IN THE SUPREME COURT OF THE STATE OF DELAWARE

HUDSON'S BAY COMPANY LUXEMBOURG, S.A.R.L., Plaintiff below, Appellant,	No. 182, 2013
v.	On Appeal from Superior Court in and for New Castle County C.A. No. N10C-12-107 JRJ CCLD
JZ LLC and AGZ LLC, Defendants below, Appellees.	

APPELLEE'S ANSWERING BRIEF

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NATURE OF PROCEEDINGS

Appellant-plaintiff Hudson's Bay Company Luxembourg, S.A.R.L. ("HBCL") appeals from a decision and judgment of the Superior Court (Jurden, J.) in favor of appellee-defendant JZ LLC (together, "JZ").[1]

The lawsuit arises out of HBCL's acquisition of the Hudson's Bay Company ("Hbc") from JZ in July 2008 pursuant to a Securities Purchase Agreement (the "SPA"). HBCL sought indemnification for Covered Losses allegedly caused by breaches of a representation and warranty that Hbc's Fiscal 2007 financial statements were prepared in accordance with Canadian generally accepted accounting principles ("GAAP").

The Trial Court's decision, after a bench trial, rests on two grounds. First, the Trial Court found that HBCL failed to prove a violation of GAAP and therefore did not prove a breach of the representation and warranty. (Op. 27.)[2] Second, the Trial Court found that HBCL failed to prove Covered Losses in excess of a contractual deductible and therefore was not entitled to indemnification. (*Id.* 31-32.)

This Court should affirm the Trial Court's decision and judgment.

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1 Defendants JZ LLC and AGZ LLC merged into surviving entity JZ LLC.

2 Citations to "Op." refer to the Trial Court's Memorandum Opinion dated March 11, 2013, annexed as Exhibit A to the Corrected Appellant's Opening Brief.

SUMMARY OF ARGUMENT

1. JZ denies HBCL's first legal proposition. The Trial Court correctly applied the unambiguous language of the SPA's "materiality scrape" by disregarding the word "material" where it appears in the SPA's representation and warranty but not where it appears in the Handbook of the Canadian Institute of Chartered Accountants ("CICA"), the source of GAAP stipulated in the SPA.

2. JZ denies HBCL's second legal proposition. The Trial Court found that under GAAP as set forth in the CICA Handbook, financial statements do not comply with GAAP if they contain either material errors or immaterial errors made intentionally. That finding was supported by substantial evidence, including the report and testimony of JZ's GAAP expert. Because HBCL conceded that Hbc's Fiscal 2007 financial statements contained no material or intentional errors, the Trial Court correctly held that HBCL did not prove a breach of the representation and warranty. The Trial Court also found that HBCL did not prove Covered Losses in excess of the $1.5 million deductible in the SPA. That finding was supported by substantial evidence, including the testimony of JZ's damages expert and HBCL's own witnesses.

3. JZ denies HBCL's third legal proposition. The Trial Court did not narrow the SPA definition of Covered Losses. Rather, it simply found that HBCL failed to prove the measure of damages it pleaded (*i.e.*, that Hbc was worth less

than it bargained for) or the measure of damages it presented at trial (*i.e.*, that alleged accounting errors negatively affected Hbc's expected cash flow).

STATEMENT OF FACTS

HBCL's Acquisition Of Hbc

In March 2006, Jerry Zucker, a South Carolina businessman, purchased Hbc, Canada's largest diversified general merchandise retailer. Zucker acquired Hbc through several corporate entities including JZ and True North Retail Investments I, Inc. ("True North"), the direct parent of Hbc. (A501.)[3]

A few months later, Zucker sold 20% of Hbc to NRDC Equity Partners ("NRDC"), a private equity firm that invested in operating companies with significant real estate holdings. (A2313-14.) NRDC's principal, Richard Baker, became a director of Hbc. (A2316-17.)

In March 2008, shortly before he died from cancer, Zucker offered to sell JZ's 80% interest in Hbc to NRDC. (A2318-19.) On April 25, 2008, JZ, True North and certain NRDC entities entered into the SPA by which NRDC would acquire JZ's interest in Hbc. (A495-558.)

The cash price to be paid to JZ was $240 million, which Baker considered a "very nice deal." (A514; A2334.)[4] NRDC negotiated the purchase price by multiplying Hbc's projected Fiscal 2008 earnings before interest, taxes,

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3 Citations to "A__" refers to the Appendix of Exhibits Cited in Appellant's Opening Brief. Citations to "B__" refer to the Appendix to Appellee's Answering Brief.

4 All monetary amounts are in Canadian dollars.

depreciation, and amortization ("EBITDA") by a seven-times multiple. (A2338; B7.)

NRDC brought in another investor, Abu Dhabi Investment Council ("ADIC"), to help fund the purchase price. (B15-16.) Baker told ADIC that $240 million was "a very cheap price" for 80% of the equity of Hbc because, in his view, "[t]he seller has not chosen to properly reflect the value of the real estate in [its] sale price." (A2333-34.) Baker noted that the proposed transaction valued Hbc at only $1.4 billion (for the equity plus assumption of long-term debt), whereas NRDC estimated Hbc's net asset value in liquidation at $1.81 billion. (A1445-46.)

Under the SPA, NRDC had the right to conduct due diligence of True North and Hbc. (A533.) It retained the accounting firm Deloitte & Touche LLP ("Deloitte") to assist with that task. (A1371.) Hbc's independent auditor, KPMG, made its audit working papers available to Deloitte for the review. (B5.)

On June 5, 2008, Deloitte provided NRDC with a Due Diligence Report that identified "Key Matters Impacting Value" and "Significant Risks and Exposures." The report discussed Hbc's inventory and its customer loyalty program, known as "Hbc Rewards," and proposed various adjustments to arrive at "normalized" EBITDA and working capital amounts. (A564-675; A1441-44.)

After it received Deloitte's report, NRDC approached JZ to re-negotiate the purchase price for several reasons, including "flags that were going up" in the due diligence. (A1396.) On June 24, 2008, the parties amended the SPA to reduce the price from $240 million to $202 million. (A679.)

On July 16, 2008, NRDC designated an affiliate, appellant HBCL, as purchaser of JZ's 80% interest in Hbc and the transaction closed on that date.

The SPA includes a representation and warranty by True North that Hbc's audited financial statements for Fiscal 2007 (which for Hbc was the year ended January 31, 2008) were "prepared in accordance with generally accepted accounting principles . . . consistently applied throughout the period[] indicated and fairly, completely and accurately present[ed] in all material respects the financial position of Hbc and the results of its operations as of the date[] and throughout the period[] indicated" (the "Financial Statement Representation"). (A517; A521-23.)[5]

"Generally accepted accounting principles" are defined in the SPA as the principles stated in the CICA Handbook. (A512.)

5 The Financial Statement Representation also covered Hbc's unaudited interim financial statements for the two months ended March 31, 2008, but HBCL did not pursue any claim with respect to those interim financial statements. (A784 n.1; A2115.)

The SPA includes an agreement by JZ to indemnify HBCL for 80% of any Covered Losses arising from any breach of a representation or warranty made by True North. Covered Losses means "any and all losses, liabilities, claims, fines, awards, deficiencies, damages, payments . . . [and] reasonable costs and expenses." (A504.) JZ's indemnification obligation was subject to an aggregate deductible of $1.5 million and a cap of $20.2 million.

Section 7.5.2 of the SPA – the "materiality scrape" – provides that for purposes of indemnification, any reference to the terms "material" or "materially" in a "representation, warranty, covenant or agreement" in the SPA shall be disregarded. (A547.)

HBCL'S CLAIMS

At trial, HBCL presented three indemnification claims arising from alleged errors in Hbc's Fiscal 2007 financial statements: (i) a claim that a footnote to the financial statements describing the anticipated effect of a change in the CICA's standard for valuing inventory overstated that effect by $9.8 million; (ii) a claim that the liability Hbc recorded for the estimated future redemption of points issued in its "Hbc Rewards" loyalty program was understated by $10.4 million; and (iii) a claim that Hbc should have reserved $3.1 million in Fiscal 2007 for an underperforming sublease in the Jane-Finch Mall in Toronto. (A1269-72.)

HBCL also asserted a claim for an underpayment of taxes, to which the parties stipulated in the sum of $1.2 million. (Op. 21.)

THE FACTS PROVED AT TRIAL

Hbc's Fiscal 2007 financial statements were prepared by experienced financial management and were independently audited by KPMG, which issued a "clean" opinion that they complied with GAAP in all material respects. (A463.) KPMG also reviewed and advised Hbc on its implementation of the new inventory standard set forth in Section 3031 of the CICA Handbook ("CICA 3031"), which would be going into effect in Fiscal 2008. (A771-72; A1622; A1631.)

Because CICA 3031 was not in effect in Fiscal 2007, the inventory on Hbc's balance sheet was valued under the then-existing GAAP standard set forth in Section 3030 of the CICA Handbook. (A465; A1614-15.) HBCL conceded that Hbc's inventory on the Fiscal 2007 balance sheet was correctly presented in accordance with GAAP. (Op. 11; A2115-16.)

KPMG's audit partner, Sebastian Distefano, testified that Hbc properly estimated inventory in the footnote disclosing the anticipated future impact of CICA 3031, (A771-72), and that its loyalty liability estimate was reasonable and in accordance with GAAP. (B65-66.) KPMG's audit working papers showed that the Jane-Finch subtenant was paying down a receivable for common area maintenance ("CAM") and property taxes during Fiscal 2007, so KPMG was "not concerned about [the] collectability" of the receivable. (A428.)

After the closing, HBCL engaged Deloitte to replace KPMG as Hbc's auditors. Deloitte – which HBCL believed had "a high quality team on the audit side" (A1993) – issued a clean audit opinion on Hbc's Fiscal 2008 financial statements. (A126.) Those financial statements used the same accounting methodology for valuing inventory under CICA 3031 as the disputed footnote in the Fiscal 2007 financial statements. (A1461-64; B63.) Indeed, Deloitte's audit opinion specifically stated that the inventory adjustments Hbc made to comply with CICA 3031 – the very adjustments HBCL now claims were in error – were appropriate in all material respects. (A126.)

HBCL's Chief Financial Officer, Francis Casale, knew that the Fiscal 2008 financial statements included a footnote on the impact of CICA 3031 that used the same methodologies and presented *the exact same numbers* as the comparable footnote in the Fiscal 2007 financial statements. Casale approved those financial statements in his capacity as Chair of the Hbc Audit Committee with acknowledged responsibility for the proper presentation of the financial position of Hbc. (A1464-67; A1474-81.)

In connection with its Fiscal 2008 audit, Deloitte prepared a Summary of adjusted and unadjusted audit differences (referred to as a "SAD schedule"), showing all errors it identified that were greater than $700,000 but below its $30 million level of audit materiality. (B54.) The non-material "errors" on which HBCL's claims are based would have affected the opening balance sheet for Fiscal 2008, so if the Deloitte auditors had believed they were errors, they would have been shown on the SAD schedule. (A2015-18; A2163.) None of HBCL's claimed errors are shown on Deloitte's SAD schedule. (*Id.*)

At trial, HBCL introduced the report and testimony of Paule Bouchard (A781-1180; A2045-2195), a partner at the Montréal office of the accounting firm RSM Richter Chamberland LLP. Bouchard conceded that inventory was correctly stated on Hbc's Fiscal 2007 balance sheet under the GAAP standard then in effect (A2115-16); but she asserted that the footnote describing the anticipated future impact of CICA 3031 overstated that impact by $9.8 million because Hbc used a flawed valuation methodology. (A791.) She also asserted that Hbc's methodology for estimating the future cost of redeeming loyalty points was flawed, resulting in a $10.4 million understatement of the long-term liability recorded for the loyalty program. (A826.) And she asserted that Hbc should have booked a reserve of $3.1 million in Fiscal 2007 because of the risk that its Jane-Finch subtenant would default on its sublease. (A834.)

HBCL offered no evidence of Covered Losses by any expert in damages quantification, business valuation, or corporate finance.

JZ introduced the reports and testimony of three experts.

Daniel B. Thornton, a Professor of Financial Accounting at Queen's University in Kingston, Ontario, described certain principles of Canadian GAAP, including the importance of materiality in making estimates and the disclosure required with respect to future accounting changes, and he gave his opinion that Hbc's footnote describing the expected impact of CICA 3031 complied with GAAP. (A2239; B79-80.)

Karen Parsons, a partner at the Toronto office of Grant Thornton LLP, gave her opinion that Hbc's methodology for valuing inventory complied with CICA 3031; that its estimate of the liability for redeeming loyalty points in the future, as recorded on Hbc's balance sheet, was in accordance with GAAP; and that a $3.1 million reserve for the Jane-Finch sublease was not required in Fiscal 2007 under GAAP. (A1209; A2380-82.)

Howard E. Johnson, Managing Director of Campbell Valuation Partners Ltd., gave his opinion that HBCL's inventory and loyalty claims related to non-cash accounting adjustments that had no impact on the enterprise value of Hbc and caused HBCL no economic loss. (A2540-42; B257.)

Several fact witnesses, including the former and current Chief Financial Officers of Hbc, testified that under HBCL's ownership, Hbc continued to value inventory using the same methodology it had used in preparing the allegedly erroneous footnote in the Fiscal 2007 financial statements. (A1461-64; A2021; B61; B63.) It changed its methodology to conform to HBCL's trial position after HBCL asserted claims against JZ. (A1808-10.)

Hbc's Vice President of Financial Accounting, Douglas Tames, testified for HBCL that he was "very uncomfortable" with the methodology Hbc used to estimate its loyalty liability in Fiscal 2007 (A1574), but on cross-examination he admitted he considered that estimate "appropriate" and did not believe it violated GAAP. (A1720-25.) In October 2008, Tames wrote a memorandum stating that the loyalty valuation endorsed by HBCL's own expert did "not reflect appropriate going concern accounting" for "historical cost accounting" under GAAP. (B4.)

Hbc's Director of Property Management and Real Estate testified for HBCL about problems with the Jane-Finch subtenant, but on cross-examination she admitted that during Fiscal 2007, the subtenant was current in paying its monthly rent and was paying down a receivable for CAM and property taxes. (A1873-75.) The subtenant bounced several checks in 2008, but those events occurred after the Fiscal 2007 financial statements had been issued. (A463; A1874-75.)

HBCL's Covered Losses Are Below the Deductible

In its Complaint, HBCL alleged that it "acquired a company that was worth tens of millions of dollars less than it bargained to acquire, and substantially overpaid for [Hbc]." (A700.) In closing argument, its counsel suggested that the alleged financial statement errors had an effect on "pricing the deal." (Op. 31.)

As the Trial Court pointed out, however, HBCL "didn't put on any evidence about how [the alleged errors] [a]ffected the deal price." (B284; Op. 29-30.) The only evidence on this issue, which the Trial Court credited (Op. 30), was the opinion of JZ's damages expert, Johnson, that the inventory and loyalty claims related to non-cash adjustments that would have had no impact on the EBITDA measure of cash flow on which the purchase price was negotiated. (A2541-43; B260-61.)

In its Answers to Interrogatories and at trial, HBCL asserted a different theory of Covered Losses: that after the closing, it had been "required to infuse additional cash into [Hbc] to compensate for the [alleged errors]." (B70-71.) HBCL's Casale testified vaguely that "if there is a shortfall [of cash] you have to find a way to make it up so usually that comes from an additional investment" (A1393); but he was unable to identify any investment attributable to the alleged accounting errors or to quantify how much cash, if any, was so "infused." (A1500-03; Op. 29-30.)

With respect to the Jane-Finch sublease, the Trial Court found that HBCL presented no evidence of any deficiency in the payment of rent, CAM, property taxes or structural repairs, except $230,000 for exterior wall repairs. (Op. 27.)

The Trial Court found that the cost of the Jane-Finch wall repairs and the tax claim constituted Covered Losses under the SPA, but aggregated less than the indemnification deductible and were therefore not recoverable from JZ. (Op. 32.)

ARGUMENT

I. THE TRIAL COURT CORRECTLY HELD THAT HBCL DID NOT PROVE A BREACH OF THE FINANCIAL STATEMENT REPRESENTATION

A. QUESTION PRESENTED

Was the Trial Court correct in holding that HBCL did not prove a breach of the Financial Statement Representation?

B. SCOPE OF REVIEW

This Court reviews the Trial Court's interpretation of the SPA *de novo*. *Schock v. Nash*, 732 A.2d 217, 224 (Del. 1999). It reviews the Trial Court's factual findings following a bench trial for clear error. *Olson v. Halvorsen*, 986 A.2d 1150, 1157 (Del. 2009). "The trial court's factual findings . . . will be accepted if they are sufficiently supported by the record and are the product of an orderly and logical deductive process." *Schock*, 732 A.2d at 224 (internal quotations and alterations omitted).

The Trial Court's determination of whether Hbc's accounting was in accordance with GAAP is a factual question typically resolved, as it was here, with expert testimony. *See In re High Strength Steel, Inc.*, 269 B.R. 560, 568 (Bankr. D. Del. 2001) (Delaware law) (whether financial statements conform to GAAP is a question of fact). *See also In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1421 (3d Cir. 1997) ("it is a factual question whether [a party's] accounting practices were consistent with GAAP," which "is best resolved by expert testimony"). Accordingly, this Court reviews the Trial Court's findings with respect to GAAP for clear error and affords "substantial deference" to findings based upon expert witness presentations. *Schock*, 732 A.2d at 224. *See also SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 37 A.3d 205, 210 (Del. 2011) (Supreme Court gives a "high level of deference" to expert financial evaluations).[6]

Finally, this Court reviews the Trial Court's decision to disregard HBCL's arguments that were raised for the first time after trial for abuse of discretion. *See Laird v. Buckley*, 539 A.2d 1076, 1079 (Del. 1988).

C. MERITS OF ARGUMENT

1. Financial Statements That Contain No Material or Intentional Errors Are In Accordance with GAAP.

To establish a breach of the Financial Statement Representation, HBCL sought to prove that Hbc's Fiscal 2007 financial statements were not prepared in accordance with GAAP. (A517; A547.) To that end, it asserted that the alleged inventory overstatement, loyalty liability understatement, and lack of a sublease reserve were "errors" as defined in Section 1506 of the CICA Handbook, which states that "**[p]rior period errors** are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to

6 HBCL cites a decision from the Wisconsin Supreme Court, *Ehlinger v. Hauser*, 785 N.W.2d 328 (Wis. 2010), for the proposition that the application of GAAP is a question of law. Although the plurality opinion there states that "the necessary components of a GAAP computation is . . . a question of law," *id.* at 338, that observation is *dicta* because "all justices agree[d] that [they] need not decide what is required to do a compilation under GAAP." *Id.* at 330 n.3.

use, or misuse of, reliable information." (HBCL Br. at 22-24;[7] A62, emphasis in original.)

Section 1506 of the CICA Handbook goes on to state:

> Financial statements do not comply with generally accepted accounting principles if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

(Op. 22-23; A69.)

The Trial Court found that "[a]n extension of this rule necessarily dictates that *immaterial errors made unintentionally* do not violate GAAP." (Op. 23, emphasis in original.) That finding was supported not only by the plain language of Handbook Section 1506 but also by JZ's GAAP expert, Thornton, who gave evidence that "immaterial errors do not represent a departure from GAAP . . . unless they are made intentionally." (B93; A2246.) Although HBCL's accounting expert, Bouchard, disagreed with Thornton on that point (A2053), the Trial Court observed the witnesses and credited Thornton's testimony. (Op. 25 n.154). Its finding is entitled to "substantial deference." *Schock*, 732 A.2d at 224.

HBCL "readily conceded" that none of the alleged errors were material and "none . . . [were] intentional." (Op. 23; A1320-21; A2117.) Accordingly, under the Trial Court's well-supported finding, HBCL failed to prove a violation of GAAP. (Op. 27.)

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7 Citations to "HBCL Br." refer to the Corrected Appellant's Opening Brief.

2. The "Materiality Scrape" Applies Only To The Words In The SPA.

Because accounting errors violate GAAP only if they are material or intentional, HBCL's fallback position was that the materiality scrape in the SPA "evidences a clear intent to eliminate materiality as a consideration in determining the existence of a representation violation." (HBCL Br. at 26.) The Trial Court carefully considered and rejected that argument. (Op. 23-27.)

The materiality scrape at Section 7.5.2 of the SPA provides in pertinent part:

> In determining whether there has been any breach of or inaccuracy in any representation . . . for purposes of [indemnification] and in determining the amount of any Covered Loss, any references to "material", "materially", or "Material Adverse Effect *in such representation* . . . shall be disregarded . . . .

(A547, emphasis added.)

The Trial Court found this provision "clear and unambiguous" (Op. 24), which HBCL does not dispute. (HBCL Br. at 2 and 22.) The court therefore "confine[d] its interpretation to the contract's 'four corners'" (Op. 24), and held that it should "disregard" the word "material" where it appears in the Financial Statement Representation. (*Id.*) The effect was to "scrape" the word "material" from the "fairly . . . present" clause of the representation, as follows:

> The Financial Statements have been prepared in accordance with generally accepted accounting principles (subject to usual year-end adjustments in the case of the Unaudited Financial Statements) consistently applied throughout the periods indicated and fairly, completely and accurately present in all ~~material~~ respects the financial position of [Hbc] and the results of its operations as of the dates and throughout the periods indicated."

(A517, alteration supplied.)

Based on this "four corners" reading of the SPA, the Trial Court held that the materiality scrape did not support HBCL's claims for two reasons: first, because HBCL did not assert claims under the so-called fair presentation clause of the Financial Statement Representation, from which the word "material" *was* scraped (Op. 24-25); and second, because materiality was *not* scraped from GAAP. (Op. 26-27.)

3. HBCL Did Not Raise A Fair Presentation Claim At Trial.

At trial, HBCL sought to prove that Hbc's financial statements violated GAAP, primarily because Hbc's estimating "methodology" was allegedly "not in accordance with GAAP." (A2056.) It offered no evidence that the financial statements did not "fairly, completely and accurately present" Hbc's financial condition or results of operations. (B276; Op. 24-25 n.148.) Nor did it brief that issue in the Trial Court. (*Id.*)

HBCL acknowledges that the principles of "fair presentation," "completeness" and "accuracy" are set forth at some length in the CICA Handbook. (HBCL Br. at 26, referencing CICA Handbook §§ 1000, 1400 and 5300.) HBCL's accounting expert, Bouchard, did not express an opinion on the application of those principles to the Fiscal 2007 financial statements in her report (A781-A1180), nor did she testify about them at trial.

The Trial Court did not abuse its discretion in concluding that HBCL did not assert a claim under the fair presentation clause. *Laird*, 539 A.2d at 1079.

HBCL's argument that the Trial Court should not have "carved the Financial [Statement] Representation into two distinct requirements" (HBCL Br. at 23 and 26-28) is unavailing.[8] Whether the representation and warranty is viewed as one clause or two, there was simply no evidence that the Fiscal 2007 financial statements did not fairly, completely and accurately present the financial condition of Hbc at January 31, 2008. (B276.)

4. Materiality Was Not Scraped Out of GAAP.

As the Trial Court recognized, HBCL's argument that materiality should be "eliminated . . . as a consideration" in determining whether GAAP was violated would require scraping the words "material" and "materially" from GAAP pronouncements themselves and the concept of materiality from GAAP generally. (Op. 25.) The Trial Court correctly rejected that argument, based on well-established rules of contract construction.

The Trial Court found that "[m]ateriality is deeply engrained in almost every aspect of GAAP." (Op. 25.) In particular, "GAAP recognizes that . . . many items in financial statements cannot be measured with precision, but instead, must be estimated" (Op. 27), and "materiality [is] the 'sole criterion'" for determining

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[8] When the Trial Court inquired about this issue in connection with closing arguments, HBCL's counsel himself characterized the fair presentation clause as a "separate standard under GAAP." (B283.)

whether an estimating mistake "rises to the level of an error." (Op. 28.) Those findings were based on the evidence of JZ's GAAP expert, (Op. 25 n.154; A2246), and are entitled to a high level of deference. *Schock*, 732 A.2d at 224.

Given those findings, HBCL's interpretation of the materiality scrape would render the use of the term "generally accepted accounting principles" in the Financial Statement Representation "virtually meaningless." (Op. 25.) It would read out of that term one of its fundamental ("deeply engrained") elements and would eliminate the "sole criterion" for determining whether an estimate violates GAAP. (Op. 28.) In short, it would make it impossible to determine whether the financial statements were prepared in accordance with GAAP. This would contravene the rule of construction that a court "will not read a contract to render a provision or term 'meaningless or illusory.'" *Estate of Osborn v. Kemp*, 991 A.2d 1153, 1159 (Del. 2010).

The Trial Court also noted that HBCL's interpretation of the materiality scrape would require the court to "leave the four corners of the SPA" to ascertain the parties' intent by reference to accounting principles or regulations, and then to "rewrite" such principles or regulations without clear "language to that effect" in the SPA. (Op. 26.) This would contravene the rule that interpretation of an unambiguous contract must be confined to the document's "four corners," *Riverbend Cmty., LLC v. Green Stone Eng'g, LLC*, 55 A.3d 330, 334 (Del. 2012), and the rule that courts should not create a contract obligation that the parties have not themselves expressed. *O'Brien v. Progressive N. Ins. Co.*, 785 A.2d 281, 288 (Del. 2001). As the Trial Court said, if the parties intended the materiality scrape to modify GAAP, "they would and should have included language to that effect. But such language was not included." (Op. 26.)

The fact that indemnification under the SPA was capped at $20.2 million, which was below Deloitte's audit materiality threshold of $30 million (Op. 27), does not undermine the Trial Court's conclusion, as HBCL contends. (HBCL Br. at 28.) The cap was a bargained-for limit on JZ's exposure, but it would not have precluded HBCL from recovering for a material financial statement error up to the cap, for an immaterial but intentional financial statement error up to the cap, or for a breach of any of the representations and warranties that made no reference to GAAP.

Finally, the Trial Court rejected HBCL's interpretation of the materiality scrape on policy grounds, observing that "[n]o company of Hbc's size (perhaps any size) can reasonably be expected to find every single error in its financial statements," and "[t]he plain language of GAAP rejects such an interpretation." (Op. 26.)

II. THE TRIAL COURT CORRECTLY ABSTAINED FROM DECIDING WHETHER THE FINANCIAL STATEMENTS CONTAINED IMMATERIAL ERRORS

A. QUESTION PRESENTED

Did the Trial Court correctly hold that it was unnecessary to decide whether Hbc's Fiscal 2007 financial statements contained immaterial errors?

B. SCOPE OF REVIEW

This Court may decide an issue not reached by the Trial Court in the interest of justice if the issue is outcome determinative and may have significant implications for future cases, and if it will promote judicial economy by resolving an issue that ultimately would have to be resolved after remand. *Scion Breckenridge Managing Member, LLC v. ASB Allegiance Real Estate Fund*, – A.3d –, 2013 WL 1914714, at *8 (Del. Supr. May 9, 2013).

C. MERITS OF ARGUMENT

HBCL asserts that "the [Trial] Court did not rule on whether [its] three claims were GAAP violations." (HBCL Br. at 29.) That assertion is wrong. The Trial Court *did* rule on this issue, holding that the three claims were not GAAP violations because they were not material or intentional. (Op. 27.)

Furthermore, the Trial Court went on to "assume[], *arguendo,* that . . . HBCL [could] seek indemnification for *any error* contained in Hbc's Financial Statements," including the alleged immaterial errors underlying HBCL's claims. (*Id.*) As is discussed in Point III below, however, the Trial Court found that HBCL failed to prove Covered Losses in excess of the SPA deductible arising from those alleged errors.

Given its findings that the alleged immaterial errors (i) did not violate GAAP and (ii) did not cause indemnifiable losses, it was doubly unnecessary for the Trial Court to decide whether HBCL had proved the errors at all. It correctly abstained from doing so. *See Gatz Props., LLC v. Auriga Capital Corp.*, 59 A.3d 1206, 1218 (Del. 2012) (trial court should not have reached or decided unnecessary issue).

This Court should likewise abstain. The Trial Court heard testimony from eleven witnesses, five of whom were experts. The accounting claims were complex and vigorously disputed, as the Trial Court's 10-page summary of the conflicting evidence demonstrates. (Op. 10-20.) The issues are fact-specific and unique to the parties, with no implications for future cases. Neither the interests of justice nor judicial economy would be served by having this Court search a lengthy record of testimony and exhibits to resolve factual disputes that were not resolved in the first instance by the Trial Court. *See, e.g., Council of Dorset Condo. Apartments v. Gordon,* 801 A.2d 1, 9 (Del. 2002) (remanding to the trial court for factual findings).

III. THE TRIAL COURT CORRECTLY FOUND THAT HBCL DID NOT PROVE IT SUFFERED INDEMNIFIABLE COVERED LOSSES

A. QUESTION PRESENTED

Was the Trial Court's finding that HBCL did not prove Covered Losses in excess of the deductible clearly erroneous?

B. SCOPE OF REVIEW

This Court reviews the Trial Court's interpretation of the SPA *de novo*. *Schock*, 732 A.2d at 224. It reviews the Trial Court's factual findings following a bench trial for clear error, *Olson*, 986 A.2d at 1157, and affords "substantial deference" to findings based upon expert witness presentations. *Schock*, 732 A.2d at 224.

C. MERITS OF ARGUMENT

The Trial Court found that HBCL did not prove an indemnifiable Covered Loss because HBCL did not show either that it overpaid for Hbc or that it suffered any actual or estimated shortfall in cash flow as a result of the alleged accounting errors. (Op. 28-32.)

HBCL criticizes the Trial Court for "requiring" proof that, but for the alleged accounting errors, HBCL would have paid less for Hbc or invested less cash after the transaction. (HBCL Br. at 32.) Yet those are the only theories of loss that HBCL either pleaded or presented at trial and the Trial Court was correct to hold that HBCL failed to prove them.

1. HBCL Did Not Prove It Overpaid For Hbc.

In its Complaint, HBCL alleged that, as a result of breaches of the Financial Statement Representation, it "substantially overpaid for Hudson's Bay" (A700), and in closing arguments it suggested that there was some "value" associated with the alleged errors relative to "pricing the deal." (Op. 31.) The Trial Court properly considered this damages theory, and properly found that HBCL offered no evidence to support it. (Op. 31.)

The measure of damages for breach of contract in Delaware is the amount of money that would put the non-breaching party in the same position it would have been in had the breach not occurred, which in similar contexts has been interpreted as the impact of the breach on the purchase price of a business relative to its "true value." *See, e.g., Cobalt Operating LLC v. James Crystal Enters., LLC*, 2007 WL 2142926, at *29 (Del. Ch. July 20, 2007), *aff'd*, 945 A.2d 594 (Del. 2008) (Table); *Interim Healthcare, Inc. v. Spherion Corp.*, 884 A.2d 513, 549 (Del. Super. Ct.), *aff'd*, 886 A.2d 1278 (Del. 2005) (Table).

The only evidence in the record on the effect of alleged accounting errors on "pricing the deal" was the opinion of JZ's damages expert, Johnson, that those errors were non-cash accounting adjustments that had no impact on normalized EBITDA and caused no economic loss. (B259-61.) As Johnson testified without contradiction: "Accounting adjustments don't create or destroy value. Cash flow is what matters." (A2574.) HBCL offered no evidence that the alleged accounting errors had any impact on Hbc's cash flow. (A1501-03.)

2. HBCL Did Not Prove A Cash Shortfall Exceeding The Deductible.

At trial, HBCL suggested that it was required to "make up" a "shortfall" of cash arising from financial statement errors through "additional investment." (A1393.) The Trial Court found that HBCL failed to prove any such shortfall or additional investment (Op. 28-32), and that finding was not clearly erroneous. HBCL's witnesses admitted that they could not quantify any shortfall or additional investment attributable to the alleged accounting errors. (A1501-03; Op. 29-30.)

Except for the Jane-Finch exterior wall repair and the tax claim, HBCL never quantified any Covered Loss, and it offered no evidence by anyone qualified as a damages or valuation expert. It therefore failed to prove that it suffered "any harm" with "reasonable certainty" and without speculation. *See SIGA Techs., Inc. v. PharmAthene, Inc.*, – A.3d –, 2013 WL 2303303, at *12 n.99 (Del. Supr. May 24, 2013); *State of São Paulo v. Am. Tobacco Co.*, 919 A.2d 1116, 1124 (Del. 2007).

HBCL's inventory claim arose out of a change in accounting policy that did not affect the physical count, condition or selling price of Hbc's inventory. (A2580-82.)[9] At midnight on February 1, 2008, when CICA 3031 became effective, Hbc had the same items of inventory with the same price tags that it had at 11:59 pm on January 31, 2008, under CICA 3030.

Hbc's long-term loyalty liability is an estimate of the projected cost to redeem all outstanding points over the life of the Rewards program and does not represent the cash expense Hbc incurs to redeem points in a given year. (A596; A1568-69; A2583-84; A2603-04.) Hence, there was no support for HBCL's vague assertion that the allegedly understated loyalty liability was "a dollar-for-dollar problem for us." (A1432.)

With respect to the Jane-Finch sublease, HBCL relied on the appraisal of its real estate expert, John Galluzzo, who offered no evidence of any actual shortfall in rent. (A2221.) Although the Trial Court incorrectly stated that Hbc booked a $2 million reserve in the Fiscal 2007 financial statements (Op. 19) (the reserve was booked in early Fiscal 2008), the court did not offset that reserve against HBCL's damage claim so the error had no impact on its analysis and was harmless. *See Loudon v. Archer-Daniels-Midland Co.*, 700 A.2d 135, 140 (Del. 1997).

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9 HBCL's argument that its damages "include the cost of replacing missing or defective assets, or of restoring them to warrantied condition," (HBCL Br. at 32), is inapposite because HBCL offered no evidence that any inventory was missing or defective.

HBCL's criticism that the Trial Court did not consider HBCL's attorneys' fee claim is misplaced because the Joint Final Pre-Trial Order expressly stated that, "[i]n the event the Court awards judgment to Plaintiff, the issues of interest and the costs of pursuing this claim shall be reserved for after trial." (A1278.) Having entered judgment for JZ, the Trial Court had no occasion to consider HBCL's attorneys' fees. *See, e.g., Swinford v. World Aviation Sys., Inc.*, 2007 WL 2565599, at *3 n.19 (Del. Ch. Aug. 29, 2007) (attorneys' fees not awarded to non-prevailing party).[10]

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[10] Although JZ conceded a breach of the Tax Representation, the amount of the tax claim did not exceed the deductible so HBCL had no right to indemnification.

CONCLUSION

For the foregoing reasons, JZ respectfully requests that the Court affirm the Trial Court's decision and judgment in JZ's favor in all respects.

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