments," including an express definitional adjustment to Reported Net Working Capital to remove cash to arrive at Definitional Net Working Capital. A16 at ¶ 23; A218-A220 at Schedule 2.4.) In the illustrative example on Schedule 2.4 of the Purchase Agreement, cash is "definitionally" excluded from the calculation:



*Id*. The Purchase Agreement also required the Seller to deliver the Purchase Price Certificate where Seller's CEO certified certain items. In the Purchase Price Certificate the CEO certified that "the components of the estimated Net Working Capital are set forth on Exhibit A attached hereto (the 'NWC Worksheet')." A449; A17 at ¶ 24. The NWC Worksheet attached to the Purchase Price Certificate did not include cash as a component of Net Working Capital:



A452; A17 at ¶ 24. This treatment of cash in the Net Working Capital calculation reflects the parties' meeting of the minds that cash in the Target and its subsidiaries at closing was not being transferred to Buyer. A18 at ¶ 25.

This is also consistent with the definition of Company Assets in the Purchase Agreement. The parties defined Company Assets as:

> all assets, properties or rights of any kind or nature of any member of the Company Group or solely or primarily used by the Company Group in the conduct of its business (i) including the Deluxe name and brand and all other company names and brands used by the Company Group, and (ii) excluding, for the avoidance of doubt, assets, properties or rights transferred out of the Company Group pursuant to the Restructuring.

A37 § 1.2. The "cash" in Target was not "solely or primarily used by the Company Group in the conduct of its business," but was instead swept up and used by Seller for all of its businesses. A493. In other words, just as with the definition of Net Working Capital, cash was never meant to be included as a Company Asset in the first instance.

### D. Target Refuses to Turn Over its Cash to Seller

Though all parties agree that Seller was permitted to do so, Seller did not sweep the funds from Target and its subsidiaries before Closing for various practical and technical reasons. A18 at ¶ 26. Seller's controller promptly requested this cash from Platinum on and after July 1, 2020. *Id.* On July 1, 2020, however, Seller's controller first discovered that the Buyer and Target were treating the cash that was in the Target at closing as if it belonged to Buyer. In a call on July 1, 2020 – the day after Closing – with among others, Platinum and Palmtree, the controller immediately told Platinum that the distribution business entities should have had zero cash on July 1, 2020, and that any cash in the Target's bank accounts at closing should be transferred immediately to Seller in accordance with the cash-free nature of the deal (the "Disputed Cash"). *Id.* Although the Purchase Agreement, the parties' discussions and the contemporaneous documentation excluded cash from all of the calculations, Platinum and its liquidity expert said nothing in response to the controller's request. *Id.*

Later on July 1, 2020, in response to a query from Platinum about money in an Australian bank account, Seller's controller instructed Platinum that Deluxe Media's Australian treasurer (who was providing finance service to Seller under a Transition Service Agreement) needed to cease immediately any "cross-funding" of the Target's Australian subsidiary and Seller's Australian operations, noting that

Buyer's Australian subsidiary needed to put in place "a control to know when they need money daily … since they started with zero cash as well." A18-A19 at ¶ 27.

On top of the problems with Buyer retaining the cash and despite providing all of the information Platinum requested about cash needs on Day 1 after closing, Buyer did not fund its payroll or rent as it needed to do immediately after closing. A19 at ¶ 28. As a result, the payroll auto-funded from Seller's bank accounts on July 3. Moreover, Seller also ended up paying the July rents Target owed. *Id.* In total, Seller had to pay over [REDACTED] to cover the payroll and rent obligations that Platinum knew about and agreed to be responsible for but simply failed to fulfill its obligations. *Id.*

Although addressing the unfunded payroll and rent issue, Seller's controller attempted to confirm the amount of cash in the Target bank accounts at closing and sought the return of such, but he was rebuffed by employees at Deluxe Media who answered to a new boss. A19 at ¶ 29. A representative from Alix spoke twice to Brett Reinhart from Platinum about the issue. Both times Mr. Reinhart claimed that the issue was "above his pay grade" and that he could not do anything about it. *Id.* Seller's attempts to get its former employees to assist in recovering its cash fared no better. A19-A20 at ¶ 30. After several attempts to contact their former colleagues, eventually the new Chief Financial Officer of Deluxe Media instructed Seller's

employees to stop contacting these former employees and direct all inquiries about the cash issue to him. *Id*.

Finally, on July 10, 2020, a senior member of Moelis called Dan Krasner of Platinum to escalate the cash issue. A20 at ¶ 31. During this call, Mr. Krasner professed ignorance of the issue and merely asked what the Purchase Agreement provided. Mr. Krasner promised to review the issue and get back to Moelis, but he never called Moelis back. *Id*. By July 13, 2020, Mr. Krasner had not returned Moelis' call, so Stefanie Liquori, the General Counsel of Seller called Mr. Krasner. A20 at ¶ 32. During this call Mr. Krasner did not offer any explanation for why he thought the Buyer would get cash "for free" under the Purchase Agreement. *Id.* Although Mr. Krasner could not provide even one example of evidence where the Buyer expected to receive any cash at closing, let alone an example of when Buyer expressed that view to Seller, he refused to honor the parties' clear negotiating history and the fundamental aspects of the parties' bargain. *Id*. Mr. Krasner simply claimed that because the Purchase Agreement does not contain a specific mechanic for the treatment of cash at closing outside of the Net Working Capital's definitional exclusion of cash, it was Buyer's prerogative to keep the cash. *Id*.

Ms. Liquori and Mr. Krasner spoke again on July 22, 2020. During this call Mr. Krasner still did not agree to return the Disputed Cash to Seller, nor did he offer any argument to support Platinum's position beyond "finder's keeper's." A20 at ¶

32. Platinum's position on the treatment of cash allowed it to reap an undeserved windfall of over [redacted], contrary to the commonsense understanding of the mergers and acquisitions marketplace. A21 at ¶ 34. Platinum reduced the purchase price by approximately [redacted] because the Definitional Net Working Capital (which according to the Purchase Agreement did not include cash), was approximately [redacted] less than the Target Net Working Capital agreed to in the Purchase Agreement. A21 at ¶ 35. Had the cash been included in the calculation of Definitional Net Working Capital, Platinum only would have been able to reduce the purchase price by approximately [redacted] Instead, Platinum reduced the purchase by at closing *and* kept the cash to which it was not entitled. *Id.*

### E. Defendants Admit that Seller was Permitted to Sweep the Cash Before Closing

Further demonstrating that Seller is entitled to the Disputed Cash is Defendants' admission at the hearing on their motion for judgment on the pleadings in front of the Court of Chancery. Indeed, at the hearing Defendants admitted the following:

> THE COURT: Thank you. Just a couple questions.
>
> The first is, by your reading of the purchase agreement, could the plaintiff have swept those funds prior to closing?
>
> MR. GARDNER: I think **they could have**, to some degree. Now, how much, I have no idea.

A468 (emphasis added). The Court acknowledged this admission in the Opinion. *See* Op. at 3 n. 7. Moreover, this is consistent with the Court's statements in the Opinion that the failure to transfer the Disputed Cash prior to closing was a "mistake." *See* Op. at 25 (describing this as an "operational mistake by Seller"), 33 ("Seller's failure to sweep Target's cash is an operations or accounting mistake").

Despite Defendants' admission and the Court's understanding that Seller could sweep the Target's cash prior to the closing of the Transaction, the Court, in error, granted Defendants' motion for judgment on the pleadings.

## ARGUMENT

### I. THE COURT BELOW ERRED IN GRANTING DEFENDANTS JUDGMENT ON THE PLEADINGS ON SELLER'S BREACH OF CONTRACT CLAIM

#### A. Questions Presented

Whether the Court correctly construed the Purchase Agreement to allow Buyer to keep the cash in Target at Closing without paying for it. Specifically, whether Target's cash was not an Excluded Asset because it was never meant to be a Company Asset, either because of the definition of Net Working Capital and illustrative example attached to the Purchase Agreement or because Target's cash at closing was not a Company Asset. A408, A424-A432, A484-A483, A492-A493.

#### B. Scope of Review

This Court reviews questions of contract interpretation *de novo*. *GMG Cap. Invs., LLC v. Athenian Venture Partners I, L.P.*, 36 A.3d 776, 779 (Del. 2012).

#### C. Merits of Argument

This Court construes contracts by "determining what a reasonable person in the position of the parties would have thought the language of the contract means." *See Lorillard Tobacco Co. v. Am. Legacy Found.*, 903 A.2d 728, 739 (Del. 2006). In this analysis, the Court takes into account the parties' respective commercial positions and the risks that the contract seeks to allocate: "[t]he basic business relationship between parties must be understood to give sensible life to any contract." *Chicago Bridge & Iron Co., N.V. v. Westinghouse Elec. Co. LLC*, 166

A.3d 912, 927 (Del. 2017). And this Court will reject an interpretation that produces a result "that no reasonable person would have accepted when entering the contract." *Osborn ex rel. Osborn v. Kemp*, 991 A.2d 1153, 1160 (Del. 2010); *see also ITG Brands, LLC v. Reynolds Am., Inc.*, 2017 WL 5903355, at *12 (Del. Ch. Nov. 30, 2017).

Here, at its most basic level, it is undisputed that Buyer agreed to purchase Target at a price so that Seller would receive net value of no less than [redacted] A13 at ¶ 15. Any cash remaining in Target that Buyer did not return effectively reduced the net value Seller would receive because cash was excluded from the Net Working Capital calculation. In other words, in determining the funds flow at closing, the Seller would not get credit for the cash in the Target. Buyer objectively had no expectation in receiving any cash held by Target at Closing – Buyer conceded that Seller could have swept some or all of the cash in Target immediately before Closing. A468. Nor is it reasonable to think that Seller would willingly enter into a contract that effectively reduced the purchase price by more than 30%. Notwithstanding this logic, the Court concluded that because Target's cash was not listed as an Excluded Asset, it was transferred at Closing.

That was error. The premise of the Court of Chancery's holding – that all Company Assets are included in the Transaction unless specifically excluded[3] –

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[3] Op. at 13.

overlooks the fundamental question of what was a Company Asset in the first instance. Target's cash was not a Company Asset because it was not "solely or primarily used by the Company Group in the conduct of its business." A37 § 1.2. Thus, it was never in the bucket of assets from which the parties selected those to be excluded. This conclusion is buttressed by the treatment of cash in the calculation of Net Working Capital. Target's cash was definitionally excluded from the calculation of Net Working Capital because it was never meant to be a Company Asset that Buyer acquired. Buyer, therefore, breached the Purchase Agreement because it obtained something that was not a Company Asset.

The Court below incorrectly concluded that the only way Seller would be entitled to keep the Disputed Cash is if it were identified as an Excluded Asset. That error stemmed from the Court below's incomplete citation to the definition of Company Asset. In footnote 38 on page 10 of the Opinion, the Court stated that "by its plain meaning, 'all assets . . . of any kind or nature of any member of the Company Group' includes the Disputed Cash, owned by Target." Op. at 10 n.38. In doing so, the Court excised the important conditional qualification in the definition of Company asset that the assets be "solely or primarily used by the Company Group in the conduct of its business." A37 § 1.2. Thus, not everything owned by Target was a Company Asset.

As an initial matter, this argument was not waived, as the Court of Chancery held in its order denying the Motion for Reargument. Defendants did not argue in their briefs that the definition of Company Assets must include the Disputed Cash. The Court raised the issue *sua sponte* during oral argument, at which time Seller explained that cash was not a Company Asset because all cash was managed by Seller and was not used solely or primarily for Target's business. The Court's interpretation of the definition of Company Assets then became the foundation for its ruling in favor of Defendants. It was error for the Court to raise and rule on the basis of an argument Defendants never raised. *Bank of New York Mellon v. Barber*, 295 So.2d 1223, 1225 (Fla. Dist Ct. App. 2020).

On the merits, the Court of Chancery's interpretation of Company Assets conflicts with the parties' overall deal and the specific mechanisms in the Purchase Agreement to effectuate the transaction. The Purchase Price Certificate details the disposition of the gross sale proceeds [REDACTED] and a price reduction [REDACTED] due to a planned shortfall in Net Working Capital resulting in [REDACTED] in net proceeds before paying for Target's debts, resulting in a cash-free, debt-free transaction. A454. Concluding that Buyer could keep Target's cash without accounting for it on the Net Working Capital worksheet, or through some other mechanic, results in a transaction that no reasonable person would have accepted

when entering the contract; by making it no longer "cash-free," Buyer received a ████████ windfall.

The Court of Chancery erred in concluding that no meaning can be taken from the exclusion of the Target's cash from the Net Working Capital calculus. The absence of cash from Net Working Capital is entirely consistent with Seller's position that Target's cash was never a Company Asset in the first place. If it was not an Excluded Asset, then it should have been included on the Net Working Capital worksheet – but it was not. The only way to explain its absence is if it is not a Company Asset.

Defendants' concession that Seller could have swept some of the Disputed Cash is fatal to their position and demonstrates the error in the Court's conclusion. If, as the Court found, the plain language of the Purchase Agreement expressly contemplates that the Disputed Cash was to belong to Buyer, then if Target had no cash at Closing, Buyer would have had a claim against Seller for breach. But Buyer could not explain to the Court how much cash Seller could have swept, meaning there was no express agreement that Buyer expected there to be any cash in target at closing, let alone regarding how much cash Buyer objectively expected to be there at Closing. Put another way, if Seller swept all of the cash, to what provision of the Purchase Agreement could Buyer look to assert a claim for breach of contract, and what would the damages be? It is inconceivable that these two parties entered into

an agreement where the disposition of millions of dollars was up to the chance of where that cash resided at closing. It is equally inconceivable that Seller would agree to a transaction that could reduce by 30% the net consideration it would receive at Closing.

## II. THE COURT BELOW ERRED IN GRANTING DEFENDANTS JUDGMENT ON THE PLEADINGS ON SELLER'S CLAIM FOR BREACH OF THE IMPLIED COVENANT

### A. Questions Presented

Whether the Court properly granted Defendants judgment on the pleadings on Seller's claim for breach of the implied covenant of good faith and fair dealing when Defendants retained approximately [redacted] in cash unaccounted for in the parties' calculations regarding the flow of funds at closing. A432-A435.

### B. Scope of Review

The standard of review of a trial court's grant of a motion for judgment on the pleadings presents a question of law, which is subject to de novo review. *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, LP*, 624 A.2d 1199, 1204 (Del. 1993).

### C. Merits of Argument

The implied covenant of good faith and fair dealing has long held an important place in Delaware jurisprudence regarding contracts. The implied covenant "attaches to every contract," *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005), and requires that a party refrain from "arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of its bargain." *Gerber v. Enterprise Prods. Hldgs., LLC*, 67 A.3d 400, 419 (Del. 2013), *overruled on other grounds by Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808 (Del. 2013). The implied covenant is a contractual gap-filler that

protects "the spirit of the agreement rather than the form." *Allen v. El Paso Pipeline GP Co., L.L.C.*, 2014 WL 2819005, at *10 (Del. Ch. June 20, 2014) (citations omitted); *see also Dunlap*, 878 A.2d at 444 (the implied covenant "requires more than just literal compliance with [the contract]").

The "fair dealing" referred to in the implied covenant is "a commitment to deal 'fairly' in the sense of consistently with the terms of the parties' agreement and its purpose." *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC*, 50 A.3d 434, 440 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds*, 68 A.3d 665 (Del. 2013). Similarly, "'good faith' envision[s] ... faithfulness to the scope, purpose and terms of the parties' contract." *Id.*

The application of the implied covenant depends on whether there is a "gap" in the agreement. Here, the Court found that the Purchase Agreement does not explicitly address the treatment of Target's cash at closing. Op. at 20-21. Thus, a "gap" does exist. Under the plain terms of the Purchase Agreement, there is no right for the Buyer to retain the Target's pre-closing cash. Indeed, if the Purchase Agreement had such a provision, Defendants would have pointed that out. Because that term does not exist, Defendants instead resorted to suggesting that the Wrong Pocket Provisions, and specifically the exclusion of any mention of the Disputed Cash in the Excluded Assets Schedule provision, constituted definitive proof that the Target's pre-closing cash was to be transferred to the Buyer. *See* A463.

In response to this argument, the Court erred in finding that the existence of the Wrong Pocket Provision implied that the parties had considered the possibility of misplaced assets and could have addressed the Disputed Cash in this provision. This conclusion is contrary to the facts asserted in the Complaint and the facts acknowledged by Defendants and the Court in this matter.

*First*, the Wrong Pocket Provisions address unintended transfers of assets. The Disputed Cash is not an asset (*see supra* § 1.C) nor was it transferred. Indeed, that is the crux of the dispute.

*Second*, the fact that Defendants and the Court acknowledged that the cash could have been swept prior to closing further supports that the Disputed Cash was not intended to be included as a Company Asset. Indeed, Defendants admitted and the Court noted in the Opinion that "Seller would have been within its rights to sweep the Disputed Cash, or at least some of it, from Target's bank account prior to closing." *See* Op. at 3 n.7; A469-A469. With this acknowledgment, it is unclear how there can be any argument that the Disputed Cash was supposed to go to the Buyer pursuant to the Purchase Agreement. Indeed, the Court even acknowledged that the mistake that Seller made in not sweeping the cash before closing was an "operational mistake by Seller." Op. at 25.

Seller had no expectation that a simple operational mistake would be held against them. This is instead a perfect example of when the implied covenant should

be utilized to ensure that the "spirit" of the agreement is enforced. As addressed above, the core tenet of this transaction was that it was "cash-free, debt-free." Consistent with that structure, the debts were satisfied at closing and not transferred to Buyer. Similarly, the Target's pre-closing cash was not to be left with Target but rather swept up prior to closing by Seller. These facts are alleged in the Complaint (A8-A9 at ¶¶ 1-2) and demonstrate that there is, at minimum, a fact dispute about the intention of the parties here.

The hallmark of a good faith and fair dealing claim is that one party has engaged in conduct that would have been proscribed had the parties addressed it in the contract. *See id.*; *see also E.I. DuPont de Nemours*, 679 A.2d at 443; *Katz v. Oak Indus, Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986). Here, as with other cases, the analysis turns "upon the purpose of and understandings surrounding" the contract at issue. *Kass v. E. Air Lines, Inc.*, 1986 WL 13008, at *3-4 (Del. Ch. Nov. 14, 1986); *see also Schwartzberg v, CRITEF Assoc Ltd P'ship*, 685 A.2d 365, 376 (Del. Ch. 1996). Indeed, as this Court has recognized, it has a duty to the "spirit of the bargain," which "is higher than its duty to the technicalities of the language." *Scherer v. R.P. Scherer Corp.*, 1988 WL 103311, at *9 (Del. Ch. Oct. 5, 1988).

Here, the Court failed to take the spirit of the bargain into consideration. The facts surrounding this issue demonstrate that Defendants are acting in an unreasonable manner and are failing to act consistently with the spirit of the

agreement as whole. Instead, the Buyer has refused to turn over Seller's pre-closing cash that was never part of the transaction, which Buyer only came into possession of because of an "operational mistake." Defendants are choosing to engage in underhanded tactics, which has resulted in Seller being deprived of the fruits of the bargain reached with Buyer. Indeed, if Seller contemplated the potential for this type of operational mistake or thought that an operational mistake would be met with the Buyer's refusal to act reasonably, Seller would have made clear that cash was not to be considered an asset of Target at any time.

The Court of Chancery's ruling does not bear the earmarks of "an orderly and logical deductive process." *Levitt v. Bouvier*, 287 A.2d 671, 673 (Del. 1972). Therefore, because the Court of Chancery did not examine or discuss the evidence under the standards applicable to an implied covenant claim, this Court should not affirm the decision below, but should reverse it, with instructions to render a decision under the legal standards properly applicable to such claims. *See, e.g.*, *Merrill v. Crothall-American, Inc.*, 606 A.2d 96, 102 (Del. 1992) (reversing grant of summary judgment by lower court where alleged facts, if believed by factfinder, would support a finding of a breach of the implied covenant of good faith and fair dealing).

## III. THE COURT BELOW ERRED IN GRANTING DEFENDANTS JUDGMENT ON THE PLEADINGS ON SELLER'S REFORMATION CLAIM

### A. Questions Presented

Whether Defendants were entitled to judgment on the pleadings on Seller's claim for reformation of the Purchase Agreement. A435-A439.

### B. Scope of Review

The standard of review of a trial court's grant of a motion for judgment on the pleadings presents a question of law, which is subject to *de novo* review. *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, LP*, 624 A.2d 1199, 1204 (Del. 1993).

### C. Merits of Argument

In its Complaint, Seller averred, in the alternative, that should the trial court find that the Purchase Agreement failed to address the parties' intent that the Disputed Cash was not an asset transferred to Buyer as part of the Transaction, but rather belonged to Seller, the absence of such language was a "scrivener's error." A24-A25 at ¶ 51. The Court of Chancery held that reformation of the Purchase Agreement was not an appropriate remedy because Seller failed to plead a mistake for which reformation is available. Op. at 30. More specifically, the Court found, "Seller fails to allege the parties struck an agreement that cash would be excluded from the Transaction" despite the Complaint being replete with detailed allegations of the parties' negotiating history in addition to the plain terms of the Purchase

Agreement supporting Seller's claim. Op. at 31-32. This ruling misapprehends the basis of Seller's claim for reformation, the language of the Purchase Agreement, and applicable Delaware law.

Delaware courts employ the equitable remedy of reformation to "reform a contract in order to express the 'real agreement' of the parties. *Cerberus,* 794 A.2d at 1151.

> There are two doctrines that allow reformation. The first is the doctrine of mutual mistake. In such a case, the plaintiff must show that both parties were mistaken as to a material portion of the written agreement. The second is the doctrine of unilateral mistake. The party asserting this doctrine must show that it was mistaken and that the other knew of the mistake but remained silent.

*Id.* at 1151-52 (footnotes omitted). In order to state a reformation claim, "[P]laintiff must show that both parties were mistaken as to a material portion of the written agreement." *Cerberus*, 794 A.2d at 1151. The mistake "must relate to the facts as they exist at the time of the making of the contract. A party's prediction or judgment as to events to occur in the future, even if erroneous, is not a mistake… An erroneous belief as to the contents or effect of a writing that expresses the agreement is, however, a mistake." 27 *Williston Contract*, § 70.1 (4th Ed.); *see also* Restatement (Second) of Contracts, § 155.

Delaware recognizes that reformation is appropriate where parties reach agreement on the economic substance of a transaction, but the later, written

agreement fails to capture the parties mutual understanding of the deal. *See Colvocoresses v. W.S. Wasserman Co.,* 28 A.2d 588, 589 (Del. Ch. 1942) ("The very purpose of reformation…is to make an erroneous instrument express correctly the real agreement between the parties."); *Collins v. Burke,* 418 A.2d 999, 1002 (Del. 1980) (same); *Cerberus*, 794 A.2d at 1151 (same); *Joyce,* 2003 WL 21517864, at *5 (Court sustained reformation claim because "the complaint clearly state[d] the terms of the parties' alleged [earlier] agreement" that was not accurately reduced to writing); *James River-Pennington Inc. v. CRSS Capital, Inc.,* 1995 WL 106554, at *9-10 (Del. Ch. Mar. 6, 1995) (Court sustained reformation claim seeking inclusion of restrictions on the exercising of call options because the Court "may reform a document to make it conform to the original intent of parties").

At the pleading stage a claim for reformation will survive a dispositive motion if the nonmoving party would be entitled to relief under any of the facts alleged in the complaint. *See Interactive Corp. v. Vivendi Universal, S.A.*, 2004 WL 1572932 at *15 n.76 (Del. Ch. 2004). Here, Seller sufficiently pled its reformation claim and, in particular, that the parties reached an agreement that the Disputed Cash was not part of the Transaction. The Complaint details the parties' pre-signing agreement that the transaction be "cash-free, debt-free" and that the Target would be transferred to Buyer without cash or debt. (*See, e.g.*, A11-A13, A15, A18 at ¶¶ 9-14, 19-20 and 25.) The Complaint pleads with particularity the negotiation process whereby the

parties agreed to the "cash-free, debt-free" transaction structure, specifically the calculation of Net Working Capital, which excludes the Target's pre-closing cash from its calculus. (*See, e.g.,* A13-A14, A-15-A16 at ¶¶ 15-17 and 21.) In fact, there is not a single shred of evidence in the pleadings contradicting the well-pled allegations of the Complaint that the parties agreed that the Disputed Cash was not part of the Transaction.

"An analysis of whether a pleading is sufficient to satisfy Rule 9(b) does not amount to a scientific inquiry. Rather, the Court makes an informed judgment to determine if the allegations, if assumed to be true, would plead the elements of a [] mistake, and would put the defendants on notice of the nature of their [] mistake." *Joyce v. RCN Corp.*, 2003 WL 21517864, at *5 (Del. Ch. July 1, 2003). "Specifically, 'particularity' in this context means that the facts upon which a plaintiff relies in pleading reformation must be set forth 'with at least some particularity' in order to put the defendant on notice of what is charged against him, but does not go so far as to require a 'textbook pleading or the use of specific words or phrases'." *Duff v. Innovative Discovery LLC,* 2012 WL 6096586, at *10 (Del. Ch. Dec. 7, 2012). The Court in *Duff* went on to state:

> Thus, a complaint for reformation based on mutual mistake will withstand a motion to dismiss for failure to comply with the requirements of Rule 9(b), if it alleges: "(i) the terms of an oral agreement between the parties; (ii) the execution of a written agreement that was intended, but failed, to incorporate those terms; and (iii) the parties'

> mutual—but mistaken—belief that the writing reflected the true agreement and (iv) the precise mistake."

*Id.* Seller satisfies that standard.

As discussed above, the Complaint details the parties' meeting of the minds that the Target's cash would not be transferred in the Transaction. To be clear, the parties pre-Purchase Agreement understanding that the Target's cash was not to be transferred in the Transaction "need not constitute a complete contract in and of itself." *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC,* 2012 WL 1869416, at *13 (Del. Ch. May 16, 2012), quoting *Cerberus Int'l Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1152 (Del. 2002). "Reformation is available even when 'the antecedent expressions…[were] no more than a part of the contract that is in the preliminary process of [being made].'" *Id.* at *13, quoting *Cerberus*, 794 A.2d at 1152 n.40 (alterations in original). The negotiation and pre-closing correspondence between the parties reflected the Target's cash being zero at the time of closing of the Transaction. *See, e.g.*, A15 at ¶ 19. The Purchase Agreement echoes the negotiation and pre-closing correspondence by reflecting the cash balance of the Target as zero in calculating the Net Working Capital. However, the Purchase Agreement does not provide a mechanism to distribute the Target's cash should any remain at the closing of the Transaction. The parties executed the Purchase Agreement with the understanding that the Target's cash would be zero as of the closing of the Transaction. In fact, the Court noted Buyer's counsel's

admission that Seller could have swept the Target's accounts of cash prior to closing. Op. at 3. That admission goes to the heart of the dispute and undermines any argument that Buyer believed it was entitled to the Disputed Cash as an asset transferred in the Transaction. To combat these well-pled facts, Buyer can only point to the absence of the identification of the Target's cash as an "Excluded Asset" in the Purchase Agreement. Here again, the absence of an explicit reference to cash in the Purchase Agreement supports Seller's contention that the mistake in drafting the Purchase Agreement was failing to include a provision to distribute the Target's remaining cash after closing.

Nevertheless, in dismissing Seller's reformation claim, the Court of Chancery held that the exclusion of cash from the Net Working Capital calculus did not support Seller's contention that the Transaction was intended to be "cash-free, debt-free" (Op. at 30), and the negotiation correspondence cited by Seller failed to show a "definite agreement between the parties." Op. at 31. In its analysis, however, the Court failed to address the unassailable fact that by inferring that the parties meant to include the Target's cash at closing as an asset to be transferred in the Transaction, the purchase price paid to Seller would be reduced by an uncertain amount to be determined at the closing. This interpretation undermines the entire purpose of the Net Working Capital calculus. Op. at 13. The only reasonable inference that can be

drawn from the facts asserted in the Complaint is that the Disputed Cash was not an asset to be transferred to Buyer at the closing of the Transaction.

Seller's reformation claim meets the particularized pleading standards set under Delaware law. To not reform the Purchase Agreement would inequitably gift the Buyer a nearly [redacted] windfall and deprive the seller approximately 30 percent of its sale proceeds. "Reformation is an equitable remedy which emanates from the maxim that equity treats that as done which ought to have been done." *Interim Healthcare, Inc. v. Sherion Corp.,* 2003 WL 22902879, at *6 (Del. Ch. Nov. 19, 2002). Here, equity demands the reformation of the Purchase Agreement.

The Court should reverse the Court of Chancery's entry of judgment in favor of Defendants on the pleadings of Seller's reformation claim and remand the claim to the Court of Chancery.

## CONCLUSION

The Court below erred in entering judgment on the pleadings in favor of Defendants on Seller's claims. Seller's interpretation of the Purchase Agreement is reasonable, and Seller stated a claim for breach of the Purchase Agreement. The Disputed Cash is not a Company Asset, but Buyer is retaining the Disputed Cash. At worst, the implied covenant of good faith and fair dealing calls for remedy where the Court held the failure to sweep up Target's cash was an operational mistake that resulted in Buyer obtaining a windfall. And finally, to the extent that the Purchase Agreement does not reflect the parties' prior agreement that Target would be cash-free and debt-free at Closing, the Purchase Agreement should be reformed to reflect that understanding.

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