IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

UNIVERSAL COMPRESSION, INC., Plaintiff, v. TIDEWATER, INC., Defendant.	)	Civil Action No. 17774

MEMORANDUM OPINION

Date Submitted: August 4, 1999
Dated Decided: October 19, 2000

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JACOBS, VICE CHANCELLOR

I. INTRODUCTION

At issue in this action is which of two parties to a stock purchase agreement is ultimately liable to pay a post-agreement $2.76 million Texas corporate franchise tax assessment: the purchaser -- plaintiff, Universal Compression, Inc. ("Universal"), or the seller -- defendant, Tidewater, Inc. ("Tidewater"). Tidewater has moved to dismiss the complaint under Court of Chancery Rules 12(b)(6) and 9(b). For the reasons stated below, Tidewater's motion will be granted as to Count I, but denied as to Counts II, III, IV and V.

II. FACTS

The relevant facts are derived from the well-pled allegations of the complaint. Tidewater is a Delaware corporation with its principal place of business in New Orleans, Louisiana. Universal, a Texas corporation whose principal place of business is Houston, Texas, is a leading provider of natural gas compressor rental, maintenance and operations services to the domestic oil and gas industry. Universal is also the successor in interest to TW Acquisition Corporation, an entity formed by Castle Harlan Partners III, L.P., which was a private investment fund ("TW"), and Tidewater Compression Services, Inc. ("Compression"), which was a Texas corporation owned by Tidewater.

In October 1997, Castle Harlan, Inc. entered into discussions with Tidewater about possibly acquiring Compression. Negotiations leading to the purchase of Compression ensued during October, November and December, 1997, and resulted in a Stock Purchase Agreement dated December 18, 1997 (the "Agreement"). Castle Harlan then organized Universal for the purpose of acquiring Compression. [1]

In the Agreement, Universal agreed to buy from Tidewater all of Compression's outstanding shares of common stock for $360 million, subject to certain adjustments. The Agreement providedthat it would be construed in accordance with the laws of New York, and that the state and federal courts located in Wilmington, Delaware would have exclusive jurisdiction over claims to enforce the Agreement. The transaction closed on February 20, 1998 (the "Closing Date").

The instant controversy arises under Section 9 of the Agreement, which is entitled "TAX MATTERS" and concerns the allocation, as between Universal and Tidewater, of liability for taxes imposed as a result of the transaction. Critical to Section 9-- and an essential part of the transaction from Universal's viewpoint --

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'Universal came into existence in 1998 when TW was merged into Compression. The resulting corporation later changed its name to Universal. For purposes of clarity, TW is referred to in this Opinion as "Universal."

was the abilityto make an election under Internal Revenue Code Section 338(h)(10) (the "Election"). That provision permits the parties to a corporate acquisition that is structured as an acquisition of the corporation's stock, to elect to treat the acquisition as a purchase of assets for federal income tax purposes. In this case the parties to the Agreement elected to treat the purchase of Compression's stock (for tax purposes) as a purchase of the assets of Compression as of the Closing Date.

A Section 338 election is often advantageous to a buyer, since it enables the tax basis of the acquired assets to be written up to their current market value, thereby increasing the buyer's future tax deductions for depreciation and amortization. But, an I. R.C. § 338 election may also result in increased tax liabilities, including liabilities for state taxes. Such increased taxes typically fall upon the seller, because the tax liability-triggering event is usually the "sale" of the assets, which is deemed to occur on the Closing Date. Thus, in such cases acquisition agreements typically allocate to the seller the increased tax liability for periods up through the Closing Date. In exchange for the seller's agreement to bear the increased tax liabilities, the buyer is often willing to pay a higher purchase price. In this case, Universal alleges that a tax liability allocation of this kind was what the parties actually intended, and that it (Universal) would never

have agreed to acquire Compression for the contract purchase price unless Tidewater committed to bear all tax liabilities triggered by the Election.

Under Section 9.3 of the Agreement, Tidewater became responsible for all taxes imposed for periods up to the Closing Date. And, under Section 9.5 of the Agreement, Tidewater would be responsible for all taxes "for," "related to," and "based on" any taxable period that began before, but ended after, the Closing Date.

The complaint alleges that Section 9.4 of the Agreement was intended to relieve Universal from liability for any and all taxes that resulted from the Election. Section 9.4, as originally drafted, made Universal liable for all taxes resulting from any action or election taken or made on or after the Closing Date. But, in an effort to shift some of the tax liability from Universal to Tidewater, there later ensued an exchange of drafts of Section 9.4. That drafting process resulted in Section 9.4 containing typographical and drafting errors in its final form. Those errors are the subject of this lawsuit.

Specifically, the plaintiff claims, the representatives of Universal and Tidewater orally agreed that *Tidewater* (not Universal), would be responsible to pay all federal and state taxes that resulted from the Election. To reflect that oral agreement, on December 5, 1997 Universal revised Section 9.4 to read as follows:

> Notwithstanding the preceding two sentences, Buyer [Universal] shall not be responsible for, and shall not pay, any Taxes that result from, or any increase in Seller's [Tidewater's] liability for Taxes, (i) imposed as a result of any Election permitted by Section 9.9 hereof [2]or (ii) any election to forego any carryback period permitted with respect to net operating losses or other Tax items attributable to periods after the Closing Date.

The quoted draft provision was intended as an exception or "carve out" from the preceding, more comprehensive, language of Section 9.4 that made Universal responsible for all taxes resulting from any election made on or after the Closing Date. According to the complaint, the "carve out" exception created by the last sentence of Section 9.4 was intended to relieve Universal from all tax liability resulting from the election allowed by Section 9.9 (i.e., the Election), irrespective of when that election was made.

Universal's attorneys sent their December 5th draft to Tidewater, which responded on or about December 7, 1997, by sending to Universal a revised, "black-lined" revision of the Agreement. The cover letter accompanying the revised draft stated: "We have considered all points raised by [Universal] in its fax to us of December 5th, and our draft reflects those changes that we have

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[2]The "Election permitted by Section 9.9" was the Section 338(h)(10) Election.

accepted." Tidewater's black-lined revision of Universal's draft of Section 9.4 read as follows:

> . . . . Notwithstanding the preceding two sentences, Buyer [Universal] shall not be responsible for, and shall not pay, any Taxes that result from, any increase in Seller's [Tidewater] liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period permitted with respect to net operation losses or other Tax items attributable to periods after the Closing Date.[3]

Universal claims that at the time it executed the Agreement, it was unaware that Tidewater, in its revision of Universal's December 5 draft, had deleted the word "or" from the clause "any Taxes that result from or any increase in Seller's liability" (underscoring added) in the last sentence of Universal's December 5 draft. Moreover, Section 9.4 also contained a second error that originated in

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[3] The quoted language became the present Section 9.4 of the Agreement, which in full text reads as follows:

> Taxes and Returns for Transactions That Occur After the Closing Date. Buyer shall be responsible for all Taxes of Compression for taxable periods after the Closing Date. The Buyer shall be responsible for any Taxes that result from, any action or election made by the Buyer or Compression at the direction of the Buyer on or after the Closing Date. If such an action or an election results in an increase in the Seller's liability for Taxes under this Agreement, the Buyer shall pay to the Seller an amount equal to the increase in such Taxes. Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, any increase in Seller's liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period permitted with respect to net operating losses or other Tax items attributable to periods after the Closing Date.

Universal's draft and was perpetuated in Tidewater's (and ultimately in the final) draft: the roman numeral (i) should have been located after the words "as a result of' in the final sentence of Section 9.4, but instead appeared (mistakenly, according to Universal) after the words "liability for Taxes." To illustrate the errors, the differences between (1) the final sentence of Section 9.4 of the Agreement as executed, and (2) what the final sentence would have stated had it been drafted without errors are presented in chart form below:

Section 9.4 As Written	Section 9.4 Without "Errors" (i.e., the Parties' Alleged Actual Agreement)
Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, any increase in Seller's liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period. ..	Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, or any increase in Seller's liability for Taxes imposed as a result of (i) any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period ...

According to the complaint, these errors were the product of either a mutual mistake or a unilateral mistake by Universal of which Tidewater was aware but never called to Universal's attention.

After the closing, and as a result of the Election, additional tax liabilities were imposed upon Compression by the taxing authorities of Alabama, Louisiana, and Texas. In December 1998, Universal paid Alabama corporation income taxes

of $240,741 (based on the 12-month period from April 1, 1997 to March 3 1, 1998) that arose from the gain generated by the Election. Similarly, in January 1999, Universal paid Louisiana corporate income taxes of $950,188 (based on the same 12-month period) that arose from the same Election gain. In June 1999, Tidewater reimbursed Universal for those Alabama and Louisiana tax liabilities.

As a result of the Election, Compression also incurred one other state tax liability, namely, the Texas Corporation Franchise Tax (the "Franchise Tax"). The Franchise Tax is nominally imposed for the "privilege" of doing business in Texas for the year in which the tax is due.[4] Functionally speaking, however, that Tax is more akin to a state corporate income tax, because it is imposed on the corporation's income for the year preceding the tax year in question. The Franchise Tax imposed here was based on Universal's income for the period April 1, 1997 through March 3 1, 1998, because the Closing Date fell within that fiscal year.

On or about November 15, 1999, Universal paid its 1999 Texas Franchise Tax assessment of $2,831,123.44, of which amount $2,755,056.69 was attributable to the gain resulting from the Election. Universal demanded

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[4] 34 Texas Admin. Code § 3.544(a)(l)(C).

reimbursement under the Agreement, but Tidewater refused to reimburse Universal for that expense. This lawsuit followed.

III. THE APPLICABLE STANDARDS AND THE PARTIES' CONTENTIONS

A. Procedural Standards

The pending motion to dismiss is brought under Court of Chancery Rule 12(b)(6) and Rule 9(b). On a Rule 12(b)(6) motion to dismiss, this Court must accept as true the well-pled allegations of the complaint.' The Court must also view the allegations in the light most favorable to the plaintiff and draw all reasonable inferences in its favor! A Rule 12(b)(6) motion to dismiss will not be granted "unless it appears to a certainty that under no set of facts which could be proved to support the claim would the plaintiff be entitled to relief."[7] To satisfy this standard, the plaintiff "must allege facts that, taken as true, establish each and every element of a claim upon which relief could be granted."' Thus, the Court may consider only those matters that are alleged in the pleading or incorporated

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[5]In re Tri-Star Pictures. Inc. Litig., Del. Supr., 634 A.2d 319,326 (1993).

[6]In re USACafes, L.P. Litig., Del. Ch., 600 A.2d 43, 47 (1991).

[7]Delaware State Troopers Lodge, Fraternal Order of Police Lodge No. 6 v. O'Rourke, Del. Ch., 403 A.2d 1109, 1110 (1979).

*Lewis v. Austen, Del, Ch., C.A. No. 12937, Jacobs, V.C., Mem. Op. at 10 (June 2, 1999).

therein by reference.'

Court of Chancery Rule 9(b) requires "the party claiming ... mistake to plead the circumstances constituting ... mistake with particularity."[10] The pleading also must give notice to the defendant of the specific alleged misconduct. Because a claim of mistake is integral to certain of Universal's claims, these standards will also be applied in the Court's analysis of the legal sufficiency of the relevant Counts.

B. The Contentions

Count I of Universal's five Count complaint alleges that Tidewater breached Section 9.4 of the Agreement, which required Tidewater to pay the portion of Universal's 1999 Franchise Tax that resulted from the Election. Count II claims, in the alternative, that if Section 9.4 is not found to so require, then it must be reformed to reflect the contracting parties' actual intent, which was that Tidewater would pay all tax liabilities resulting from the Election. Universal alleges that Section 9.4 was incorrectly drafted because of either a mutual mistake of both parties, or a unilateral mistake of Universal coupled with concealment of

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[9] James River-Pennington Inc. v. CRSS Capital, Inc., Del. Ch., C.A. No. 13870, Steele, V.C., Mem. Op. at 9 (Mar. 6, 1995) (citing Hart Holding v. Drexel Burnham Lambert, Inc., Del. Ch., 593 A.2d 535, 538 (1991)).

[10] James River-Pennington, at 17.

the mistake by Tidewater. Universal also claims that Tidewater breached Section 9.4 of the Agreement as reformed.

In Count III, Universal claims that Tidewater breached Section 9.5 of the Agreement by refusing to pay the Franchise Tax on net taxable earned surplus for the period April 1, 1997 through March 31, 1998. Count IV claims that under Section 9.7 of the Agreement, Tidewater was required -- but failed -- to indemnify Universal for that portion of the 1999 Franchise Tax for which Tidewater was responsible under the Agreement. Finally, Count V alleges that Tidewater breached its duty to perform the Agreement in good faith by improperly relying on the typographical errors in Section 9.4 as a reason to refuse payment of that portion of Universal's 1999 Franchise Tax which resulted from the Election.

These claims are now addressed.

IV. ANALYSIS

A. Count I

In Count I Universal alleges that Tidewater breached Section 9.4 of the Agreement by refusing to pay the portion of Universal's 1999 Franchise Tax that resulted from the Election, despite due demand therefor. Tidewater responds that Count I fails to state a cognizable claim, because the only provision of the Agreement that expressly covers post-closing tax periods is Section 9.4, which

does not as a matter of law obligate Tidewater to pay Universal's increased tax liability resulting from the Election.

Universal responds that Tidewater's motion to dismiss Count I is flawed, because it assumes that as a matter of law Section 9.4 must be interpreted to mean the opposite of what Universal alleges Section 9.4 means. Tidewater's assumption, Universal argues, is incorrect, because on a motion to dismiss the Court "cannot choose between two differing reasonable interpretations of ambiguous [d]ocuments.. .[d]ismissal is proper only if the defendants' interpretation is the *only* reasonable construction as a matter of law."" That contention frames the issues and analysis that pertain to Count I.

These contentions require intensive scrutiny of Section 9.4 which, to aid the reader in following the analysis, is set forth in full text below:

> Taxes and Returns for Transactions That Occur After the Closing Date. The Buyer shall be responsible for all Taxes of Compression for taxable periods after the Closing Date. The Buyer shall be responsible for any Taxes that result from, any action or election made by the Buyer or Compression at the direction of the Buyer on or after the Closing Date. If such an action or an election results in an increase in the Seller's liability for Taxes under this Agreement, the Buyer shall pay to the Seller an amount equal to the increase in such Taxes. Notwithstanding

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"Vanderbilt Income v. Arvida/JMB Managers, Del. Supr., 691 A.2d 609,613 (1996) (emphasis in original) (citing Barsky v. Flaherty, Del. Ch., C.A. No. 9132, Jacobs, V.C. (September 9, 1987)).

> the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, any increase in Seller's liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period permitted with respect to net operating losses or other Tax items attributable to periods after the Closing Date.

Both sides agree that the first sentence of Section 9.4 establishes the general principle that the Buyer (Universal) is responsible for taxes incurred for taxable periods after the Closing Date.[12] The initial question is whether any of the following three sentences of that Section creates an exception to that general principle. The next two sentences, which are also clearly worded and whose meaning is not disputed, prescribe that (a) Universal is responsible for any taxes resulting from a closing or post-closing tax election, and (b) Universal must indemnify Tidewater for any such taxes that Tidewater is required to pay.

Thus, if Universal has a cognizable claim, that claim must be predicated on the fourth sentence, which states:

> Notwithstanding the preceding two sentences, Buyer [Universal] shall not be responsible for, and shall not pay, any Taxes that result from, any increase in Seller's [Tidewater] liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period permitted with respect to net operating losses or other Tax items attributable to periods after the Closing Date.

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[12] Plaintiff's Answering Brief at 16, Defendant's Reply Brief at 4.

Tidewater argues that this last sentence does not create any exception that is relevant to the case at bar, because it provides only that "for two types of such elections (including the ... [Election] at issue here), Universal will not be responsible for any increase in Seller's - *Tidewater 's* - taxes resulting from such elections."[13] But, Tidewater contends, the fourth sentence does not address the question presented here, which is whether Tidewater is contractually responsible for *Universal 's* increased taxes. [14] Therefore, Tidewater concludes, nothing in Section 9.4 exempts Tidewater from the operation of the general principle created by the first sentence --that Universal is responsible for any increase in Tidewater's taxes resulting from the Election.

Universal disagrees. It argues that the fourth sentence does create an exception to the preceding two sentences, and that when properly read, it must be construed to mean that notwithstanding the two preceding sentences, "Buyer [Universal] shall not be responsible for, and shall not pay, any Taxes that result from. .. any election permitted by Section 9.9 ..."[15] As thus interpreted,

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[13]Defendant's Reply Brief at 6.

[14]Id.

[15]Plaintiff's Answering Brief at 15 (emphasis added). Section 9.9 of the Agreement allows for the Election.

Tidewater argues that this last sentence does not create any exception that is relevant to the case at bar, because it provides only that "for two types of such elections (including the ... [Election] at issue here), Universal will not be responsible for any increase in Seller's - *Tidewater's* - taxes resulting from such elections."[13] But, Tidewater contends, the fourth sentence does not address the question presented here, which is whether Tidewater is contractually responsible for *Universal's* increased taxes.[14] Therefore, Tidewater concludes, nothing in Section 9.4 exempts Tidewater from the operation of the general principle created by the first sentence --that Universal is responsible for any increase in Tidewater's taxes resulting from the Election.

Universal disagrees. It argues that the fourth sentence does create an exception to the preceding two sentences, and that when properly read, it must be construed to mean that notwithstanding the two preceding sentences, "Buyer [Universal] shall not be responsible for, and shall not pay, any Taxes that result from. .. any election permitted by Section 9.9 ..."[15] As thus interpreted,

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[13]Defendant's Reply Brief at 6.

[14]Id.

[15]Plaintiff's Answering Brief at 15 (emphasis added). Section 9.9 of the Agreement allows for the Election.

Universal argues, Section 9.4 does require Tidewater to reimburse Universal for the increase in *Universal's* Franchise Tax liability attributable to the Election. Thus, Universal concludes, because this competing interpretation is equally reasonable, and because the two interpretations create an ambiguity that can only be resolved on an evidentiary record, Count I is not dismissible.

To prevail on its motion to dismiss Count I, Tidewater must demonstrate not only that its interpretation is reasonable but also that it is the only reasonable interpretation. [16] In my view Tidewater has satisfied this test. Although the fourth sentence of the final version of Section 9.4 is poorly drafted, nonetheless, its clear thrust is that the Buyer [Universal] will *not* be responsible to pay any increase in the *Seller's* [Tidewater's] tax liability resulting from the Election. To be found ambiguous, the fourth sentence must be subject to at least two reasonable interpretations. Here, only Tidewater has established a reasonable interpretation. The critical issue is who is responsible for the Buyer's increased Franchise Tax. The final sentence of Section 9.4 cannot reasonably be interpreted in a way that would shift the Buyer's tax burden to the Seller. Indeed, no reasonable interpretation other than Tidewater's is possible, because the fourth sentence

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[16] Vanderbilt Income, 609 A.2d at 613.

relieves Universal from liability to Tidewater only for any increase in ***Tidewater's*** taxes resulting from the Election, not from any increase in ***Universal's taxes.***

Tidewater's interpretation of Section 9.4 is reasonable and consistent with the plain language of that Section. Because Section 9.4 cannot reasonably be construed to mean what Universal claims it means, Tidewater's interpretation is also the only reasonable construction of Section 9.4. That construction is fatal to the claim being advanced in Count I,[17] for which reason that Count must be dismissed.

B. Count II

In Count II Universal alleges, in the alternative, that if the Court accepts Tidewater's interpretation of Section 9.4, then that provision must be reformed to accomplish the contracting parties' actual intent, namely, that Tidewater would be responsible to pay any increased tax liability of Universal resulting from the Election. The essence of the reformation claim is that Section 9.4 was incorrectly written, because of either a mutual mistake of both parties or a unilateral mistake of Universal combined with the knowledge and concealment of the mistake by

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[17]Because Section 9.4 is not ambiguous, it becomes unnecessary to address the issue of par01 evidence. Under New York law extrinsic evidence cannot be introduced to alter, vary or contradict unambiguous terms of an integrated contract. A.H.A. Gen. Constr.. Inc. v. New York City Housing Auth., 699 N.E.2d 368,375 (N.Y. 1998) (citing W.W.W. Assocs. v. Giancontieri, 566 N.E.2d 639 (N.Y. 1990)).

Tidewater. Specifically, Universal claims that despite the errors and omissions in the final version of Section 9.4,[18] both parties understood and agreed that Tidewater would be responsible to pay (i) any Taxes that resulted from, or (ii) any increase in Seller's liability for Taxes imposed as a result of, the Election. Universal alleges that the final version of Section 9.4 was not correctly drafted to reflect that intent, and that Tidewater is in breach of the Agreement, if it is reformed.

Tidewater responds that Universal's reformation claim must be dismissed for two reasons. First, it argues that Count I does not meet the pleading standard for mistake prescribed by Court of Chancery Rule 9(b). Second, Tidewater contends that even if Section 9.4 were reformed to read as Universal contends, that reformed provision would still not support the relief that Universal seeks.

These arguments are next addressed.

1. The Rule 9(b) Pleading Standard

The first Count II-related issue is whether Universal has met the pleading standard of Rule 9(b). I conclude that it has, and that Count II cannot be

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'*Universal's December 5 proposed version of Section 9.4 (to repeat) was as follows: "Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, **or** any increase in Seller's liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof, or (ii). .." (Underscoring added).

dismissed for failure to adequately plead mistake. As earlier discussed, to state a claim for reformation of a contract, a party must allege that the contract as written does not represent the parties' actual intent, because of either fraud, mutual mistake or a unilateral mistake coupled with the other party's knowing silence or concealment.[19] Under New York contract law,.which applies here, all that Rule 9(b) requires is that the defendant be put on notice of the transaction at issue and of the facts allegedly concealed.[20]

Applying that standard here, I conclude that the complaint gives clear notice that the transaction at issue was the sale of Compression by Tidewater to Universal, and that the specific provision giving rise to the reformation claim is the last sentence of Section 9.4 of the Agreement. The complaint also explicitly describes: (1) the nature of the alleged mistake, namely, various exchanges of drafts and black-lined copies of revisions between the parties; and (2) the parties' actual oral agreement, which was incorrectly expressed in the written Agreement. Because these allegations are sufficient to satisfy the Rule 9(b) pleading standard,

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[19] James River-Pennington at 9; Chimart Assocs. v. Paul, 489 N.E.2d 23 1 (N.Y. 1986).

[20] American Home Products Cornoration v. Norden Labs. Inc., Del. Ch., C.A. No. 11615, Hartnett, V.C., Mem. Op. at 10 (July 24, 1991) (where New York contract law applies, it is enough for the purposes of Court of Chancery Rule 9(b) that the defendant be put on notice as to the transaction at issue and the facts allegedly concealed).

Count II will not be dismissed on Rule **9(b)** grounds.

2. **Whether Section 9.4, As Reformed, Would Support The Relief Universal Requests**

Tidewater's alternative argument is that even if Section 9.4 were reformed to read as Universal suggests, the reformed provision would still be dismissible because it would not support Universal's requested relief. Universal disagrees.

Having considered the contentions of both sides, I conclude that if Section 9.4 of the Agreement were reformed, the reformed provision would support Universal's desired outcome. The chart below shows why. It illustrates the differences between the actual language of the fourth sentence of Section 9.4 and how the sentence would read if it were reformed. (Universal's requested reformation changes are underscored and set forth in bold type):

Language of Actual Agreement	Language of Agreement as Reformed
Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result **from,** any increase in Seller's liability for Taxes (i) imposed as a result of any election permitted by Section 9.9 hereof or (ii) any election to forego any carryback period **...**	Notwithstanding the preceding two sentences, Buyer shall not be responsible for, and shall not pay, any Taxes that result from, **or** any increase in Seller's liability for Taxes imposed as a result of **(i)** any election permitted by Section 9.9 hereof or (ii) any election to forego any **carryback** period **...**

As the chart illustrates, under the reformed last sentence of Section 9.4, Universal would be relieved from liability for (1) any increase in Seller's tax

liability resulting from the Election ***and also*** from (2) any Taxes that result from the election. Because Section 9.4 as reformed would capture the disputed Franchise Tax liability in this case, it would also support Universal's requested tax burden-shifting remedy. Therefore Count II will not be dismissed on the basis that reformation would not support the plaintiffs requested remedy.

c. **Count III**

In Count III Universal claims that Section 9.5 of the Agreement obligates Tidewater to pay the 1999 Franchise Tax. That Section requires Tidewater, under certain circumstances, to pay all or a portion of a tax for taxable periods that "begin before the Closing Date and end after the Closing Date."[21] Tidewater contends that Count III fails to state a claim. Although Tidewater concedes that

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"Section 9.5 of the Agreement reads in relevant part:

> Taxes and Returns for Periods Commencing Before the Closing Date and Ending After the Closing Date. The Buyer shall prepare or cause to be prepared and file or cause to be filed any Tax Return of Compression for taxable periods that begin before the Closing Date and end after the Closing Date. At least fifteen (15) business days before the filing of any such Tax Returns with respect to income Taxes, the Buyer shall submit copies of such Returns to the Seller for the Seller's approval, which approval shall not be unreasonably withheld. The Seller shall pay to the Buyer within fifteen (15) days after the date on which Taxes are paid by the Buyer with respect to such periods an amount equal to the excess of(i) the portion of such Taxes which relates to the portion of such taxable period ending on the Closing Date (the "Pre-Closing Period") over (ii) the amount of any Taxes ... paid by the Seller prior to the Closing Date with respect to such taxable periods ....

Section 9.5 makes it responsible for taxes of Compression incurred through the Closing Date for periods beginning before and ending after the Closing Date, it contends that the Franchise Tax was not a tax imposed "for" that period. Rather, Tidewater argues, the tax was assessed for the period April 1, 1998 through March 3 1, 1999 -- a period after the February 28, 1998 Closing Date. Accordingly, Tidewater concludes, because Section 9.5 is not applicable, Count III does not state a claim.

Universal responds that its complaint alleges that the Franchise Tax was imposed for the period April 1, 1997 through March 3 1, 1998 -- a period that began before and ended after the Closing Date. Because the allegations of the complaint normally control on a Rule 12(b)(6) motion to dismiss, Universal urges that Count III must be found to state a cognizable claim under Section 9.5. I agree.

In this procedural context, Tidewater's motion cannot prevail unless the Court is able to conclude, based on the allegations of the complaint, that Universal's alleged "tax period" for which the Franchise Tax was imposed is incorrect as a matter of law. The Court is unable to so conclude, because Tidewater's pro-dismissal argument that the Franchise Tax was not imposed for the period encompassed by Section 9.5, is at best an ipse dixit assertion.

Tidewater makes no effort to support that assertion with any reasoned argument based on the Texas Franchise Tax statute. Tidewater's "legal insufficiency" argument is itself legally insufficient, and therefore fails.

D. Count IV

In Count IV Universal claims that Section 8.1 obligates Tidewater to indemnify Universal for losses and attorneys fees resulting from a breach of the Agreement.[22] Universal claims also that Section 9.7 specifically directs Tidewater to indemnify Universal for taxes that are Tidewater's responsibility under Section 9.5 of the Agreement.[23]

Tidewater responds that Count IV is legally insufficient because neither Section 8.1 nor Section 9.7 can support an independent cause of action. Rather (Tidewater argues), any claims under those two provisions are necessarily derivative of claims brought under Sections 9.4 or 9.5, and therefore can survive only if Universal has adequately pled a cause of action under one or both of those

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[22]Section 8.1 provides, in relevant part, that Tidewater:

> shall indemnify and hold harmless the Buyer [Universal] and its Affiliates, including Compression ... [from any loss] arising from, or in connection with ... a breach of any agreement or covenant contained herein ...

[23]Section 9.7 reads, in relevant part, that Tidewater shall indemnify "Buyer [Universal] and Compression from any and all Taxes ... imposed on Compression ... for any Pre-Closing Period (as defined and determined in Section 9.5)."

latter two provisions.

Because I have determined that Universal has adequately pled claims under Counts II and III, it becomes unnecessary to address Tidewater's argument any further. The complaint adequately pleads claims that (i) Tidewater is legally responsible for the 1999 Franchise Tax under Sections 9.4 and 9.5 of the Agreement, and (ii) that Tidewater has breached the Agreement by refusing to accept that responsibility. Accordingly, Universal's indemnification claims under Sections 8.1 and 9.7 survive this motion.

E. Count V

Count V alleges that Tidewater breached its duty to perform the Agreement in good faith by relying on a typographical omission in Section 9.4 as a ground for refusing to pay that portion of Universal's 1999 Franchise Tax which resulted from the Election. Tidewater responds that this claim is not legally cognizable, because there can be no implied duty to perform in good faith a contractual term that is made the subject of an express contractual obligation. Because the implied duty that is the subject of Count V was made the subject of two express obligations in Sections 9.4 and 9.5, Tidewater concludes that Count V fails to state a cognizable claim.

Universal rejoins that Count V does not allege a breach of an express contractual term. Rather, what Count V alleges is that Tidewater acted in bad faith by frustrating the parties' expectations that Universal would be relieved from all tax liability resulting from the Election.

New York law implies into every contract a covenant of good faith and fair dealing that "neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract."[24] To plead a claim for breach of such an implied covenant, Universal must allege the existence of a specific implied contractual obligation and the breach of that obligation.[25] The implied obligation, however, cannot impose a duty or restriction that varies from the express written agreement.[26]

I conclude that Universal has sufficiently pled that Tidewater acted in bad faith by paying, without objection, the Alabama and Louisiana franchise taxes that were assessed for the same period as the Texas Franchise Tax. Only when it was presented with the significantly larger Texas Franchise Tax bill, did Tidewater

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[24]Dalton v. Educational Testing Serv., 663 N.E.2d 289,291 (N.Y. 1995).

[25]Moore Bus. Forms. Inc. v. Cordant Holdings Corp., Del. Ch., C.A. No. 13911, Jacobs, V.C., Mem. Op. at 16 (Nov. 2, 1995).

[26]Id. at 18.

resort to the literal provisions of the Agreement in an effort to relieve itself from the Texas Franchise Tax liability that was indistinguishable from the Louisiana and Alabama tax liabilities Tidewater had willingly assumed.[27] Those allegations are sufficient to state a claim that Tidewater did not deal fairly with Universal or perform in good faith the provisions of the Agreement obligating Tidewater to pay the Franchise Tax.[28]

V. CONCLUSION

For the foregoing reasons, Tidewater's motion to dismiss is granted as to Count I of the complaint, and denied as to Counts II, III, IV and V of the complaint. **IT IS SO ORDERED.**

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[27] Complaint at ¶¶ 44 - 48.

[28] RJ Assocs.. Inc. v. Health Pavors' Org. LP, Del. Ch., C.A. No. 16873, Jacobs, V.C., Mem. Op. at 26 (Jul. 16. 1999) (finding allegations that defendants acted unfairly under contract sufficient to state a claim for breach of good faith and fair dealing); accord Bonnie & Co. Fashions v. Bankers Trust Co., 693 N.Y.S.2d 19 (N.Y. App. Div. 1999) (finding complaint raised issues of fact regarding defendant's possible breach of obligation of good faith and fair dealing).