IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

INTERACTIVECORP (f/k/a USA INTERACTIVE) and USANI SUB LLC,	)	
Plaintiffs,	)	
v.	)	C.A. No. 20260
VIVENDI UNIVERSAL, S.A., USI ENTERTAINMENT INC., and VIVENDI UNIVERSAL ENTERTAINMENT LLLP,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: May 12, 2004
Decided: June 30, 2004
Revised: July 6, 2004

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LAMB, Vice Chancellor.

I.

In furtherance of an effort to create a global media and entertainment business, defendant Vivendi Universal, S.A. sought to acquire the entertainment assets of plaintiff USA Interactive.[1] After three months of negotiation, Vivendi and USA entered into a transaction (the "Transaction") which created a joint venture between them, with USA contributing its entertainment assets and Vivendi contributing the entertainment assets of Universal Studios, Inc. ("Universal").[2]

In order to effect the Transaction, a limited liability limited partnership was created to which the entertainment assets would be contributed. The agreement creating this partnership provides for USA to receive certain preferred interests. The current litigation requires the court to determine whether that agreement as memorialized requires the partnership to make certain tax distributions to USA as the holder of those preferred interests. If so, the court must then determine whether the obligation to do so is the result of a mistake.

On a motion for judgment on the pleadings, the court holds that the plain meaning of the partnership agreement is to require the partnership to make those tax distributions. Further, the court finds that the defendants have not adequately pleaded the elements of either mutual or unilateral mistake.

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[1] USA Interactive is currently known as Interactive Corp. (hereinafter referred to as "USA").
[2] Vivendi owned Universal's assets. Vivendi itself was created out of a 2000 merger of Vivendi, S.A. Seagrams (which owned Universal Studios), and the French cable provider/movie studio Canal Plus, S.A.

II.[3]

A. The Parties

USA is a publicly traded Delaware corporation that "via the internet, television, and the telephone engages in the worldwide business of interactivity through electronic retailing, travel services, ticketing services, personal services, local information services and teleservices."[4] Plaintiff USANI Sub LLC ("USANI") is a Delaware limited liability company and wholly owned subsidiary of USA. USA and USANI (together referred to as "USA" or the "plaintiffs") are limited partners of defendant Vivendi Universal Entertainment LLLP ("VUE").

Defendant Vivendi is a *société anonyme* incorporated under the laws of France whose shares trade on the Paris Bourse and whose American Depository Receipts trade on the New York Stock Exchange. Vivendi operates businesses in telecommunications, music, television, and film. Defendant USI Entertainment, Inc. (referred to jointly with Vivendi simply as "Vivendi," and jointly with Vivendi and VUE as the "defendants"), a Delaware corporation, is a subsidiary of Vivendi and the general partner of VUE. VUE is the Delaware limited liability limited partnership created to effect the Transaction.

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[3] All facts herein are taken from the well-pleaded facts contained in the answer, those facts contained in the complaint and admitted in the answer, and the contents of documents specifically referred to by the answer.
[4] Compl. ¶ 7.

B. General Negotiations Leading To The Transaction Agreement

In late 2001, Vivendi and USA began holding informal discussions regarding a potential strategic transaction between the two companies, focusing on the entertainment assets of USA and Universal. As discussions continued, Vivendi hired Cravath, Swaine & Moore LLP as legal advisor and Goldman, Sachs & Co. as financial advisor; USA hired Wachtell, Lipton, Rosen & Katz and Allen & Co. in the same capacities. In the first week of December 2001, USA's board of directors appointed a special committee of independent directors (the "Special Committee") to work toward and evaluate such a transaction. The Special Committee retained Morris, Nichols, Arsht & Tunell as legal counsel and Bear Stearns as financial advisor.

Throughout December, negotiations continued and drafts of transaction documents were exchanged. On December 16, 2001, following approval by the USA board and the Special Committee, the parties entered into the Amended and Restated Transaction Agreement (the "Transaction Agreement").[5] Under the terms of the Transaction Agreement, USA contributed to VUE various entertainment-related assets valued at approximately $11.7 billion. In return, USA received certain interests in VUE (described below), approximately $1.62 billion in cash,

[5] The Transaction Agreement is among USA, Vivendi, Universal, USANI, and Liberty Media Corp., and is dated as of December 16, 2001. The transactions contemplated by the Transaction Agreement closed on May 7, 2002. The answer refers to the Transaction Agreement for its contents.

and the retirement of securities of a USA subsidiary held by Vivendi that were exchangeable for approximately 321 million shares of USA common stock with a public market value of $7 billion.

C. The Partnership Agreement

An Amended and Restated Limited Liability Limited Partnership Agreement (the "Partnership Agreement")[6] setting up VUE was attached as Annex A to the Transaction Agreement. In exchange for the contributions made by it under the Transaction Agreement,[7] USA[8] received both common and preferred interests in VUE.

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[6] The Partnership Agreement is dated as of May 7, 2002 and is entered into by USI Entertainment, Inc.; USANI Holding XX, Inc.; Universal Pictures International Holdings BV; Universal Pictures International Holdings 2 BV; NYCSPIRIT Corp. II; USA; USANI; New-U Studios Holdings, Inc.; and Barry Diller. The Partnership Agreement is attached as Exhibit A to the complaint and the answer refers to the Partnership Agreement for its contents.

The Partnership Agreement contains an integration clause. Partnership Agreement § 14.04. The Partnership Agreement is governed by, and is to be construed in accordance with, Delaware law, *id.* § 14.08, and the signatories have consented to the jurisdiction of the Delaware courts, *id.* § 14.09.

The court notes that jurisdiction in this case arises under 6 *Del. C.* § 17-111, which states "[a]ny action to interpret, apply or enforce the provisions of a partnership agreement . . . may be brought in the Court of Chancery."

[7] Section 3.01(b) of the Partnership Agreement provides that "[i]n return for such initial Capital Contributions, Common Interests and/or Preferred Interests shall be issued to the Partners as provided in Articles V and VI hereof."

[8] For simplicity, references to USA include certain USA affiliates (*e.g.*, New-U Studios).

1. Common Interests

The "Common Interests" are the equity interests by which VUE is controlled. Section 6.01[9] sets forth the participation percentage of each partner's Common Interest. According to this provision, USA holds a 5.44% Common Interest in VUE. This interest is, subject to certain limitations, callable by Universal after five years and puttable to Universal after eight years.[10] The put and call, if exercised, are to be exercised through either Vivendi stock or cash, at Universal's election.[11]

Of the remaining Common Interests, Vivendi holds 93.06%, and Barry Diller, the USA principal, holds 1.5%. By virtue of its majority equity stake in VUE, Vivendi essentially exercises control over it, subject only to certain consent and veto rights of USA.

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[9] When this memorandum opinion refers simply to Section numbers, it is referring to sections of the Partnership Agreement.

[10] Partnership Agreement § 10.03. The limitation provided for in Section 10.03 states:

> [F]or so long as USAi or its Affiliates shall be the holder of any Preferred Interests, at the election of USANi Sub, any Call or Put under this section 10.03(a) shall only be applicable to a portion of the Common Interests of USANi Sub and its Affiliates such that upon the consummation of the applicable purchase and sale USAi and its Affiliates would retain a Participation Percentage of 1%, and in such event the determination of Appraised Value shall only apply to the portion of the Common Interests of USAi and its Affiliates subject to such Call or Put.

[11] *Id.* § 10.03(e).

2. Preferred Interests

USA also received two forms of preferred interests (the "Preferred Interests") in VUE initially totaling $2.5 billion at face value. USA (or more specifically USANI) is the only holder of these Preferred Interests.

The Class A Preferred Interests (the "A Interests") had an initial face value of $750 million.[12] The face value of the A Interests accretes at a rate of 5% per annum.[13] Importantly, this face-value accretion is mandatory; it occurs regardless of partnership income.[14] On May 7, 2022 (twenty years from the closing date), these A Interests mature and will be redeemed by VUE through a cash distribution equal to the face value of those interests.[15] At such time, the A Interests will cease to exist.[16] Further, if VUE should liquidate, the A Interests have a preferred position, receiving proceeds of the liquidation after creditors of VUE, but before the holders of Common Interests.[17]

The Class B Preferred Interests (the "B Interests") USA receives under the Partnership Agreement have distinct characteristics from those of the A Interests. The initial face value of the B Interests was $1.75 billion,[18] which accretes at a

[12] *Id.* § 5.01(a).
[13] *Id.* § 5.03.
[14] *See id.* § 5.03(a) ("The Face Value of the Class A Preferred Interests *shall* accrete at a rate . . .") (emphasis added).
[15] *Id.* § 8.06. Face value will include accretion through and including the date of redemption.
[16] *Id.*
[17] *Id.* § 13.02(b)(ii).
[18] *Id.* § 5.01(b).

1.4% rate per annum.[19] As is true of the A Interests' face-value accretion, this 1.4% face-value accretion occurs without regard to partnership income.[20] While the B Interests have the same liquidation preference as the A Interests,[21] they also have an additional ongoing distribution preference. This preference requires VUE to make cumulative preferential distributions to the holders of the B Interests at a 3.6% rate per annum of the face value of the B Interests.[22] These distributions are to be made quarterly and in cash.[23] Like the mandatory face-value accretion of the A and B Interests, the cash distributions the B Interest holders receive are on their face entitlements—they are not tied to partnership income.[24] Unlike the A Interests, the B Interests have no maturity date—they are perpetual. However, the B Interests are callable by and puttable to Universal after 20 years, at the lesser of their then-face value or the then-value of approximately 56.6 million USA common shares.[25]

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[19] *Id.* § 5.03.
[20] *Id.* § 5.03(b) ("[T]he Face Value of the Class B Preferred Interests *shall* accrete at a rate of 1.4% per annum, . . .") (emphasis added).
[21] *Id.* § 13.02(b)(ii).
[22] *Id.* § 8.01.
[23] *Id.*
[24] *See id.* § 8.01(a) ("The Partnership *shall* make cumulative preferential distributions . . .") (emphasis added).
[25] *Id.* § 8.07.

3. Allocation Of Partnership Income

Section 7.02 of the Partnership Agreement sets forth the order for allocating VUE income among the holders of all interests of VUE and is central to the current dispute. It provides:

> SECTION 7.02. Allocation of Net Income and Net Loss.
> (a) General. (i) Except as otherwise provided in this Section 7.02, Net Income shall be allocated to the extent therof:
>
> (A) first, if any Net Loss has been allocated to the holders of Preferred Interests under Section 7.02 (a)(ii)(B), to the holders of Preferred Interests pro rata in proportion to the amount of Net Loss so allocated until the aggregate Net Income allocated under this paragraph (A) shall equal the aggregate amount of such Net Loss;
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> (B) second, to the holders of Preferred Interests pro rata until the aggregate amount allocated under this paragraph (B) equals a return of 5% per annum on the Face Value of their Preferred Interests;
>
> (C) third, if any Net Loss has been allocated to the holders of Common Interests under Section 7.02(a)(ii)(A) or (C), to the holders of Common Interests pro rata in proportion to the amount of Net Loss so allocated until the aggregate Net Income allocated under this paragraph (C) shall equal the aggregate amount of such Net Loss; and
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> (D) fourth, to the Partners in accordance with their Participation Percentages.

The key paragraph in this Section is paragraph (B). It allocates VUE income to the holders of the Preferred Interests in an amount that equals a return of 5% per annum on the face value of those interests. As will be discussed below, what is crucial is that the capital accounts of each partner of VUE are increased by allocations of income under this Section.

4. Tax Distributions

This case centers on the tax distribution provisions of the Partnership Agreement and thus a brief discussion of the nature of tax distributions and of the negotiation history of this particular tax distribution provision is warranted.

At the outset, a "partnership distribution" is the "payment of cash or property to a partner out of earnings or as an advance against future earnings, or a payment of the partners' capital in partial or complete liquidation of the partner's interest."[26] Because partnerships are generally considered flow-through entities—the income of the partnership "flows through" to the individual partners (here based on the allocation provisions of Section 7.02) and is not taxed at the partnership level—allocations of income to a partner not accompanied by a distribution can result in a tax liability to be paid by a partner without a concomitant receipt of cash from the partnership. To remedy this, some partnerships provide for certain "tax" distributions to ensure that the partners have enough liquidity to make tax payments on their allocated share of the partnership income.

The tax distribution provision ultimately set forth in Section 8.02 was the subject of much negotiation. The first draft of the tax distribution provision, prepared by Cravath and dated December 6, 2001, provided for discretionary tax

[26] BLACK'S LAW DICTIONARY 488 (7th ed. 1999).

distributions and limited such distributions to those permitted by the terms of any loan agreement or indenture to which VUE is a party:[27]

> SECTION 8.02. Tax Distributions. To the extent permitted by the terms of any loan agreement or indenture to which the Partnership is a party, the Partnership may, at the discretion of the General Partner, as soon as practicable after the close of each taxable year, make cash distributions to each Partner in an amount equal to the product of (i) the amount of taxable income allocated to such Partner for such taxable year pursuant to section 7.02 . . . and (ii) the highest aggregate marginal statutory Federal, state, local and foreign income tax rate . . . .

Following receipt of this draft, USA's vice chairman, Victor Kaufman, and Vivendi's then-CFO, Guillaume Hannezo, had a conversation. During this conversation, Hannezo rejected Kaufman's demand for a mandatory tax distribution provision with respect to the Preferred Interests. This conversation is the only negotiation history alleged in the pleadings that occurred between the principals to the transaction. The remaining negotiation history contained in the pleadings is simply draft provisions exchanged between Cravath and Wachtell, with Cravath holding the pen throughout negotiations.

Attorneys at Wachtell prepared a mark-up of the December 6 draft, dated December 8, 2001. This mark-up would have made the tax distributions mandatory and eliminated the compliance limitations (changes notated by strikethrough or in brackets):

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[27] The answer refers the court to the drafts for their contents. Ans. ¶¶ 25, 26.

SECTION 8.02. Tax Distributions. ~~To the extent permitted by the terms of any loan agreement or indenture to which the Partnership is a party~~, [T]he Partnership [shall] ~~may, at the discretion of the General Partner,~~ as soon as practicable after the close of each taxable year, make cash distributions to each Partner in an amount equal to the product of (i) the amount of taxable income allocated to such Partner for such taxable year pursuant to section 7.02 . . . and (ii) the highest aggregate marginal statutory Federal, state, local and foreign income tax rate . . . .

Cravath's second draft of the Partnership Agreement, dated December 11, 2001, acceded to making the distributions mandatory, but rejected Wachtell's elimination of the compliance limitations:

SECTION 8.02. Tax Distributions. [To the extent permitted by the terms of any loan agreement or indenture to which the Partnership is a party,] the Partnership ~~may, at the discretion of the General Partner~~[shall], as soon as practicable after the close of each taxable year, make cash distributions to each Partner in an amount equal to the product of (i) the amount of taxable income allocated to such Partner for such taxable year pursuant to section 7.02 . . . and (ii) the highest aggregate marginal statutory Federal, state, local and foreign income tax rate . . . .

Wachtell's markup of the December 11, 2001 draft again eliminated the compliance limitations. The third Cravath draft, dated December 13, 2001, accepted and incorporated this change:

SECTION 8.02. Tax Distributions. ~~[To the extent permitted by the terms of any loan agreement or indenture to which the Partnership is a party,] the~~ The Partnership ~~may, at the discretion of the General Partner~~[shall], as soon as practicable after the close of each taxable year, make cash distributions to each Partner in an amount equal to the product of (i) the amount of taxable income allocated to such Partner for such taxable year pursuant to section 7.02 . . . and (ii) the highest aggregate marginal statutory Federal, state, local and foreign income tax rate . . . .

The executed Partnership Agreement reflects the December 13, 2001 draft and incorporates all of Wachtell's proposed changes to this section:

> SECTION 8.02. Tax Distributions. The Partnership shall, as soon as practicable after the close of each taxable year, make cash distributions to each Partner in an amount equal to the product of (a) the amount of taxable income allocated to such Partner for such taxable year pursuant to Section 7.02 . . . and (b) the highest aggregate marginal statutory Federal, state, local and foreign income tax rate . . . .

Thus Section 8.02, working in conjunction with Section 7.02, provides for mandatory annual tax distributions equal to allocations of taxable income as provided for under Section 7.02 multiplied by a statutory tax rate. There are no compliance limitations.

5. Effect Of Distributions And Allocations Of Income On Capital Accounts

Each partner has a separate capital account for each form of VUE interest (Common, A, or B) it holds.[28] Central to the functioning of the Partnership Agreement is how distributions and allocations of income made under that agreement affect these capital accounts. The key section 7.01, which provides:

> SECTION 7.01. Capital Accounts. (a) The Partnership shall establish a separate capital account (a "Capital Account") in respect of each Common Interest and Preferred Interest held by each Partner on the books of the Partnership. The Capital Account of a Partner shall be

[28] Partnership Agreement § 7.01. When referring generally to these accounts, the term is used in its plural form. When referring to a specific interest or specific affect, the singular "capital account" is used.

> increased by (i) the amount of money contributed by that Partner to the Partnership, (ii) the fair market value of property contributed by that Partner to the Partnership (net of liabilities related to such contributed property that the Partnership is considered to assume or take subject to under Section 752 of the Code) and (iii) allocations to that Partner pursuant to Section 7.02 of profit, income and gain (or items thereof). The Capital Account of a Partner shall be decreased by (i) the amount of money distributed to that Partner by the Partnership, (ii) the fair market value of property distributed to that Partner by the Partnership (net of liabilities related to such distributed property that such Partner is considered to assume or take subject to under Section 752 of the Code) and (iii) allocations to that Partner pursuant to Section 7.02 of loss, expense and deduction (or items thereof).

Capital contributions attributable to each partner at the outset were set out in Schedule B to the Partnership Agreement.[29] Other than cash and property contributed to VUE (and the "bump up" provision described in detail below), a partner's capital accounts increase solely based on allocations of income pursuant to Section 7.02(a).[30] Capital accounts are decreased by allocations of loss under that Section, and by the amount of cash or the fair market value of property distributed to a partner (including tax distributions under Section 8.02 and annual cash distributions under Section 8.01).

Under this structure, the annual allocation of income (up to 5% of the face value of each of the Preferred Interests) pursuant to Section 7.02(a)(i)(B) increases

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[29] *See Id.* § 3.01(b) ("Schedule B indicates the amount of Capital Contributions attributable to Common Interests and Preferred Interests, respectively, for each Partner.").
[30] Sections 7.02(b)-(f) also allocate income if necessary to comply with certain tax regulations not at issue in this memorandum opinion.

USA's capital accounts. For the A Interests, Section 7.02(a)(i)(B) would allocate income (to the extent there is income) to USA's capital account to directly reflect the 5% face-value accretion mandated by Section 5.03. For the B Interests, Section 7.02(a)(i)(B) would (again, to the extent there is income) increase USA's capital account by 5% of the face value of the B Interests. Because capital accounts are decreased by the amount of money distributed by VUE to a partner, the mandatory 3.6% cash distribution tied to the B Interests would decrease USA's capital account by that amount. The resultant difference between the initial 5% allocation (and concomitant increase in capital account) contemplated by Section 7.02(a)(i)(B) and the 3.6% cash distribution (and concomitant decrease in capital account) contemplated by Section 8.01 is a 1.4% increase in capital account equal to Section 5.03(b)'s contemplated face-value accretion of the B Interests. Thus, to the extent enough income is available to affect the allocations called for under Section 7.02(a)(i)(B), that Section, along with Sections 8.01 and 5.03, working together and in a vacuum ensure that yearly capital accounts increases reflect exactly the mandatory yearly face-value accretion of both classes of the Preferred Interests.

However, these Sections do not operate in a vacuum; other provisions in the Partnership Agreement also affect the capital accounts. Specifically, since capital accounts are decreased by *any* distribution made by VUE to a partner, if tax

distributions pursuant to Section 8.02 are made, the capital account balances would decrease and be lower than the Preferred Interests' face value. Similarly, if VUE did not have enough income to allocate the full amount called for under Section 7.02(a)(i)(B), capital accounts would not reflect the face value of the Preferred Interests.

6. Capital Accounts And Liquidation

Although the Partnership Agreement allows liquidation in extremely narrow circumstances, it has detailed provisions as to preferences in liquidation. Section 13.02(b) provides:

> (b) The proceeds of the liquidation of the Partnership shall be distributed in the following order and priority:
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> (i) first, to the creditors (including any Partners or their respective Affiliates that are creditors) of the Partnership in satisfaction of all of the Partnership's liabilities (whether by payment or by making reasonable provision for payment thereof, including the setting up of any reserves which are, in the judgment of the liquidator, reasonably necessary therefor);
>
> *(ii) second, to the Partners holding Preferred Interests pro rata up to the amount of the Face Value of such Preferred Interests;*
>
> (iii) third, to the Partners holding Common Interests pro rata based on the amount of Capital Contributions attributable thereto, up to the amount of such Capital Contributions; and

> (iv) fourth, to the Partners holding Common Interests pro rata in accordance with their respective Participation Percentages;[31]

Thus, after creditors, the Preferred Interest holders are in a preferred position, and USA (as the holder of those interests) will receive face value for its interests upon liquidation. There is a proviso (the "Liquidation Preference Proviso") to this preference schedule, however. It ties payments in liquidation directly to the balances of the capital accounts:

> provided, however, that in the event that distributions pursuant to clauses (ii) through (iv) above would not otherwise be identical to distribution in accordance with the positive balances in the Partners' Capital Accounts, such distributions shall instead be made in accordance with such positive balances; . . . .[32]

Thus, to the extent there is a lack of income to make sufficient allocations under Section 7.02(a)(i)(B) to allow capital account balances to keep pace with the face-value accretions of the Preferred Interests, or to the extent tax distributions are made, the amount paid out upon liquidation of VUE will likely be less than the face value of the Preferred Interests. For this reason, the face value of the Preferred Interests is tied directly to the balances of the capital accounts unless the difference is made up by the "bump up" provision described below.

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[31] Partnership Agreement § 13.02(b) (emphasis added).
[32] *Id.*

7. The Capital Account Bump Up

Notwithstanding the Liquidation Preference Proviso, there is a provision (the "Bump Up Provision") in the Partnership Agreement which tends to negate to a certain extent the effect of the proviso. Section 7.02(g) provides:

> (g) Allocations in Liquidation and upon Maturity of Class A Preferred Interests. Upon a dissolution of the Partnership in accordance with Article XIII, the Net Income or Net Loss (or items of profit, income, gain, loss, deduction and expense) of the Partnership shall be allocated to the Partners so that the balance in each Partner's Capital Account as of the date of dissolution shall equal the amount distributable to such Partner pursuant to Section 13.02(b)(ii) through (iv) (determined without regard to the provisos thereto); . . . .

This provision acts as a supplement to the basic Section 7.02(a) income allocation provision. According to it, if the capital accounts do *not* equal the face value of the Preferred Interests upon liquidation, net income of VUE will be allocated to the respective capital accounts until the balances of the capital accounts equal the face value of the Preferred Interests. Net income, however, is a defined term and is limited.[33] Net income during the period preceding liquidation (or, when dealing

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[33] Specifically, Net Income is defined as:

> [F]or any period, the taxable income . . . of the Partnership for such period for Federal income tax purposes, taking into account any separately stated tax items and increased by the amount of any tax-exempt income of the Partnership during such period and decreased by the amount of any Section 705(a)(2)(B) expenditures (within the meaning of Treasury Regulation Section 1.704-1(b)(2)(iv)(i)) of the Partnership; provided, however, that Net Income . . . of the Partnership shall be computed without regard to the amount of any items of gross income, gain, loss or deduction that are specially allocated pursuant to Section 7.02(c), (d) or (e). With respect to any property contributed to the Partnership at a time when its adjusted tax basis differs from its fair market value, and with respect to all Partnership property after any adjustment to the Capital Accounts pursuant to Section 7.01(c), the Net Income . . . of the Partnership (and the constituent

with the A Interests, during the period proceeding maturity) may not be enough to make up for shortfalls between capital account balances and face value of the Preferred Interests that build up over the life of the partnership. In this event, USA would not receive the face value of the Preferred Interests.

D. Vivendi Takes The Position That VUE Is Not Required To Make Tax Distributions With Respect To The Preferred Interests And Subsequent Litigation

In the fall of 2002, Vivendi informed USA that it did not believe that VUE was obligated to pay tax distributions with respect to the Preferred Interests, but rather only with respect to the Common Interests. This position was reasserted in a written memorandum prepared by attorneys at Cravath dated November 13, 2002, and a letter dated December 13, 2002 and prepared by Mr. Jean-Bernard Lévy of Vivendi.

In a January 30, 2003, letter, VUE was instructed by USI Entertainment, Inc. (a subsidiary of Vivendi) not to make distributions pursuant to Section 8.02. Further, in its form 6-K filed with the SEC on March 28, 2003, VUE states that "it does not intend to make such [tax] distributions [on the Preferred Interests] for such taxable year" because it "believes that USAi's position is without merit."[34]

> items of income, gain, loss and deduction) shall be computed in accordance with the principles of Treasury Regulation Section 1.704-1(b)(2)(iv)(g).

Id. § 1.01.

[34] These documents were referred to for their contents in the answer.

USA filed a complaint in this court on April 14, 2003, seeking specific performance of the Partnership Agreement, as well as a declaratory judgment regarding the interpretation of Sections 7.02 and 8.02. Vivendi filed an answer on June 30, 2003, containing eight affirmative defenses and three counterclaims. The affirmative defenses are that USA has failed to state a claim; amounts due under Section 8.02 were already satisfied by previous distributions to USA by VUE; waiver; estoppel; unclean hands; mutual mistake; unilateral mistake; and the reservation of the right to raise further affirmative defenses as might arise through discovery. Vivendi's counterclaims seek a declaratory judgment that the plain meaning of the Partnership Agreement does not require VUE to make tax distributions based on the Preferred Interests, and for reformation based on the theories of mutual or unilateral mistake. USA replied to these counterclaims on July 21, 2003, and, on January 30, 2004, moved for judgment on the pleadings. Following briefing and oral argument, this is the court's opinion on that motion.

III.

Court of Chancery Rule 12(c) provides for motions for judgment on the pleadings: "After the pleadings are closed but within such time as not to delay the trial, any party may move for judgment on the pleadings." The standard utilized to determine such a motion is generally the same as the standard utilized to determine motions filed pursuant to Court of Chancery Rule 12(b)(6). Judgment on the

pleadings should be granted only when, accepting as true all of the nonmoving party's well-pleaded factual allegations, "there is no material fact in dispute and the moving party is entitled to judgment as a matter of law."[35] Any inferences that may be drawn from the pleadings are drawn in favor of the nonmoving party.[36]

The court, however, is not required to accept conclusory allegations as true.[37] Moreover, "[a] trial court need not blindly accept as true all allegations, nor must it draw all inferences from them in [the nonmoving party's] favor unless they are reasonable inferences."[38]

While courts generally do not look beyond the pleadings in deciding motions for judgment on the pleadings, "[i]n particular instances and for carefully limited purposes," considering documents referred to in the pleadings of the nonmoving party "may be an appropriate practice."[39] This is particularly true when "the

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[35] *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund II, L.P.*, 1992 WL 181718, at *1 (Del. Ch. July 28, 1992), *rev'd on other grounds*, 624 A.2d 1119 (Del. 1993).
[36] *Id.* The court notes that to the extent Vivendi seeks reformation of the Partnership Agreement based on a theory of either unilateral or mutual mistake, the standard at trial would be the "clear and convincing evidence" standard. *See Brandywine Dev. Group, L.L.C. v. Alpha Trust*, 2003 WL 241727, at *6 (Del. Ch. Jan. 30, 2003) (stating that the clear and convincing evidence standard is the appropriate standard when deciding whether to reform a contract based on the doctrine of mutual mistake). This standard of *proof* is not implicated here. Decisions on motions for judgment on the pleadings assume as true the well-pleaded allegations of the nonmoving party.
[37] *Orman v. Cullman*, 794 A.2d 5, 15 (Del. Ch. 2002).
[38] *Grobow v. Perot*, 539 A.2d 180, 187 n.6 (Del. 1988), *quoted in Werner v. Miller Tech. Mgmt., L.P.*, 831 A.2d 318, 327 (Del. Ch. 2003).
[39] *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 69 (Del. 1995).

document is integral to [the nonmoving party's] claim and incorporated in" that party's pleadings.[40]

IV.

A. Interpretation Of The Partnership Agreement

The principles of contract interpretation in Delaware are well settled. In deciding a contract interpretation dispute, the court will first "examine the entire agreement to determine whether the parties' intent can be discerned from the express words used or, alternatively, whether its terms are ambiguous."[41] If the contract is clear on its face, the court will rely solely on the clear, literal meaning of those words.[42] The court will not consider extrinsic evidence when a contract is unambiguous and will not attempt to discern the intent of the parties.[43] If the contract appears ambiguous, or "fairly susceptible of different interpretations," the court will consider extrinsic evidence, including evidence of intent, in order to uphold the "reasonable shared expectations of the parties at the time of contracting."[44]

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[40] *Id.*
[41] *Comrie v. Enterasys Networks, Inc.*, 837 A.2d 1, 13 (Del. Ch. 2003).
[42] *See Demetree v. Commonwealth Trust Co.*, 1996 WL 494910, at *4 (Del. Ch. Aug. 27, 1996), *aff'd*, 647 A.2d 382 (Del. 1994) (unpublished table decision) ("Under the plain meaning rule of contract construction, if a contract is clear on its face, the Court should rely solely on the clear, literal meaning of the words.").
[43] *See Star Cellular Telephone Co., Inc. v. Baton Rouge CGSA, Inc.*, 1993 WL 294847, at *4 (Del. Ch. Aug. 2, 1993) (noting that if the court determines a contract has a plain meaning, "then no other evidence need be considered").
[44] *Comrie*, 837 A.2d at 13.

Here, the meaning of Section 8.02, standing alone, is clear as day. Annual cash distributions are to be made in an amount equal to the product of "the amount of taxable income allocated to such Partner for such taxable year *pursuant to Section 7.02* . . . and . . . the highest aggregate marginal statutory" tax rate.[45]

Section 7.02 not only provides for Preferred Interest holders to be allocated income, it gives them a preference in regard to income allocation ahead of the Common Interest holders.[46] Both Section 8.02 and Section 7.02 are mandatory provisions. Nowhere in the text of either provision is there any carve out of Preferred Interests or a discussion of the Common Interests separate from the Preferred Interests. Had the parties intended to limit tax distributions to be made solely on allocations of income based on holdings of the Common Interests, or to make distributions under Section 8.02 discretionary, they could have easily done so. They did not. The meaning of the language they adopted is plain on its face.

Vivendi, notwithstanding the crystal clear meaning of Section 8.02, argues that such a meaning would render that Section in conflict with other Sections of the Partnership Agreement. Noting the mandate that courts should construe contracts

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[45] Partnership Agreement § 8.02 (emphasis added).
[46] *Id.* § 7.02. Specifically, Section 7.02 provides for allocation "second, to the holders of Preferred Interests pro rata until the aggregate amount allocated under this paragraph (B) equals a return of 5% per annum on the Face Value of their Preferred Interests."

so as to give effect to all of their provisions,[47] Vivendi points to several sections of the Partnership Agreement that it says, when read in connection with Section 8.02, make Section 8.02 ambiguous. These arguments are addressed in turn.

1. Section 5.01 Does Not Conflict With The Plain Meaning Of Section 8.02

Vivendi argues that, since Section 5.01 "specifically identifies, by Section numbers, the distributions on the Preferred Interests," but does not "mention[] the extremely material tax gross-up distributions that [USA] claims that it is entitled to under Section 8.02,"[48] allowing tax distributions to the holders of Preferred Interests based on the provisions of Section 8.02 would be contradictory.

This argument fails. First, Section 5.01 itself only purports to list "*preference[s]* with respect to distributions . . . and liquidation"[49] that are conferred on the Preferred Interests; it does not purport to list *all* distributions associated with the Preferred Interests. Second, Section 6.01, which provides the basic characteristics of the Common Interests, does not discuss the tax distribution. If Vivendi's theory were true, the tax distributions would be included in Section 6.01 as well as Section 5.01.

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[47] *See Council of Dorset Condo. Apartments v. Gordon*, 801 A.2d 1, 7 (Del. 2002) ("A court must interpret contractual provisions in a way that gives effect to every term of the instrument, and that, if possible, reconciles all of the provisions of the instrument when read as a whole.").
[48] Defs.' Mem. of Law in Opp'n to Pls.' Mot. for J. on the Pleadings ("Defs.' Br.") at 33-34.
[49] Partnership Agreement § 5.01(a), (b) (emphasis added).

There is simply no conflict between the plain language of Section 8.02 and that of Section 5.01.

2. <u>Internal Revenue Code-Based Arguments</u>

As discussed above, partnerships are flow-through entities. The partnership does not pay tax on partnership income at the partnership level; rather, partnership income, once calculated, is allocated among individual partners, who are "liable for income tax only in their separate or individual capacities."[50]

In determining the amount of partnership income to report on their individual income tax returns, each partner of a partnership must "take into account separately his *distributive share* of the partnership's" gains and losses.[51] Section 704 of the Internal Revenue Code (the "IRC") provides how to determine a partner's distributive share of partnership income. At first, it leaves such determination to the partnership agreement.[52] Notwithstanding that allowance, if "the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item therof) does not have substantial economic effect," the partner's distributive share will not be determined in accordance with the partnership agreement, but rather in accordance with her interest in the partnership.[53]

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[50] I.R.C. § 701.
[51] *Id.* § 702 (emphasis added).
[52] *Id.* § 704(a) ("A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this chapter, be determined by a partnership agreement.").
[53] *Id.* § 704(b).

Moreover, certain payments made to individual partners, for purposes of calculating gross income and business expenses that qualify as a deduction on partnership income, are specifically defined *not* to be allocations of partnership income under the IRC. These payments, called "guaranteed payments," are defined as payments "to a partner for services or the use of capital," to the extent they are "determined without regard to the income of the partnership."[54] When calculating gross income and business expenses that qualify as deductions on partnership income, these payments are to be considered as payments made "to one who is not a member of the partnership."[55] A determination of status as a "guaranteed payment" affects the calculation of gross income at the partnership level (by, for example, allowing for a deduction of a business expense).

Vivendi makes two arguments relating to this general code-defined tax structure. Generally, the first argument is that, although Section 7.02 textually purports to allocate partnership income, it is really only representative of "guaranteed payments" made by the partnership to certain of its partners (the B Interest holders)—payments which are specifically defined not to be allocations of partnership income under the IRC for purposes of determining gross (and subsequently taxable) partnership income. The second argument is that, to the extent it does allocate partnership income, allocations made under Section 7.02 do

[54] *Id.* § 707(c).
[55] *Id.*

not have “substantial economic effect,” and so that Section does not follow the mandates of IRC section 704(b).

a. Section 7.02 Allocates Taxable Income

Section 8.02 of the Partnership Agreement allows distributions equal to the product of “the amount of *taxable income* allocated . . . pursuant to Section 7.02” and a specified tax rate. Vivendi argues that Section 7.02(a)(i)(B) merely represents annual payments made to the holders of the B Interests[56] in the form of cash distributions to the holders of the B Interests (pursuant to Section 8.01) and face-value accretions of the B Interests (pursuant to Section 5.03). Section 7.02, Vivendi argues, is not *really* allocating partnership income, but only recounting that B Interest holders have received the payments. Thus, the argument goes, to the extent these payments are guaranteed payments, Section 7.02 is not allocating “taxable income,” and Section 8.02 becomes ambiguous.

Vivendi argues that the court should ignore Section 7.02(a)(i)(B)’s clear text—which expressly provides that B Interest holders are allocated partnership income and equally as clearly does not reference the annual face-value accretion of B Interests and cash distributions to B Interest holders provided for elsewhere in the Partnership Agreement—because to not do so would be to transform what are

[56] Vivendi does not make such an allegation with regard to the A Interests.

economically guaranteed payments into allocated shares of partnership income.[57] Vivendi asserts that recognizing the 5% income allocation *in addition* to the 3.6% cash distribution to the holders of the B Interests and the 1.4% face-value accretion of the B Interests would result in a 10% return to the B Interest holders. This assertion is based on an incomplete reading of the Partnership Agreement. As discussed more fully below, the cash distributions and face-value accretions are not worth their nominal amounts if not accompanied by an allocation of partnership income under Section 7.02; indeed, it is the allocation of income under Section 7.02 that gives true value to the distributions and face-value accretions provided for elsewhere in the Partnership Agreement.

Even accepting Vivendi's argument, the payments that Section 7.02(a)(i)(B) would be recounting are not guaranteed payments. According to IRC section 707(c), the key trait of guaranteed payments is that they are determined *without regard to the income of the partnership*.[58] This trait is not a trait of either the cash distributions to holders of the B Interests or the face-value accretion of the B Interests.

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[57] *See* Defs.' Br. at 36-37 ("Although [USA] may argue that the language of the Partnership Agreement says that [USA] would be allocated income under Section 7.02 in amount of a 5% return, that phrasing cannot trump the tax law and transform what are economically guaranteed payments into allocated shares of partnership income.").

[58] *See also* Treas. Reg. § 1.707-4 ("The term guaranteed payment for capital means any payment to a partner by a partnership that is determined without regard to partnership income and is for the use of that partner's capital.").

Although the cash distributions under Section 8.01 are required to be made to holders of B Interests regardless of VUE's income, Section 7.01(a) requires that capital accounts be decreased by "the amount of money distributed to" a partner by VUE. Thus, the cash distributions result in a decrease in the capital account. Given that, as discussed in parts II.C.6-7 of this opinion, the *true* value of the Preferred Interests in liquidation is tied directly to capital accounts, and not to the nominal face value of those interests, the 3.6% distributions reduce, dollar-for-dollar, the amount that the holders of the B Interests will receive in liquidation unless the distribution is offset by a corresponding allocation of income under Section 7.02(a)(i)(B). Because the allocation of income under Section 7.02(a)(i)(B) would serve to replenish the capital account following a mandatory cash distribution, the true value of that cash distribution is dependent on the partnership's net income. That is to say, if a cash distribution decreases the liquidation value of the B Interests, its true worth is not the 3.6% of the face value of the B Interests the Partnership Agreement nominally accords it if that distribution is not accompanied by a concomitant allocation of partnership income.

Similarly, the 1.4%-face-value accretion of B Interest value is required regardless of VUE's income. But, as discussed above, the actual liquidation value of the Preferred Interests, regardless of how much face value is said to "accrete," is tied directly to the capital accounts. To the extent VUE does not have enough

income in any given year to allocate the full 5% of face value according to Section 7.02(a)(i)(B), the face-value accretion contemplated by Section 5.03 is accretion in name only. Face-value accretion, then is tied directly to VUE's income and the allocations provided for in Section 7.02(a)(i)(B).[59]

Moreover, a term defined in Treasury Regulation 1.707-4, promulgated under IRC section 707, more aptly describes transactions under Sections 8.01 and 5.03 of the Partnership Agreement. A "preferred return," is "a preferential distribution of partnership cash flow to a partner with respect to capital contributed to the partnership by the partner that will be matched, to the extent available, by an allocation of income or gain."[60] Rather than being made without regard to the income of the partnership, payments under Sections 8.01 and 5.03 are distributions matched by the allocations of income, to the extent available, under Section 7.02; allocations which give the distributions their true value.

What both sides label a "leading treatise" on tax, William S. McKee's Federal Taxation of Partnership and Partners, discusses the differences between guaranteed payments and preferred returns:

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[59] Vivendi argues that the Bump Up Provision would serve to nullify the effects of the Liquidation Preference Proviso. But, as discussed above, the Bump Up Provision is tied directly to Net Income, as that term is defined and temporally limited in the Partnership Agreement, and to the extent VUE cannot allocate enough Net Income to replenish the capital accounts to an amount equal to face value of the B Interests, the B Interest holders will not receive B Interest face value.

[60] Treas. Reg. 1.707-4(a)(2).

> If a partner's right to receive amounts from his partnership is fixed and certain, or "guaranteed" in some sense, it may be difficult to determine whether the amounts are § 707(c) guaranteed payments or § 731 distributions [*i.e.* , preferred returns]. The touchstone for this determination should be the effect on the recipient's capital account . . . . If the amounts received do not result in a charge to the recipient's capital account or otherwise reduce his rights to other partnership distributions, then the amount should be treated as § 707(c) guaranteed payments. Conversely, if the recipient's capital account is charged, or his rights to future distributions are reduced, the amounts should generally be treated as § 731 distributions.[61]

It is clear that the cash distribution and face-value accretion of the B Interests *do* result in a form of charge to the holder's capital account in that they work (whether by increasing nominal face value of the B Interests or by decreasing the balance of the capital accounts) to decrease the capital account's value in relation to the face value of the B Interests (which represents the value both parties anticipated in determining consideration for Vivendi's assets). Thus they are preferred returns, not guaranteed payments under the IRC.[62] Similarly, Section 7.02 allocates taxable income to the individual partners and Section 8.02, which references such an allocation, is not ambiguous.

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[61] 1 William S. McKee et al., FEDERAL TAXATION OF PARTNERSHIPS AND PARTNERS ¶ 13.03[1][b], at 13-42.

[62] Vivendi has already treated the cash distribution as allocated income for purposes of its federal income taxes. Without reaching a theory of estoppel, and notwithstanding Vivendi's statement that "VUE will make all corrections to that return which are legally required and is reviewing the need to amend the return," Defs.' Br. at 36 n.23, the court simply notes this as an offshoot of the clear meaning of Sections 7.02 and 8.02.

b. Section 8.02 Does Not Conflict With Section 7.01(e)[63]

Section 7.01(e) requires the Partnership Agreement to be "interpreted and applied in a manner consistent with" the "Treasury Regulations promulgated under Section 704(b)" of the IRC.

These promulgated regulations extrapolate on the IRC's requirement that an allocation of income under a partnership agreement's allocation provisions have "substantial economic effect" in order for those provisions to be upheld. As Vivendi describes, "[i]n order to comply with [IRC] § 704(b), Section 7.02's 5% nominal income allocation on the [B Interests] must affect, dollar for dollar, the amount that [USA] will receive under the Partnership Agreement from [VUE], for its [B Interests]."[64] Or, as the Treasury Regulations provide:

> (ii) Economic effect -- (a) Fundamental principles. In order for an allocation to have economic effect, it must be consistent with the underlying economic arrangement of the partners. This means that in the event there is an economic benefit or economic burden that corresponds to an allocation, the partner to whom the allocation is made must receive such economic benefit or bear such economic burden.[65]

The McKee treatise sums this test as:

> An allocation has economic effect only if the economic benefit or burden of the allocation has a dollar-for-dollar impact on the net

[63] Again, Vivendi's argument extends only to the B Interests.
[64] Defs.' Br. at 38.
[65] Treas. Reg. § 1.704-1(b)(2)(ii).

> aggregate amounts of money that the partners will ultimately receive over the life of the partnership.[66]

As set forth throughout this opinion, the Section 7.02 income allocation provision is one part of an intricately designed structure of payments, distributions, accretions and allocations, all working in harmony. The cash distributions to the B Interest holders and the face-value accretion on the B Interests each year clearly have a substantial economic effect in liquidation. The income allocation provision's substantial economic effect is clear—it counterbalances the effect of the cash distribution and face-value accretion provisions. The Bump Up Provision does not nullify the importance of this substantial economic effect because it may not replenish the capital accounts to the extent they do not match the face value of the B Interests due to distributions or a lack of income allocable in previous years. To quote Vivendi, "Section 7.02's 5% nominal income allocation on the [B Interests]" *do* "affect, dollar for dollar, the amount that [USA] will receive under the Partnership Agreement from [VUE], for its [B Interests]."[67]

Vivendi argues that notwithstanding that capital accounts may not equal the face value of the B Interests upon liquidation, "[t]he possibility that the Partnership may be liquidated is . . . a remote contingency that cannot change the illusory

[66] McKee, at ¶ 10.02[2][a][i], at 10-14.
[67] Defs.' Br. at 38.

nature of the nominal income allocation to the holder of the [B Interests]."[68] It further argues that the put/call options tied to the B Interests are "substantially certain to be exercised,"[69] and so the court should not look to the function of the capital accounts in liquidation. A "virtual certainty" does not mean that a court should ignore a possibility in interpreting a contract. This is especially true when the clear language of the contract provision at issue is completely unambiguous, and the court is merely ensuring that such a reading can be made consistently with other provisions of the contract. Moreover, Treasury Regulation 1.704-1(b)(2)(ii)(b) provides that IRC § 704(b) is not violated:

> if all or part of the partnership interest of one or more partners is purchased (other than in connection with the liquidation of the partnership) by the partnership or by one or more partners . . . pursuant to an agreement negotiated at arm's length by persons who at the time such agreement is entered into have materially adverse interests and if a principal purpose of such purchase and sale is not to avoid the principles of [IRC § 704(b)].

The put/call options described above are contained in the Partnership Agreement. That Agreement was negotiated at arm's length by parties who had materially adverse interests. Vivendi has not pleaded that the principal purpose of the put/call options is to avoid the substantial economic effect principle. Thus, the existence of the put/call options contained in the Partnership Agreement do not

[68] *Id.* at 42.
[69] *Id.* at 41.

serve to prevent Section 7.02's income allocations from otherwise meeting the requirements of IRC § 704(b).

For these reasons, Section 7.02 does not conflict with Section 7.01(e).

3. Tax Distributions Under Section 8.02 Will Not Conflict With Section 8.06 In Calendar Year 2023[70]

Vivendi also argues that because the final tax distributions based upon income allocable to the A Interests under Section 7.02(a)(i)(B) would be made after the A Interests cease to exist, reading Section 8.02 to allow tax distributions on the A Interests would put it in conflict with Section 8.06. Section 8.06 provides for maturity of the A Interests 20 years from the closing date of the Transaction, in 2022. At that time, Section 8.06 states, the A Interests "shall cease to be outstanding and all rights of the holders thereof shall cease." However, Section 8.02 allows for the tax distribution based on income allocable to the A Interests before they are redeemed in 2022, to be made at the close of that taxable year (in 2023). Vivendi argues this illustrates a conflict between Sections 8.02 and 8.06.

This argument simply does not hold water. The economic facts that determine the amount of the final 2023 tax distribution—the income allocable to the A Interest holders for VUE fiscal year 2022—will be fixed at redemption. That the rights associated with holding the A Interests cease before the final tax

[70] Vivendi's argument addressed in this section, converse to the previous two arguments, deals solely with the A Interests.

distribution is made is irrelevant. As such, the probability of a final tax distribution made after the A Interests are redeemed does not put Section 7.02(a)(i)(B) in conflict with Section 8.06.

4. Section 8.02 Provides For Tax Distributions, Not A Tax Indemnity

Vivendi's final argument in this regard is that "[b]ecause the cash coupon on [the B Interest], payable under Section 8.01(a), already covers [USA's] tax liability for its Preferred Interests, any additional distribution essentially gives USA a tax indemnity—but the parties never bargained for, or intended one."[71] Vivendi asserts that the cash distribution on the B Interests is intended to cover all of the tax liability incurred by holders of Preferred Interests as a result of the allocation provision in Section 7.02.

Nowhere in the Partnership Agreement is this expressed. Rather, the cash distribution is entirely related to the B Interests; there is no indication it is tied in any way to the Common or A Interests. Moreover, this argument would require that tax distributions for the Preferred Interests be set out under a heading simply labeled "Distributions," not in the provision dealing expressly with, and in fact labeled, "Tax Distributions." Finally, although the 3.6% cash distribution may be sufficient to pay tax liabilities based on the current maximum statutory rate, there is no guarantee that this rate will not increase in the future so that tax liabilities

[71] Defs.' Br. at 43.

based on the allocated income would exceed the cash distributions on the B Interests.

Vivendi has provided no evidence that Section 8.02 represents a tax indemnity. Its argument, therefore, fails.

Given that the language of Section 8.02 is unambiguous, not susceptible of another reading, and its clear reading does not conflict with any other provision of the Partnership Agreement, the court determines that it provides for tax distributions to be made on both the Common and Preferred Interests.

B. Mistake

1. Nature Of Mistake Claims

Having determined that Section 8.02 requires VUE to make tax distributions to USA based on income allocations provided for under Section 7.02(a)(i)(B), the court turns to Vivendi's affirmative defenses and its counterclaims seeking reformation of the terms of the Partnership Agreement. These are premised on the two theories of mistake—mutual and unilateral.

Before turning to the claim itself, it is important to understand the implications of finding that the elements of mistake have been adequately pleaded. As recounted above, in order for a dispute centered on the interpretation of a contract to move beyond the pleading stage, a court must find that a contract's terms are ambiguous or susceptible of different meanings. If the court finds the

terms are not ambiguous, the court will enforce those terms as written, and the case will not move to the expensive, time-consuming stages of discovery and trial. Through this framework, contracting parties are assured that their well-documented agreements will be upheld without significant time and funds expended.

Mistake is a claim that disregards this framework. One claiming mistake assumes that the contract is clear on its face. The claimant must argue that, notwithstanding this clarity, the court should enforce another meaning of the contract. The argument is that the contract's "clear meaning" is not *really* the meaning the parties intended.

The implications of allowing such a claim are readily apparent, and have been highlighted in many Delaware opinions.[72] To allow one party to a contract to argue that an unambiguous writing does not reflect the parties' real agreement deprives the other contracting party of the protections of the framework described above. Though mistake is a necessary legal tool to reform contracts that do not

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[72] *See e.g.*, *Cerberus Int'l, Ltd. v. Apollo Mgmt., L.P.*, 794 A.2d 1141, 1153 (Del. 2002) (noting that the purpose of requiring clear and convincing evidence to prove mistake is to "uphold a contract as the parties' written expression of their intent"); *Joyce v. RCN Corp.*, 2003 WL 21517864, at *3 (Del. Ch. July 1, 2003) (stating that the heightened pleading standard required when pleading mistake serves to "preserve the integrity of written agreements by making it difficult to re-open completed transaction"); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 155 cmt. c. (1981) ("Care is all the more necessary when the asserted mistake relates to a writing, because the law of contracts, as is indicated by the parol evidence rule and the Statute of Frauds, attaches great weight to the written expression of an agreement."), *cited in Cerberus Int'l, Ltd.*, 794 A.2d at 1153 n.44.

reflect the parties' intent because of problems such as scriveners' errors, it must be applied narrowly so as to ensure to contracting parties that in only limited circumstances will the court look beyond the four corners of a negotiated contract.[73] This is especially true here, where the Partnership Agreement is an integrated document.[74]

2. Requirements For Pleading Mistake

This caution in entertaining mistake claims is reflected in three ways. First, our court rules require the circumstances constituting mistake to be pleaded with particularity.[75] Second, the standard of proof required to succeed on a mistake claim is the intermediate "clear and convincing evidence" standard.[76] Finally, and

[73] *Cf. James River-Pennington, Inc. v. CRSS Capital, Inc.*, 1995 WL 106554, at *7 (Del. Ch. Mar. 6, 1995) ("Reformation is appropriate only when the contract does not represent the parties' intent because of fraud, mutual mistake or, in exceptional cases, a unilateral mistake coupled with the other parties' knowing silence.").

[74] Section 14.04 of the Partnership Agreement states:

> Section 14.04. Integration. This Agreement and the Transaction Documents constitute the entire agreement among the parties hereto pertaining to the subject matter hereof and supercede all prior agreements and understandings of the parties in connection herewith, and no covenant, representation or condition not expressed in this Agreement or in any Transaction Document shall affect, or be effective to interpret, change or restrict, the express provisions of this Agreement. Notwithstanding the foregoing, the parties hereto agree to be bound by the terms and provisions of the Letter Agreement (the "Letter Agreement") dated as of the Closing Date, by and among the Universal Partners and the USAi Limited Partners relating to the clarification of certain matters in this Agreement, and the terms and provisions of the Letter Agreement are hereby expressly incorporated herein by reference.

[75] Ct. Ch. R. 9(b) ("In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.").

[76] The Supreme Court, in *Cerberus International, Ltd. v. Apollo Management, L.P.*, held that trial courts must account for this standard in deciding upon motions for summary judgment. *Cerberus Int'l, Ltd.*, 794 A.2d at 1149 ("[T]he trial court must determine whether the plaintiffs on the summary judgment record proffered evidence from which any rational trier of fact could

most relevant to the current litigation, a substantive element of a claim of mistake—whether mutual or unilateral—is that the parties came to a specific prior understanding that differed materially from the written agreement. The Supreme Court, in *Cerberus International, Ltd. v. Apollo Management, L.P.*, highlighted this requirement:

> There are two doctrines that allow reformation. The first is the doctrine of mutual mistake. In such a case, the plaintiff must show that both parties were mistaken as to a material portion of the written agreement. The second is the doctrine of unilateral mistake. The party asserting this doctrine must show that it was mistaken and that the other party knew of the mistake but remained silent. *Regardless of which doctrine is used, the plaintiff must show by clear and convincing evidence that the parties came to a specific prior understanding that differed materially from the written agreement.*[77]

This description is important because it sets forth that no matter what theory of mistake is used the party claiming mistake must allege a specific prior agreement. Moreover, it demonstrates that although Court of Chancery Rule 9(b)'s particularity requirement may heighten what is required to plead mistake, the substance of a mistake claim—by itself—requires the pleading of a "specific" prior agreement.[78] While an alleged prior agreement may be informal,[79] oral,[80] and not

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infer that plaintiffs have proven the elements of a prima facie case [of mistake] by clear and convincing evidence."). This case, unlike *Cerberus*, is decided at the pleading stage. Thus, the court does not apply any standard of proof; rather it simply decides whether the nonmoving party, here Vivendi, "would . . . be entitled to relief under any of the facts (or reasonable inferences therefrom) alleged in the complaint." *Joyce*, 2003 WL 21517864, at *2.

[77] *Cerberus Int'l Ltd.*, 794 A.2d at 1151-52 (emphasis added).

[78] Thus, while the *Joyce* opinion rejected the argument that the complaint "must refer to the time, place, and content of the *mistake*," 2003 WL 21517864, at *5 (emphasis added), that opinion

constitutive of a complete contract,[81] some form of specific prior agreement must be alleged. Furthermore, conclusory factual allegations do not suffice for a claim of mistake to survive a motion for judgment on the pleadings.[82] In this case, Vivendi's affirmative defenses and counterclaims contain only conclusory allegations of a prior agreement at odds with the written contract.

3. Vivendi's Allegations

Nowhere in Vivendi's counterclaims is there any pleading of even an oral, informal, or incomplete agreement. The only allegations of an agreement between the parties in Vivendi's answer when discussing mutual mistake are, as follows:

- [T]he parties' agreement at the date of execution of the Partnership Agreement, as evidenced by the history of negotiations between them, was that Section 8.02 of the Partnership Agreement, as a standard boilerplate tax distribution provision, was designed to ensure only that the holders of common interests in VUE would have adequate liquidity

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went on to state, that while "it is not necessary to plead how or why the mistake occurred," it is "essential to articulate the alleged mutual mistake," *id.*, which would necessarily require pleading a specific prior agreement.

[79] *See Hob Tea Room v. Miller*, 89 A.2d 851, 856 (Del. 1952) (noting that "the clear language of a formal instrument, duly executed . . . will be set aside . . . where the evidence leaves no serious doubt but that a specific agreement was informally made . . .").

[80] *James River-Pennington, Inc.*, 1995 WL 106554, at *9 (allowing mistake claim based on alleged prior oral agreement).

[81] *Cerberus Int'l Ltd.*, 794 A.2d at 1152 ("Th[e prior] understanding need only be complete as to the issue involved. It need not constitute a complete contract in and of itself.").

[82] *Joyce*, 2003 WL 21517864, at *2 (noting, in a decision on a motion to dismiss pursuant to Rule 12(b)(6), "[w]here the factual allegations are conclusory in nature, they will not be accepted as true for purposes of the motion").

Vivendi argues that the purpose of Rule 9(b)—to "giv[e] notice of the claimed ground or mistake to the defendant," *Joyce*, 2003 WL 21517864, at *3—is served by its counterclaims. The court disagrees with this assessment. Nevertheless, the court's decision is based not on the heightened pleading requirements of Rule 9(b) but on the lack of the pleading of a *specific* prior agreement. Thus, Vivendi's argument that USA waived its right to raise 9(b) concerns (which the court also highly suspects) is irrelevant.

to pay their respective share of the taxes allocated under the Partnership Agreement as they fell due. Section 8.02 of the Partnership Agreement was not intended to provide distributions to the preferred shareholders in addition to the specifically negotiated cash distributions set forth in Sections 8.01(a) and 8.06;[83]

- In the event that the objective terms of the Partnership Agreement do require VUE to make tax distributions to Counterclaim-Defendants pursuant to Section 8.02 in the manner that they contend, then the Partnership Agreement does not accurately reflect the parties' prior agreement regarding that term.[84]

When pleading unilateral mistake, Vivendi does not once, even in conclusory fashion, reference a specific prior agreement. The conclusory allegations Vivendi does plead are not sufficient to defeat a motion for judgment on the pleadings.

Nevertheless, Vivendi argues it has adequately pleaded a specific prior agreement. First, it refers to the point in negotiating history discussed in Part II.C.4 hereof, during which Hannezo informed Kaufman that Vivendi would not accede to providing mandatory tax distributions based on allocations of income to the Preferred Interests. Alleging a prior *disagreement*, however, is not a substitute for alleging a prior *agreement*. The sequence of events described is that of a *dis*agreement, followed by an intricately documented negotiation in which several draft agreements were exchanged, that led ultimately to the tax distribution

[83] Answer, p. 11. This allegation is repeated at *id.* p. 14, ¶ 2.

[84] *Id.* p. 16, ¶ 10. Vivendi also alludes to the existence of a deal "previously agreed to by the parties at the time of [the Partnership Agreement's] execution" when discussing the nature of the dispute between the parties. *Id.* p.3, ¶ 3; *id.* p.4, ¶ 10.

provision memorialized at Section 8.02.[85] Thus, Vivendi's oft-repeated allegations that "[i]n the course of negotiations prior to the execution of the Partnership Agreement, Vivendi rejected plaintiffs' demand for a so-called tax 'gross-up' provision with respect to plaintiffs' proposed preferred interests in VUE,"[86] or that "[d]uring the negotiation of the transaction, Vivendi unequivocally communicated its refusal to accede to that demand,"[87] are of no consequence in determining whether a specific prior *agreement*, and therefore a claim for mistake, has been

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[85] The complaint specifically states that this conversation took place after the circulation of the December 6 draft. Compl. ¶ 25. While generally denying the allegations of paragraph 25 of the complaint, the answer goes on to reference the conversation a number of times. In a May 26, 2004, letter submitted to the court subsequent to the submission of briefs and conclusion of oral argument, Vivendi states:

> Giving defendants all required inferences, [the] conversation may prove to have occurred after Section 8.02's drafting was concluded, with Mr. Kaufman asking for distributions that he knew defendants had not agreed to; Mr. Hannezo rejecting that request; and the parties then proceeding to contract, thus showing the parties' prior agreement that was imperfectly reflected in the Partnership Agreement.

At oral argument, however, counsel for Vivendi placed this conversation as taking place immediately after the December 6 draft was circulated. *See* Tr. at 46 ("If Cravath gave this draft of December 6th and Mr. Kaufman gets the draft and, as Vivendi pleads, calls Mr. Hannezo up and says . . ."). Further, counsel for Vivendi specifically referenced paragraph 25 of the complaint, stating, "[t]he pleading, by [USA] as well, in 25, is that Victor Kaufman then contacts Vivendi's then-CFO, Guillaume Hannezo." *Id.* at 45-46. Indeed, Vivendi asserts in its brief that the final tax distribution provision was the result of a drafting error. *See* Defs.' Br. at 21 n.15 ("Accordingly, Vivendi is not required to plead the details of exactly how that completely unintentional drafting error might have occurred." Finally, Vivendi's counsel repeatedly referred to the conversation taking place when "both sides have the first Cravath draft." *See generally* Tr. at 70-80.

Moreover, this court is only required at the pleadings stage to take all *reasonable* inferences from the well-pleaded facts of the nonmoving parties. To infer that the Kaufman/ Hannezo conversation took place *after* all drafts were exchanged would be to infer that, following draft negotiations in which USA objectively and clearly received exactly what it demanded, USA would call Vivendi to demand that very concession. This inference is inherently *unreasonable*.

[86] Defs.' Br. at 12.

[87] *Id.*

pleaded. Simply put, there is no allegation by Vivendi of a prior agreement of any kind on the tax distributions, much less that there was an agreement that tax distributions would be made based on allocations of income to the holders of the Common Interests, but not on allocations of income to the holders of the Preferred Interests.[88]

4. Other "Facts" Pleaded By Vivendi Do Not Support The Assertion That There Was A Specific Prior Agreement

Vivendi argues that the court may utilize parol evidence to piece together a pleading of a prior specific agreement. While the nature of mistake claims allows parol evidence to be used as *proof* of a mistake at the summary judgment or trial stage, it is unclear whether such evidence, when properly before the court at the pleadings stage, may be used to *discern an allegation* of a specific prior agreement in the absence of an explicit allegation. If such evidence were permitted at this stage to discern a pleading, it would necessitate the court finding whether or not there is enough *proof of an allegation* to survive a motion to dismiss on the pleadings. This is not the type of inquiry a motion on the pleadings typically

[88] *See Jefferson Chem. Co. v. Mobay Chem. Co.*, 253 A.2d 512, 516 (Del. Ch. 1969) ("The difficulty here is that Jefferson has not alleged any 'facts' in support of its allegation seeking reformation. It states merely that the 'intent of the parties' when they made the contract was something different than what Mobay now contends that it is."). *But see* Petition for Reformation at ¶¶ 10, 11, *Joyce*, 2003 WL 21517864 (No. 19621-NC) (pleading that a disputed issue *had been resolved* as the petitioner claimed and alleging the specific terms that would have appeared in a contract but for a mistake); Compl. at ¶¶ 26-30, 37, *Universal Compression, Inc. v. Tidewater, Inc.*, 2000 WL 1597895 (Del. Ch. Oct. 19, 2000) (No. 17774-NC) (same). The court takes judicial notice of these public filings.

invites. Regardless, the parol evidence introduced by Vivendi—the Proxy Statement filed by USA disclosing the consideration it would receive as part of the VUE transaction (the "Proxy Statement")[89] and the teleconference announcing the transaction[90]—both of which are properly before the court at this stage—do not point to a specific prior agreement.

a. <u>Proxy Statement</u>

Vivendi first argues that USA must have known (and therefore agreed) that it is not entitled to tax distributions based on Preferred Interest holdings because if it were entitled to such distribution "the value of [the Preferred Interests] far exceeds the value disclosed by [USA] in its SEC filings and Proxy Statement, which as a mater of law was required to fully and accurately disclose all material information."[91] In furtherance of this argument, Vivendi points to the facts that (1) the Proxy Statement does not mention that the Preferred Interests are entitled to a tax-exempt yield; (2) the value of that yield would exceed $600 million (which would make it material); (3) the Proxy Statement contains pro forma financials showing that taxes are owed on the Preferred Interests without showing any offsetting tax distributions; (4) the Proxy Statement values the A Interests using a

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[89] A court may consider proxy statements at the pleadings stage to consider what information is disclosed in the proxy statement when such statements are incorporated by reference into the pleadings. *See In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d at 69-70.
[90] The text of this teleconference is provided in Vivendi's counterclaims, and a transcript of the teleconference is provided to the court in the Affidavit of Jon E. Abramczyk ("Abramczyk Aff."), Ex. I.
[91] Defs.' Br. at 11.

pre-tax discount rate instead of an after-tax discount rate (which, Vivendi argues, USA would have used if it believed it was entitled to the distributions); (5) the Proxy Statement states that Bear Stearns valued the A Interests using a 9% to 9.85% discount rate instead of a lower range of discount rates (which, again, Vivendi argues should have been used if USA were entitled to the tax distributions); (6) the Proxy Statement states that Allen & Co. valued the Preferred Interests using pre-tax discount rates of 7% to 8% instead of valuing those interests on an after-tax basis; and (7) the Proxy Statement includes statements in the pro forma financials that underestimate the value of the A Interests because that value was derived using a pre-tax discount rate.

The Proxy Statement, however, plainly states that "VUE will make mandatory tax distributions to cover taxes allocable to USA and its subsidiaries, Universal or Diller with respect to VUE's taxable income."[92]

USA initially valued the A Interests on an after-tax basis ($750 million).[93] In a responsive letter to the SEC during the review-and-comment process, USA

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[92] Proxy Statement at 63 (submitted to the court in Transmittal Declaration of Candice M. Toll, Esq.). Vivendi argues that this "language refers to nothing other than the tax distributions to the Common Interests holders." Defs.' Br. at 11-12 n.8. Specifically, it states that because the provision refers not only to USA, but also Universal and Diller (who do not hold Preferred Interests), it only contemplates tax distributions to Common Interest holders. That argument is unsupported by any language in the Proxy Statement.

[93] This valuation was represented in a letter from USA to the SEC. Correspondence between the SEC and USA was pleaded in the Complaint. Vivendi, while neither admitting nor denying the contents of the letters, referred the court to them for their contents. The letters are thus

revised its valuation to reflect the value of those interests on a pre-tax basis ($540 million). In a letter to the SEC, USA wrote:

> The Company's initial [$750 million] valuation took into consideration certain tax distributions of the partnership. In the revised valuation, the Company used the valuation methodology and resulting range of values estimated by Allen & Co., because it was advised that valuation of such instruments are more typically performed on a pre-tax basis rather than the Company's valuation methodology for valuing this security.[94]

Thus this correspondence, *which was shared with Vivendi and Cravath*,[95] explains that the Proxy Statement reflects Allen & Co.'s analysis, which utilizes a pre-tax methodology, simply because that is how it is "more typically performed." Given the totality of USA's correspondence with the SEC, it is clear that the decision to use a pre-tax, as opposed to an after-tax, analysis does not reflect a prior agreement that tax distributions would not be made to account for allocations of income to holders of the Preferred Interests; it merely reflects a decision that the information in the Proxy Statement should reflect industry standard.[96] Moreover, the Proxy Statement itself reinforces that the parties contemplated tax distributions based on allocations of income to holders of the A Interests:

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incorporated by reference into the pleadings and are properly considered at this stage. USA's initial valuation is submitted in Abramczyk Aff. Ex. G, p. 11.

[94] Abramczyk Aff. Ex. H.

[95] Answer p. 8, ¶ 31.

[96] Accordingly, Vivendi's argument in regard to the Bear Stearns valuation of the A Interests does not show a prior agreement.

> Allen & Co. valued the [Preferred Interests] in VUE using a range of pre-tax discount rates of 7% to 8% . . . (on an after-tax basis the preferred interests received by USA would be valued significantly in excess of the values Allen & Co. used in this analysis).[97]

Notwithstanding Vivendi's argument that this language "simply helps the reader understand the implications of the numbers on the page,"[98] the clear meaning of this passage is that USA contemplated receiving tax distributions based on its holdings of the Preferred Interests.

Finally, the pro forma financial statements in the Proxy Statement show taxes due, but do not reflect countervailing tax distributions as income. This is consistent with the workings of the partnership, in which income is allocated only in accordance with Section 7.02. Tellingly, the pro formas not only do not show tax distributions as income in respect of the Preferred Interests, but also do not show tax distributions as income in respect of the Common Interests—interests which USA claims are entitled to receive the tax distributions.

b. Conference Call

Vivendi has pleaded that:

> [A]t a December 17, 2001, analysts' conference, USA Interactive's Vice-Chairman Victor Kaufman stated that "USA will receive enough cash dividends relating to the preferred stocks that we're receiving to more than cover all of the deferred taxes on the transaction, which become due 15 or 20 years out with respect to the cash and securities." He further confirmed that "the cash dividends that we're

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[97] Proxy Statement at 41.
[98] Defs.' Br., at 11-12 n.8.

> receiving start at over $60 million a year and actually get up to over $100 million a year towards the end, so that the aggregate sum well exceeds the tax that we're going to pay on all of the instruments."[99]

Vivendi argues that this statement, without an accompanying reference to the annual tax distributions on the Preferred Interests, is evidence of a prior agreement that those tax distributions would not be made. This statement, however, explicitly refers to *deferred* taxes—not to taxation on the year-to-year partnership income allocated under Section 7.02.

In sum, neither the conference call nor the contents of the Proxy Statement support an allegation of a prior specific agreement between USA and Vivendi to form the basis of a mistake claim. Because the pleadings of Vivendi are entirely devoid of such an allegation, Vivendi's mistake claims—mutual and unilateral—fail as a matter of law.[100]

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[99] Answer, pp. 14-15, ¶ 3.

[100] In addition to stating a prior specific agreement between the parties, to state a claim for mutual mistake a party must allege execution of a writing that was intended, but failed, to incorporate the terms of that prior agreement; and that the parties had a mutual but mistaken belief that the writing reflected their true agreement. *Cerberus Int'l Ltd.*, 794 A.2d at 1152. The elements of unilateral mistake are the same as mutual mistake save that unilateral mistake requires a mistaken belief by only *one* party, coupled with the other party's knowing silence. *Id.* at 1151. Because Vivendi has failed to prove the bedrock element for either form of mistake—a prior specific agreement—the court does not reach the other elements of mistake.

V.

The pleadings show a contract that is unambiguous on its face and the product of long negotiation between sophisticated parties supported by some of the world's most well-regarded investment banks and law firms. USA is not seeking a "double dip" as Vivendi alleges, but merely what it contracted for. For the foregoing reasons, the plaintiffs' motion for judgment on the pleadings is granted. The parties shall confer and submit a conforming order within ten days of the issuance of this memorandum opinion.