IN THE SUPREME COURT OF THE STATE OF DELAWARE

DSG ENTERTAINMENT SERVICES INC. (f/k/a Deluxe Entertainment Services Inc.),	)	No. 185, 2021
Plaintiff Below-Appellant,	)	Court Below: Court of Chancery of the State of Delaware, C.A. No. 2020-0618-MTZ
v.	)	
DLX ACQUISITION CORPORATION and DELUXE MEDIA INC.	)	Public Redacted Version Filed: September 24, 2021
Defendants Below-Appellees.	)	

APPELLANT'S REPLY BRIEF

BAYARD, P.A.

Peter B. Ladig (#3513)
Brett M. McCartney (#5208)
Sarah T. Andrade (#6157)
600 N. King Street, Suite 400
Wilmington, Delaware 19801

Attorneys for Plaintiff Below-Appellant DSG Entertainment Services Inc. (f/k/a Deluxe Entertainment Services Inc.)

Dated: September 10, 2021

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PRELIMINARY STATEMENT

Throughout the proceedings below, Defendants[1] consistently argued that the Purchase Agreement contained no mechanism to allocate the Target's cash, so the parties' agreement could only be interpreted to allow Defendants to keep all of the cash in Target at closing. But Defendants make a remarkable concession in Appellees' Answering Brief ("AB") when they argue it is possible that *Defendants* would have been entitled to seek the return of some or all of the Disputed Cash had Seller swept it before closing. This position cannot be squared with Defendants' prior argument that the Purchase Agreement was "intentionally silent" on the treatment of cash. Either the Purchase Agreement contains a provision addressing the treatment of cash in Target at closing or it doesn't. What the Purchase Agreement certainly cannot mean is that Seller is powerless under the contract to reclaim the cash left in Target at closing that did not belong to Target, but Buyer had a contractual right to reclaim some or all of that cash if Seller swept it before closing. It is simply inconceivable that the parties would have agreed to such a one-sided and fickle arrangement.

That concession affects all three of Seller's claims. If it would have been a breach for Seller to have swept the Disputed Cash before closing, as Defendants now

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[1] Capitalized terms not defined herein have the same meaning as in Appellant's Opening Brief ("OB").

argue, then the Purchase Agreement must directly address the issue. Defendants cite to the portion of § 1.2 of the Purchase Agreement containing the definition of Company Assets to support this argument. If Defendants believe that they had the right to argue that the Disputed Cash was a Company Asset if it had been swept out before closing, it must be that Seller has the right to argue that the Disputed Cash was *not* a Company Asset. Thus, Defendants concede that Seller has a claim for breach of contract.

Defendants' concession also supports reversal of the Court of Chancery's decision to grant Defendants judgment on the pleadings on the implied covenant and reformation claims. The concession that Defendants could have claimed breach of contract had the Seller swept the case means that the agreement must have, in fact, addressed treatment of cash, and there was a "gap" to fill to ensure the parties' agreement regarding treatment of the Disputed Cash is respected. Further, the admission that the Purchase Agreement provided Defendants with the contractual right to recover swept cash means that Defendants cannot argue that the Purchase Agreement was silent on the issue. Therefore, the Purchase Agreement did not reflect the parties' prior agreement.

At bottom, Seller came to a court of equity seeking to do equity. This is not a case of a "gotcha" argument where a party lay silent until a transaction closed, hoping to obtain a benefit it never bargained for because its counterparty did not notice certain language. Rather, this is a case where the plaintiff *lost* an asset it never intended to lose, immediately sought to resolve the issue with its counterpart, only to be rebuffed by a "gotcha" claim. Instead of addressing that inequity, the Court below left Seller with the inequitable result that Buyer can keep cash that it neither bargained for nor paid for. Regardless of the legal theory, that is not a result that equity should allow to stand. The Court should reverse the Court of Chancery and remand for further proceedings.

ARGUMENT

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

A. Defendants' Reliance on the Definition of Excluded Assets is Misplaced.

As they did below, Defendants rely on the definitions of Excluded Assets and Excluded Liabilities to argue that they were always meant to receive the Disputed Cash. But that argument cannot be reconciled with the definition of Net Working Capital.

The definition of Net Working Capital defers to the adjustments made on Schedule 2.4. That schedule implements the multiple definitional adjustments to Net Working Capital found throughout the Purchase Agreement. Thus, the adjustments to Net Working Capital on Schedule 2.4 must be read in a manner consistent with the language of the Purchase Agreement on which they are based.

Defendants argue that only if the liability or asset was listed as an Excluded Liability or Excluded Asset would it be excluded from the transaction. (AB 26.) Thus, Defendants say, simply because an asset or liability was listed as a definitional adjustment to Net Working Capital does not mean that the asset or liability was not meant to transfer to Buyer. (AB 26.)

Defendants' argument, however, overlooks the source of those definitional adjustments to Net Working Capital and the ambiguity in the Purchase Agreement.

In fact, except for cash, all of the definitional adjustments are excluded from the transaction even though only one – [redacted] – is specifically listed as an Excluded Asset. [redacted] and [redacted] are captured in the definition of "Indebtedness" and by definition are subtracted from the Closing Date Purchase Price. (A42-43.) [redacted] are subtracted from the Closing Date Purchase Price by that term's definition. (A37.) [redacted] is eliminated entirely by the terms of § 6.15. (A93-94.) Buyer either did not receive those assets or liabilities subject to definitional adjustments (*i.e.*, [redacted]) or, if Buyer did receive them, Buyer effectively paid for them or effectively charged Seller for them (*i.e.*, [redacted]). In other words, every definitional adjustment affected the economics of the transaction, but the only item listed as a definitional adjustment that Buyer received but did not pay for was the cash.

At bottom, being listed as an Excluded Liability or Excluded Asset is not the only way that assets or liabilities were excluded by the parties. Each definitional adjustment finds its basis somewhere in the Purchase Agreement. Thus, the reasonable inference is that cash must be treated similarly within the Purchase Agreement. Defendants claim that cash was simply not addressed at all (AB 27), but that makes no sense given that the rest of the adjustments derive from the Purchase Agreement. Cash, therefore, must have been treated somewhere in the

Purchase Agreement. And because it was excluded as a definitional adjustment to Net Working Capital, the parties must have meant it was not to be an asset transferred to Buyer in the transaction or Buyer would have to pay for it.

Defendants' concession that they could have sought to recover cash swept by Seller before closing supports this point. Defendants rely on the definition of Company Assets to make this argument, so even under Defendants' interpretation cash is addressed in the Purchase Agreement. because it is excluded from the definition of Net Working Capital, it should also be excluded from the assets being transferred to Buyer, just as each of the other definitional adjustments to Net Working Capital were not transferred to Buyer unless the Buyer paid for it.

B. Seller Did Not Waive the Company Asset Argument

Defendants also argue that Seller waived the argument that the Disputed Cash was not a Company Asset. Defendants are wrong.

The Court's analysis of the Company Asset definition contained a fatal flaw that permeated the Court's reasoning, rendering the Court's ultimate conclusion to be error. Buyer's counsel addressed that specific issue at oral argument in response to a question from the Court. Buyer's counsel did not attempt to "walk back" the initial statement that the Disputed Cash "could" be considered a Company Asset. Counsel's statement at the end of the argument is entirely consistent with the notion that the Disputed Cash may, but is not necessarily, a Company Asset. Indeed, that is the entire point – that conclusion cannot be reached on a motion for judgment on the pleadings. Seller addressed the error in a timely-filed Motion for Reargument which the Court of Chancery denied.

Put simply, the Court below raised the issue itself, Seller gave an appropriate response consistent with the Seller's other arguments, and the Court ruled against Seller on the issue. Seller then moved for reargument on the issue which provided Defendants with the opportunity to address the issue. Seller did not remain silent below after learning of the error and Court below had a separate opportunity to consider the issue on the Motion for Reargument. *Cf. Shawe v. Elting*, 157 A.3d 152, 169 (Del. 2017) (quoting 5 AM. JUR. 2D *Appellate Review* § 618 (2016)) (noting policy prohibiting arguments raised for the first time on appeal is that it is "fundamentally unfair to fault the trial court for failing to rule correctly on an issue it was never given the opportunity to consider" and "unfair to allow party to choose to remain silent in the trial court in the face of error.") Thus, it is appropriate to consider this issue on appeal. *Id.* ("Opponents should have a fair chance to address arguments at the trial court. It is prudent for the development of the law that appellate courts have the benefits that come with a full record and input from learned trial judges.")

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

As Defendants acknowledge, the implied covenant of good faith and fair dealing inures in every contract. *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 442 (Del. 2005). "Stated in its most general terms, the implied covenant requires 'a party in a contractual relationship to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits' of the bargain." *Id.* (citing *Wilgus v. Salt Pond Inv. Co.*, 498 A.2d 151, 159 (Del. Ch. 1985)).

Defendants first argue that no "gap" exists. (AB 32.) However, while Defendants agree that the contract is silent as to the treatment of Target's cash at closing, they argue that because excluded assets are expressly covered by the contract and the contract is "intentionally silent" as to cash, it means there is no "gap" to fill. (AB 32-33.) This argument is inconsistent with the facts asserted in the Complaint, the Purchase Agreement read in its entirety, and Defendants' own admissions.

First, as Plaintiff alleged in detail in the Complaint, the core tenet of this transaction was that it was "cash-free, debt-free." (*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.) Thus, Defendants' argument that the Purchase Agreement is "intentionally silent" as to cash is incorrect and is directly contradicted by the specific allegations in the Complaint.

Second, when read in its entirety, it is clear that the Purchase Agreement was not "intentionally silent" on the Target's cash. At the outset, the Wrong Pocket Provisions address unintended transfers of assets. As explained in the Opening Brief, the Disputed Cash is not an asset nor was it transferred. (OB § 1.C.) Recognizing the inapplicability of this provision, Defendants state that "the 'wrong pocket' provisions do not have to be directly applicable to the disputed cash in order to defeat Plaintiff's argument." (AB 34.) Instead, Defendants argue that it was appropriate for the Court to assume, in contradiction to the well-pled allegations of the Complaint, that the presence of a provision that was not directly applicable to the treatment of the Target's cash should demonstrate that the parties chose to intentionally be silent on that issue. This is nonsensical and is not consistent with the Court's duty to the "spirit of the bargain." *Scherer v. R.P. Scherer Corp.*, 1988 WL 103311, at *9 (Del. Ch. Oct. 5, 1988).

Moreover, Defendants' argument that "the parties intentionally declined to identify cash as an 'Excluded Asset,' and intentionally declined to provide a postclose adjustment for cash assets, indicating that the parties did not intend for cash assets to be returned to Plaintiff following the sale" should similarly be ignored. (AB 34.) As Defendants admitted and the Court acknowledged in the Opinion, "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.) Seller had no expectation that it would make an operational mistake or that such a simple operational mistake would be held against them. "The 'implied covenant of good faith and fair dealing involves ... inferring contractual terms to handle developments or contractual gaps that ... neither party anticipated.'" *Nationwide Emerging Managers, LLC v. Northpointe Holdings, LLC*, 112 A.3d 878, 896 (Del. 2015) (quoting *Nemec v. Shrader*, 991 A.2d 1120, 1125 (Del. 2010)). Defendants cannot realistically argue that anyone anticipated that Seller would not sweep the cash at Target before closing or that Buyer would receive cash is had not paid or bargained for. Further, courts recognize that "[g]aps also exist because some aspects of the deal are so obvious to the participants that they never think, or see no need, to address them." *In re El Paso Pipeline Partners, L.P. Deriv. Litig.*, 2014 WL 2768782, at *16 (Del. Ch. June 12, 2014). This is a perfect example of when the implied covenant should be utilized to ensure that the "spirit" of the agreement is enforced and an operational mistake created a situation that was not anticipated.

Additionally, to the extent that Defendants argue that the presence of an integration clause in the Purchase Agreement undermines Plaintiff's claim that Defendants' conduct violates the implied covenant (AB 35), there is no support for this proposition in Delaware law. The covenant is implied into every contract subject to Delaware law and, as such, "the presence of an integration clause in a contract, alone, does not preempt a claim based on the implied covenant of good faith and fair dealing." *Fitzgerald v. Cantor*, 1998 WL 842316, at *1 n.5 (Del. Ch. Nov. 10, 1998).

Third, and most tellingly, the argument that the Purchase Agreement was intentionally silent on the issue of the treatment of the Target's cash is contrary to Defendants' own statements. Recognizing that its admission that cash could have been swept prior to closing supported that the Disputed Cash was not intended to be included as a Company Asset, Defendants attempt to clarify their statement, but in doing so, made an even more telling admission. Indeed, Defendants stated:

> As noted, supra, the parties disagree about how much cash is actually in dispute in this case, because it is unclear how much cash Plaintiff could have swept from the accounts consistent with the Purchase Agreement. It is possible the disputed cash, or some portion of it, would still have been an asset, property, or right "solely or primarily used by the Company Group in the conduct of its business" ***to which Defendants would have been entitled even if it had been transferred out of the entities prior to closing***. *See* A37 § 1.2.

(AB 35-36.) This statement is telling for several reasons. First, Defendants are arguing that the Purchase Agreement allowed for some of the cash to be swept but stating that there is only a gap in the Agreement as to how much would be permitted. Second, Defendants appear to be arguing that if Seller had swept all of the cash at closing, Defendants would still have had some right to an unquantified portion of that cash. Defendants, however, fail to point to any provision in the Purchase Agreement that entitles Defendants to Target's cash, because no such provision exists. This admission is telling because it exemplifies the gap, which is how the Target's cash was to be treated at closing, which Defendants admit is unclear.

Finally, Defendants also ask this Court to affirm the decision below because "Defendants were entitled to all assets owned by the Company Group at the time of closing, including any cash assets left in the purchased entities." AB 36. Essentially, Defendants ask this Court to ignore equitable remedies and revert to a "finders keepers, losers weepers" mentality. However, Plaintiff brought this in the Court of Chancery, which is a Court of equity, and the Implied Covenant is an equitable remedy. Defendants have prevented Plaintiff from receiving the fruits of its bargain, which should not be permitted. *Dunlap*, 878 A.2d at 442. Defendants have admitted that it is "unclear how much cash Plaintiff could have swept from the accounts consistent with the Purchase Agreement." (AB 36.) Thus, 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

It is well-settled law and beyond dispute that the equitable remedy of reformation is employed by Delaware courts to "reform a contract in order to express the 'real agreement' of the parties." *Cerberus Int'l Ltd. v. Apollo Mgmt., L.P.,* 794 A.2d 1141, 1151 (Del. 2002). In the instant action, the Court of Chancery and Defendants admit that Seller could have swept up the Target's cash prior to the closing of the Transaction. Despite that admission, neither the Court of Chancery or Defendants identify an express provision or mechanism in the Purchase Agreement addressing the distribution of the Target's cash at the time of closing of the Transaction. Notwithstanding these facts, the Court and Defendants misconstrue the Purchase Agreement to arrive at the conclusion that the Defendants are entitled to keep nearly [redacted] in cash Buyer admits the Seller had a right to sweep up prior to closing. These points lead to a single conclusion: that the Court of Chancery erred in dismissing Seller's reformation claim.

To state a claim for reformation a party "must show that both parties were mistaken as to a material portion of the written agreement." *Cerberus*, 794 A.2d at 1151. Reformation is appropriate where parties reach agreement on the economic substance of a transaction, but the subsequent memorialized agreement fails to capture the parties' mutual understanding. *See Colvocoresses v. W.S. Wasserman*

Co., 28 A.2d 588, 589 (Del. Ch. 1942). At its core, reformation is an equitable remedy dispatched to put parties in the position they were supposed to be in pursuant to the parties' true agreement. It is for precisely this reason and those stated herein that Seller sought recourse from Delaware's court of equity and why, on appeal, the dismissal of Seller's reformation claim should be reversed and remanded.

As addressed in Seller's Opening Brief, and largely ignored in Defendants' answering papers, both the Court of Chancery and Defendants concede that the Target's cash could have been swept by Seller prior to the closing of the Transaction. (Op. at 3; AB 36.) There is obvious cognitive dissonance emanating from the conclusion that Seller could have kept some or all of the Target's cash but, after the closing of the Transaction, Seller has no remedy to recover those funds. But, as noted above, Defendants' answering papers take this absurd result a step further by arguing that some or all of the Disputed Cash would have been a Company Asset "to which Defendants would have been entitled ***even if it had been transferred out of the entities prior to closing***." (AB 36 (emphasis added)). Defendants do not direct the reader to a section of the Purchase Agreement providing Defendants the recourse to pursue wrongfully dispersed cash of the Target after the Transaction closed other than the definition of Company Asset. The absence of any specific provision is not surprising, given that Defendants previously argued that the parties failed to memorialize a term concerning the disposition of the Target's cash.

Indeed, Defendants' new argument makes it clear that cash in the Target was not meant to be transferred to Buyer at closing. The Purchase Agreement prohibited only non-cash dividends by Target but did not restrict cash dividends or otherwise preclude Seller from the ministerial act of sweeping cash from Target's accounts (or any other cash sweeping) as part of Seller's ordinary cash management scheme prior to closing. (A80 § 6.01(b)(3).) Defendants now argue they could seek return of some or all of any cash that Seller swept prior to closing but cite only to the definition of Company Asset for support. But under Defendants' reading, cash does not become a Company Asset unless and until it is held by Target, at closing, and is not an Excluded Asset. So, for Defendants' argument that they could seek return of the cash swept prior to closing to be successful, there must be some other mechanism, not expressed in the Purchase Agreement, to address cash.

Despite conceding that the Target's cash was not an asset automatically transferred at the closing of the Transaction by the plain terms of the Purchase Agreement, Defendants' answering papers suggest that the parties did not understand that the Transaction was intended to be "cash-free, debt-free." (AB 40.) Instead, Defendants contend that the phrase "cash-free, debt-free" used in the parties' correspondence prior to the memorialization of the Purchase Agreement relates to the "Enterprise Value" of the Company Group as opposed to the basis of a transaction. (AB 40.) The Court of Chancery held that the use of the phrase "cash-free, debt-free" was in relation to the Target's valuation. (Op. at 31.) But the Opinion fails to reconcile the parties' understanding that the Target was valued on a "cash-free, debt-free" basis with the transfer of the Target's *cash* as an asset to be transferred at closing. This leads to an illogical outcome where the purchase price agreed to by the parties on a "cash-free, debt-free" basis is ultimately reduced by the Target's cash on hand at closing. This unreasonable outcome further emphasizes Seller's right to reformation of the Purchase Agreement to reflect the intent of the parties regarding the disposition of the Target's cash.

Defendants' answering papers parrot the Opinion by contending that the true mistake alleged by Seller is operational in failing to perform the sweep of the Target's cash prior to closing. (AB 42; Op. at 33.) This assertion ignores the clear and unambiguous averments in the Complaint that the parties understood that the Target's cash and debt were not being transferred in the Transaction. (*See, e.g.*, A13 at ¶ 16; A14 at ¶ 17; A14 at ¶ 18; A15 at ¶ 19; A15 at ¶ 21; A17 at ¶ 24.) Rather than an operational mistake, the Complaint clearly indicates that the parties' mistake was failing to include a mechanism in the Purchase Agreement for the disposition of the Target's cash. Such a provision would surely be needed for Buyer to seek recourse for wrongly distributed cash from the Target, as alluded to in Defendants' answering papers. (AB 36.) Indeed, if Seller's mistake was purely operational by failing to sweep the Target's cash despite having the right to do so, logic dictates that a trial court would determine that Buyer's receipt of those ill-gotten funds was inequitable. Holding otherwise promotes and encourages an inequitable "finders keepers" attitude among deal parties.

For these reasons, as well as those stated in Seller's Opening Brief, the Court of Chancery's dismissal of Seller's claim for reformation should be reversed and remanded.

CONCLUSION

The Court of Chancery's decision led to a plainly inequitable result and should be reversed.

BAYARD, P.A.

/s/ Peter B. Ladig
Peter B. Ladig (#3513)
Brett M. McCartney (#5208)
Sarah T. Andrade (#6157)
600 N. King Street, Suite 400
Wilmington, Delaware 19801

Attorneys for Plaintiff Below-Appellant DSG Entertainment Services Inc. (f/k/a/ Deluxe Entertainment Services Inc.)

Dated: September 10, 2021

CERTIFICATE OF SERVICE

I hereby certify that on September 24, 2021, a true and correct copies of the foregoing were caused to be served on the following by File & Serve*Xpress*:

Srinivas M. Raju
Angela Lam
Richards, Layton & Finger, P.A.
920 North King Street
Wilmington, Delaware 19801

/s/ Sarah T. Andrade
Sarah T. Andrade (#6157)