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IN THE SUPREME COURT OF THE STATE OF DELAWARE

WALTER A. WINSHALL, in his capacity as the Stockholders' Representative, Plaintiff Below, Appellant, Cross Appellee, v. VIACOM INTERNATIONAL INC. and HARMONIX MUSIC SYSTEMS, INC., Defendants Below, Appellees, Cross Appellants.	No. 39, 2013 On appeal from the Court of Chancery of the State of Delaware C.A. No. 6074-CS

DEFENDANTS VIACOM INTERNATIONAL INC. AND HARMONIX MUSIC SYSTEMS, INC.'S REPLY BRIEF ON CROSS APPEAL

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Dated: May 28, 2013

TABLE OF CONTENTS

Page(s)

TABLE OF AUTHORITIES

Page(s)

CASES

ARGUMENT

I. The Lower Court Erred in Holding as a Matter of Law that the Merger Agreement Did Not Set Forth a Duty for Plaintiff to Pay Defendants' Costs of Defending Against Third-Party Claims.

The plain language of Section 8.2(d) of the Merger Agreement creates an independent obligation for the Selling Shareholders to reimburse Defendants for the costs of defending against third-party claims when the third party makes an allegation which, if true, would result in a finding of a breach of a representation or warranty in the Merger Agreement. At a minimum, if Section 8.2(d) does not clearly create a separate obligation to pay defense costs, then the agreement is ambiguous on this point. As such, summary judgment was not warranted.

A. Section 8.2(d) provides for an independent duty to pay defense costs.

In an attempt to avoid the contractual provisions in Section 8.2(d) requiring Plaintiff to pay Defendants' costs for defending against third-party claims, Plaintiff builds his argument around language that the Merger Agreement *could have* contained, or, in his view, *should have* contained—not the language that the Merger Agreement *actually* contains. Plaintiff argues that the only way the Merger Agreement could have obligated him to pay Defendants' defense costs is if the agreement provided in Section 8.2(a) that Plaintiff shall "indemnify and defend" Defendants. *See* Reply Br. at 20-22. But parties are not required to employ special, talismanic language to create a duty to pay defense costs. Indeed, they are

free to choose their own language, so long as the language makes their respective obligations clear. *Cf. United Rentals, Inc.* v. *RAM Holdings, Inc.*, 937 A.2d 810, 845 (Del. Ch. 2007) ("The law of contracts . . . does not require parties to choose optimally clear language . . . .").

The language the parties employed in Section 8.2(d) created a duty to pay defense costs. In Section 8.2(d), the parties provided that when Viacom gives notice to Plaintiff of any *claim* as to which Viacom "may request indemnification pursuant to Section 8.2(a)," then:

- "[Viacom] shall have the right to direct, through counsel of its own choosing . . . the *defense* or settlement of any such claim *at the expense of the applicable indemnifying parties*," A156 § 8.2(d)(i) (emphasis added), and
- "[Plaintiff] shall not have the right to assume control of the *defense* of any such claim, and *shall pay the reasonable fees and expenses of counsel* retained by [Viacom], if the claim which [Plaintiff] seeks to assume control . . . seeks non-monetary relief," A156 § 8.2(d)(ii) (emphasis added).

By their plain terms, these provisions obligated Plaintiff to pay Defendants' *defense* costs. Plaintiff attempts to analogize to two other cases analyzing contracts using the term "indemnify," as used in Section 8.2(a), instead of the words "in-

demnify and defend." *See* Reply Br. at 21-22. Both cases, however, apply Illinois, rather than Delaware law, and are readily distinguishable. In *Moriarty* v. *Hills Funeral Home, Ltd.*, 221 F. Supp. 2d 887 (N.D. Ill. 2002), the contract at issue did not contain separate provisions, such as those quoted above, setting forth a duty to pay defense costs. *Id.* at 896-97. In *Lear Corp.* v. *Johnson Electric Holdings Ltd.*, 2003 WL 21254253 (N.D. Ill. May 30, 2003), *aff'd*, 353 F.3d 580 (7th Cir. 2003), the language of the contract differed from the language in the Merger Agreement in two important respects: first, it did not set forth an *obligation* to defend against third-party claims, such as exists in the Merger Agreement, but rather an *option* to defend against such claims; second, the contract there expressly provided that the "indemnified party," rather than the "indemnifying party," was required to bear the expense of settling third-party claims. *Id.* at *7-8. Therefore, in contrast to the Merger Agreement, the contract in *Lear* made clear that the primary responsibility for defending against third-party claims rested with the party against whom the claims were being made, unless the indemnifying party chose otherwise. *Id*.

After making the argument, addressed above, that the Merger Agreement should have contained specific "indemnify and defend" language, Plaintiff next argues against Defendants' interpretation of Sections 8.2(a) and (d) on five grounds. *See* Reply Br. at 23-27. Each is unavailing.

First, Section 8.2(d) does not condition the obligation to pay defense costs on the *existence* of a duty to indemnify, as Plaintiff contends, but rather on a *request* for indemnification. Section 8.2(d)(i) makes clear in its first sentence that it applies to "any claim . . . as to which [Viacom] may request indemnification pursuant to Section 8.2(a)." Section 8.2(d)(ii) refers to "any such claim," which clearly refers back to this clause. Notably, the reference in these provisions is to a "claim," not a judgment. If the matter at issue is still a "claim," then there cannot yet be a finding of a breach of a representation or warranty in the Merger Agreement. The parties thus indicated, by their choice of language, that no such finding was required to create a duty to pay defense costs. Rather, the duty to pay defense costs following a request for indemnification pursuant to Section 8.2(a) is a duty separate and independent from the duty to pay losses after there has been a finding of a breach of a representation or warranty.

The references to settlements throughout Section 8.2(d) make this clear. For example, Section 8.2(d)(i) provides that Viacom may direct "the defense *or settlement* of any such claim at the expense of the applicable indemnifying parties." A156 § 8.2(d)(i) (emphasis added). [redacted]

[redacted]

These repeated references to "settlement" make clear that the Merger Agreement contemplated the payment of defense costs by Plaintiff even where there has been no final determination as to a breach of the representations or warranties. This is especially evident from Sections 8.2(d)(i) [redacted] which discuss the undertaking of a settlement "at the expense of the applicable indemnifying parties." Under these provisions, a third-party claim against Defendants may be settled before a final court judgment, and Plaintiff is required to pay the cost of defending against and settling that claim, as the "applicable indemnifying party."

Thus, contrary to Plaintiff's argument that the use of the word "indemnifying" here somehow limits Plaintiff's obligations, the term "applicable indemnify-

[redacted]

ing party" is simply the way the contracting parties chose to refer to the parties obligated to pay defense costs. Many contracts employ similar such shorthand language where the contract clearly and unambiguously provides both for a duty to indemnify and a duty to defend. *See, e.g.*, *Zimmerman* v. *Crothall*, 62 A.3d 676, 715 (Del. Ch. 2013) (contract provided that "[t]he Company shall indemnify, defend and hold harmless each Indemnified Party"); *Patton* v. *24/7 Cable Co., LLC*, 2013 WL 1092147, *4 (Del. Super. Jan. 30, 2013) (contract set forth "obligation to indemnify, defend, and hold harmless the Indemnified Parties"); *Rodgers* v. *Erickson Air-Crane Co, L.L.C.*, 2000 WL 1211157, at *4 (Del. Super. Aug. 17, 2000) (discussing clause providing that "[e]ach shall defend and indemnify the other party," and employing shorthand "the indemnifying party").

In addition, Section 8.2(d) provides that, in certain circumstances, Plaintiff or his constituents can "assume" or "undertake" the defense and/or settlement of a third-party claim against Defendants. *See* A156 § 8.2(d)(ii) ("[Plaintiff] shall be entitled to *assume the defense* of any such claim" (emphasis added)); [redacted]

In such a circumstance, namely where Plaintiff undertook to conduct the defense of a claim, or settle a claim, he would pay the costs of the defense or settlement on an as-incurred basis. Those costs would necessarily be incurred—and paid—by

Plaintiff before any final determination as to a breach of the representations or warranties in the Merger Agreement. The fact that Plaintiff would, in these circumstances, be responsible for paying these costs prior to any determination regarding a breach of the representations and warranties provides yet one more concrete example where the parties agreed that Plaintiff was obliged to pay the costs of defense, independent from his duty to indemnify arising from a breach of the representations or warranties.

Second, contrary to Plaintiff's argument, the notice provision in Section 4(c)(1) of the Escrow Agreement does not somehow alter the meaning of the term "may request indemnification" in Section 8.2(d)(i) of the Merger Agreement. The former merely discusses procedures for disbursing monies from escrow, and uses the term "indemnification" as shorthand to refer to all of the obligations created by the substantive terms set forth in the Merger Agreement, including the obligation to pay defense costs. If anything, the fact that the parties agreed to the language "entitled to indemnification" elsewhere, but not in Section 8.2(d) of the Merger Agreement, indicates that the use of different language in Section 8.2(d) was intentional, and that the parties' intent was that the defense costs obligations set forth in Section 8.2(d) *not* be conditioned on a finding that Defendants are entitled to indemnification. *See, e.g.*, *GRT, Inc.* v. *Marathon GTF Tech., Ltd.*, 2012 WL 2356489, at *5 (Del. Ch. June 21, 2012) (use of words "survive" and "expire" in

different parts of agreement "demonstrates that the parties knew the difference between the terms 'survive' and 'expire,' and when they wanted to provide for the survival of a right, they provided for the 'surviv[al]' of that right").

Third, Section 8.2(d) does not, as Plaintiff argues, provide for an unlimited duty to pay defense costs. Indeed, by using the phrase "any claim . . . as to which [Viacom] may request indemnification pursuant to Section 8.2(a)," the parties circumscribed the duty to pay defense costs to claims which allege wrongdoing covered by the Merger Agreement's representations and warranties. Indeed, because Section 8.2(a) provides for indemnification only for those claims "arising out of or by reason of . . . the breach of any representation or warranty . . . contained in this Agreement," Defendants may seek indemnification only for claims that, if proved, would establish such a breach. A153 § 8.2(a)(i). That circumscribed set of claims serves to circumscribe the scope of the duty to pay defense costs.

Moreover, as Defendants demonstrated in their opening brief on cross appeal, to the extent that Section 8.2(d) sets forth a duty to defend against potentially unforeseeable or frivolous claims, this is a natural and foreseeable result of the "broader" duty to defend. *See* Ans. Br. at 36. Conspicuously, Plaintiff does not respond to Defendants' argument that the Court in *LaPoint* v. *AmerisourceBergen Corp.*, 970 A.2d 185 (Del. 2009), adopted the general rule in *Molex Inc.* v. *Wyler*, 334 F. Supp. 2d 1083 (N.D. Ill. 2004), that Delaware law recognizes a duty to de-

fend that is independent of and broader than the duty to indemnify outside the context of insurance contracts—and therefore implicitly concedes this argument.

Fourth, although Plaintiff argues that Section 8.2(d) could have been drafted more clearly to create a duty to pay defense costs, the parties were not required to use talismanic language in drafting their agreement, and their intent must be ascertained from the language that they actually employed. *See Citadel Holding Corp.* v. *Roven*, 603 A.2d 818, 822 (Del. 1992). That language, for the reasons described herein, establishes that Plaintiff did indeed have a duty to pay defense costs. As noted, the agreement clearly imposes a duty to pay defense costs by using such language as "shall pay the reasonable fees and expenses of counsel."

Fifth, the question of whether the "indemnify and hold harmless" clause in Section 8.2(a) provides for the payment of ongoing litigation expenses is immaterial, as the separate duty to defend language in Section 8.2(d) clearly does so provide. *See LaPoint*, 970 A.2d at 197 ("whether a duty to defend exists can be resolved before the underlying litigation is resolved").

B. At the very least, Plaintiff failed to meet his burden of demonstrating that his interpretation of the Merger Agreement is the only reasonable one.

As the movant below on Counts 2 and 3, Plaintiff bore the burden to "demonstrate that there are no genuine issues of material fact," and Defendants, as non-movants, were entitled to have the Court view the evidence in the light most

favorable to them. *See United Rentals*, 937 A.2d at 830. Specifically, Plaintiff bore the burden of establishing that his "construction of the merger agreement is the *only* reasonable interpretation." *Id.*; *accord Bean* v. *Fursa Capital Partners, LP*, 2013 WL 755792, at *8 (Del. Ch. Feb. 28, 2013). Plaintiff has failed to meet this burden. Indeed, as Defendants demonstrated in their opening brief on cross-appeal, even if the Merger Agreement does not clearly set forth a separate duty to pay defense costs—and Defendants maintain that it does—the agreement is at the very least ambiguous as to whether such a duty exists.

Plaintiff's one-paragraph reply to this argument is at best feeble and at worst disingenuous. Plaintiff argues that reversal is not warranted because "Defendants never offered any extrinsic evidence in the court below." Reply Br. at 27. In so arguing, Plaintiff attempts to shift the burden onto Defendants to have presented extrinsic evidence before the Chancery Court demonstrating an ambiguity. Defendants were under no such obligation. All Defendants had to do was "meet the lesser burden of demonstrating that their interpretation was *a* reasonable interpretation and that, therefore, [P]laintiff's interpretation of the Merger Agreement is not the sole reasonable interpretation." *United Rentals*, 937 A.2d at 833 n.104. Defendants have done just that.

Moreover, *Intel Corp.* v. *American Guarantee & Liability Insurance Co.*, 51 A.3d 442 (Del. 2012), to which Plaintiff pins his argument, is wholly inapposite.

In that case, the agreement was subject to California law, and the defendant sought to introduce extrinsic evidence, arguing that "under California law, extrinsic evidence of the parties' intent may be introduced to determine the existence of a latent ambiguity." *Id.* at 451. Here, however, Defendants do not seek to introduce extrinsic evidence, and, in any event, under Delaware law, extrinsic evidence may not be used on a summary judgment motion "to create an ambiguity." *Eagle Indus., Inc.* v. *DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997).

Ultimately, because at the very least "reasonable minds could differ as to the contract's meaning, a factual dispute results" and "summary judgment is improper." *GMG Capital Invs., LLC* v. *Athenian Venture Partners I, L.P.*, 36 A.3d 776, 783 (Del. 2012) (footnotes omitted).

II. The Third-Party Claims Fell Within the Ambit of the Representations and Warranties of the Merger Agreement.

The representations and warranties in Sections 4.15(k) and 4.15(o)(i) of the Merger Agreement cover the third-party claims at issue, such that Defendants' request for indemnification under Section 8.2(a) of the agreement triggered Plaintiff's obligations to pay Defendants' cost of defending against those claims.

A. Defendants did not need to offer evidence that *Rock Band* infringed any third-party intellectual property.

Plaintiff argues that "Defendants never alleged—let alone presented evidence—that *Rock Band* infringed any third-party IP." Reply Br. at 29. Defendants, however, do not need to establish infringement to be entitled to the escrowed funds they currently seek. As made clear in their opening brief on cross-appeal, Defendants are not seeking monies awarded to the plaintiffs in the four third-party claims at issue, but instead "legal fees and expenses" associated with those claims—*i.e.*, their defense costs. *See* Ans. Br. at 8. The third-party claims alleged that Defendants engaged in conduct that contravened the representations and warranties contained in Sections 4.15(k) and 4.15(o)(i) of the Merger Agreement, and are therefore claims for which Defendants "may request indemnification pursuant to Section 8.2(a)."[2] Therefore, under Section 8.2(d), Defendants' April 24, 2008

[redacted]

and July 21, 2008 notices of third-party claims triggered a duty, on the part of Plaintiff and his constituents, to pay those defense costs.

Furthermore, because Defendants do not need to establish infringement and are instead seeking defense costs associated with the third-party claims, Plaintiff's argument that "indemnity provisions are to be construed strictly rather than expansively," Reply Br. at 33, does not apply.

B. Sections 4.15(k) and 4.15(o)(i) cover *Rock Band*.

Plaintiff unsuccessfully argues that the representations and warranties in Sections 4.15(k) and 4.15(o)(i) of the Merger Agreement do not apply to *Rock Band*. Plaintiff hinges his argument on a textually-unhinged distinction between "future" games and "current" games. *See* Reply Br. at 30. In truth, at the time the merger closed, *Rock Band* was indisputably a game that was "in development." Indeed, as Harmonix's officers testified at their depositions, by late 2006, development work on *Rock Band* was already well underway. *See, e.g.*, B380 (agreeing that by "the August timeframe, 2006," "Harmonix was working on a new game . . . that came to be called Rock Band"), B389 (agreeing that Harmonix had decided it would use a "track" to display game-play information for *Rock Band* in the "first half of 2006"), B408 (in response to questions regarding Harmonix activity "at the time of the merger agreement," discussing "the work that we were doing on Rock Band at that point").

Both Sections 4.15(k) and 4.15(o)(i) cover *Rock Band*. [redacted]

Plaintiff argues that Defendants did not raise a triable issue of fact as to whether the "concept" of the "note highway" was in place at that time because

concepts cannot be copyrighted. *See* Reply Br. at 31 & n.12. [redacted]

Similarly, Section 4.15(k) applies because [redacted] make allegations concerning the purportedly infringing then-"current use" of "Company Developed Software" in a "Game[] in development"—namely, the software used in *Rock Band*. [redacted] the claims alleged as follows:

- 1st Media alleged that *Rock Band* infringed its patent claiming a "System and Apparatus for Interactive Multimedia Entertainment," and describing a device that functions to enable the user to select songs, transmit the song on a network, and control the play and display of songs and video in various ways. The claimed invention describes the use of controller units and algorithms, and can be embodied in various mixtures of hardware and software. *See* B84, B373.

- Gibson alleged that *Rock Band* infringed its patent claiming a "System and Method for Generating and Controlling a Simulated Musical Concert Experience." The patent encompasses both system—implementable in hardware or a mixture of hardware and software—as well as method claims, but because *Rock Band* does not have hardware implementations of elements of the claims in the patent, to the extent it allegedly infringed, it necessarily included the game's software. *See* B119, B133.
- Konami alleged that *Rock Band* infringed certain of its patents covering devices that are implemented using various mixes of software and hardware. Those patents describe a "Music Playing Game Apparatus, Performance Guiding Image Display Method, and Readable Storage Medium Storing Performance Guiding Image Forming Program," a "Music Game Machine with Selectable Controller Inputs," and a "Music Staging Device Apparatus, Music Staging Game Method, and Readable Storage Medium." B192-95. For example, one patent describes a device reliant upon "a game program stored in a storage medium." *See* B213.

Plaintiff's argument that these claims do not put forth allegations concerning "Company Developed Software" for the purposes of Section 4.15(k) is unavailing.

The Merger Agreement nowhere requires that the software employed in a "Game in development" be fully realized or finalized by the time the merger closed in order to quality as "Company Developed Software." Such an interpretation would create internal inconsistencies in Section 4.15(k), such that it would require *Rock Band* to be both "fully developed" and "in development." *See, e.g.*, *GRT, Inc.*, 2012 WL 2356489, at *4 ("[A] court will prefer an interpretation that harmonizes the provisions in a contract as opposed to one that creates an inconsistency or surplusage.").

For these reasons, the third-party claims are covered by the representations and warranties in Sections 4.15(k) and 4.15(o)(i) of the Merger Agreement.

C. Defendants' notice of the Konami lawsuit was timely.

Finally, Defendants' July 21, 2008 notice to Plaintiff regarding the Konami lawsuit was timely because Defendants had already notified Plaintiff on April 24, 2008 as to the existence of a claim for any breach of a representation or warranty in the Merger Agreement. The Merger Agreement provides that the Selling Shareholders have "no liability with respect to any claim for any breach . . . of any representation or warranty" in the Merger Agreement unless Defendants submit written notice to Plaintiff "of *such a claim* on or before the date which is eighteen (18) months following the Closing Date." *See* A152 § 8.1 (emphasis added). The April 24, 2008 letter functioned as notice of "such a claim." It advised Plaintiff of

a breach of the representations and warranties under Section 4.15 of the Merger Agreement [redacted] It then expressly "reserve[d] the right to seek indemnification for any other claims . . . by other third parties that may result due to the Company's breach of its representations and warranties." B295.

[redacted]

For these reasons, the notice of the Konami lawsuit was timely.

CONCLUSION

For the foregoing reasons, and the reasons stated in Defendants' opening brief on cross appeal, the judgment of the Court of Chancery granting summary judgment in favor of Plaintiff on Counts II and III should be reversed.

Respectfully submitted,

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Dated: May 28, 2013

CERTIFICATE OF SERVICE

I hereby certify that on June 12, 2013, a copy of the foregoing was electronically served via File & Serve*Xpress* on the following counsel of record:

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