EFiled: Dec 23 2005 12:06PM EST
Transaction ID 7714207

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

ROBERT Y. BONHAM, an individual, GARY D. MABRY, an individual, CHARLES E. NAIL, JR., an individual, and MABRY FAMILY LIMITED PARTNERSHIP, a Florida limited liability partnership,	)	
Plaintiffs,	)	
v.	)	Civil Action No. 820-N
HBW HOLDINGS, INC., a Delaware corporation, and ARIAS ACQUISITIONS, INC., a Florida corporation,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: August 25, 2005
Decided: December 23, 2005

Daniel V. Folt, Esquire, Gary W. Lipkin, Esquire, Matt Neiderman, Esquire, DUANE MORRIS LLP, Wilmington, Delaware; Charles C. Papy, III, Esquire, James A. Weinkle, DUANE MORRIS LLP, Miami, Florida, *Attorneys for Plaintiffs*

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PARSONS, Vice Chancellor.

This action arises out of the sale of Arias Acquisitions, Inc. ("Arias") to HBW Holdings, Inc. ("HBW"). Plaintiffs, Robert Y. Bonham, Gary D. Mabry, Charles E. Nail, Jr., and the Mabry Family Limited Partnership, LLP, are the former owners of all outstanding capital stock of Defendant Arias, which is now a wholly owned subsidiary of Defendant HBW.

In their First Amended Complaint ("Complaint"), Plaintiffs allege that HBW improperly caused $25 million of the purchase price to continue to be held in escrow and improperly attributed $27 million of the purchase price as consideration for the noncompete agreements provided in connection with the Stock Purchase Agreement ("SPA" or "Agreement"). Defendants moved to dismiss the Complaint, and on July 12, 2005 moved to stay discovery pending resolution of the motion to dismiss. The motions to stay and to dismiss were argued on August 4 and 25, respectively. The Court issued an opinion on September 20 granting in part and denying in part the motion to stay. For the reasons stated in this opinion and order, the Court now denies substantially all of Defendants' motion to dismiss.

I. FACTS

Plaintiffs are the former stockholders of Arias, a Florida corporation that holds various companies engaged in the home warranty business. Pursuant to a transaction that closed on or about November 8, 2002, Plaintiffs agreed to sell Arias to HBW in exchange for approximately $202 million, consisting of $182 million in cash, $20 million in promissory notes, and a minority ownership interest in HBW. As a condition of closing, the SPA through which the transaction was effected required that $25 million of the $202 million purchase price be held in escrow for two years following the closing for

indemnification of HBW for any loss HBW incurs for breaches of Plaintiffs' representations, warranties, or obligations under the SPA. An Escrow Agreement ("EA") reached between the parties to this suit governs that fund.

A. The Stock Purchase Agreement

The SPA contains a number of provisions important to this dispute. Underlying this case, of course, are the representations and warranties provided to HBW by the former Arias shareholders. These include promises that Arias "prepared [their financial statements] in all material respects in compliance with accounting practices generally accepted in the United States …."[1] Arias also warranted that the financial statements it provided to HBW before closing were "prepared in accordance with GAAP applied in a manner consistent with Arias's past practices."[2] Plaintiffs further agreed to indemnify and hold HBW harmless for certain tax liabilities broadly defined in the SPA.[3]

The SPA also provides ways to resolve disputes that arise out of these indemnification provisions. Key to this case is SPA § 7.6, which requires that HBW provide Arias with written notice of any claims for indemnification. By contract, this notice is required to describe:

> in reasonable detail the facts giving rise to any claim for indemnification hereunder and shall include in such Claim Notice (if then known) the amount or method of computation of the amount of such claim, and a reference to the provision of this Agreement or any other agreement, document, or

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1 SPA § 3.5(b)(ii).

2 SPA § 5.8(c).

3 SPA § 6.2(b).

> instrument executed hereunder or in connection herewith upon which such claim is based.[4]

The SPA also contains two significant provisions addressing the resolution of tax disputes, as opposed to other types of claims. SPA § 6.2(c) requires HBW to give Plaintiffs notice within 15 business days of any written assessment by a governmental authority of taxes for which Plaintiffs are liable. The purpose of this requirement is to ensure that Plaintiffs can preserve their rights to dispute, negotiate or settle tax claims with that governmental authority. Additionally, the Agreement requires that the validity of any disputed tax claims made against the escrow be determined through mandatory arbitration. Finally, as a general matter, the SPA provides that all obligations contained therein are to be carried out in good faith, promptly, and in accordance with the terms of the Agreement.

B. The Escrow Agreement

In accordance with the SPA, which requires $25 million to be held in escrow until November 8, 2004, HBW and the Arias shareholders entered into an Escrow Agreement dated November 8, 2002. Like the SPA, this agreement also contains certain provisions of importance to the current dispute.

To the extent HBW seeks to rely on an indemnity claim to keep funds in escrow, the EA required HBW to provide notice to the Arias shareholders of any indemnity claims on or before November 8, 2004.[5] After that date, HBW is required to release any funds in excess of the amounts noticed from escrow. EA § 3(b) sets out the form of an

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4 SPA § 7.6(a).

5 *Id.*

effective claim notice. Briefly, that provision requires that HBW write to the "sellers and Escrow Agent certifying that they are making a claim in good faith and specifying in reasonable detail the nature and dollar amount of any claim it may have under Article 7 and Section 6.2 of the Purchase Agreement."[6] Escrow funds held based on a claim for which HBW failed to give proper notice would be held without justification.

If HBW issues a claim notice against the escrowed funds, Arias has the right to dispute that claim within 30 days of receipt by issuing a Counter-Notice to both HBW and the Escrow Agent. The EA provides that any dispute about amounts being held in escrow that cannot be resolved by the parties alone is to be pursued through the dispute resolution procedures set out in the SPA.[7]

C. HBW's Indemnity Claims

Pursuant to the procedures set forth in both the SPA and the EA, HBW has asserted three types of indemnity claims against the $25 million currently in escrow. First, HBW has asserted claims for $2 million in state and local taxes (the "SALT claims"). These claims were made initially in a letter to Plaintiffs dated March 25, 2004,[8] in which HBW stated that:

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6 EA § 3(b).

7 Compl. ¶ 38.

8 Plaintiffs argue that it is inappropriate for HBW to selectively submit unauthenticated documents, in the form of the claim notices, that are concededly outside the pleadings to establish the reasonableness of its claim descriptions, and then to seek final resolution of the reasonableness issue based on the untested contents of the document. Pls.' Ans. Br. at 21. On this motion to dismiss, however, the Court expresses no opinion as to the reasonableness of the notices other than to decide that Plaintiffs' claims survive the motion to dismiss. The Court considers it appropriate to rely on the claim notices in that limited sense.

> [T]he Department of Revenue of the State of Arkansas has contacted HBW with respect to sales taxes owed by Home Buyers Resale Warranty Corporation. Based on certain information from PricewaterhouseCoopers, HBW currently estimates that HBW, the Company and/or its subsidiaries may have $2 million in unpaid state and local tax liability ("SALT Liability") in various jurisdictions, including Arkansas, for the Pre-Closing Period.[9]

Second, Defendants gave notice of $4 million in claims for "unclaimed property" liability in a March 25, 2004 letter. As to these claims, HBW noted that:

> [T]he State Treasurer for the State of Colorado has contacted HBW with respect to unclaimed property and reports thereon. Based on information from PricewaterhouseCoopers, HBW currently estimates that HBW, the Company and/or its subsidiaries may have $4 million in liability related to amounts owed in connection with the failure to file unclaimed property reports and/or deliver unclaimed property to the proper governmental authorities ("Unclaimed Property Amounts") in various jurisdictions, including Colorado, for the Pre-Closing Period.[10]

HBW supplemented this information in a letter of October 12, 2004. In that communication, HBW wrote that Arias owed $1,102,572 in unclaimed property amounts to Colorado.[11] It further stated that "additional Unclaimed Property Amounts may exist, both in Colorado and in other states in which the Company does business, for which indemnification may be applicable."[12]

Third, HBW provided notice of a claim in excess of $25 million for an alleged financial misstatement relating to Arias's financial information for the years 1999-2001.

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9 Clark Decl. Ex. D.

10 *Id.*

11 Clark Decl. Ex. E.

12 *Id*.

This claim, also introduced in the October 12, 2004 letter, was summarized by HBW as follows:

> It is now clear that the Company's audited financial statements for the fiscal years ended December 31, 2001, 2000 and 1999 were not prepared in all material respects in compliance with accounting practices generally accepted in the United States, contrary to the representation made to HBW in Section 3.5(b) of the Agreement.
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> Based on our current information, if such financial statements had been prepared in compliance with accounting practices generally accepted in the United States, the Company would have shown significantly reduced net income, and potentially even net losses, for each of the fiscal years ended December 31, 2001, 2000 and 1999. We believe, as a result of extensive, ongoing investigations and consultation with our accountants, that the financial statements were erroneously prepared due to the application of an inappropriate revenue recognition methodology.[13]

HBW gave final notice of its claims on November 4, 2004,[14] just four days before any unclaimed funds were to be released from escrow. Regarding the SALT claims and unclaimed property claims, the notice stated:

> As you know, the Companies are subject to claims by various jurisdictions that have asserted or will assert that the Companies are liable for unpaid sales taxes on certain services. The Companies are also subject to claims by various jurisdictions that the Companies are liable for use taxes on property purchased by the Companies. Finally, the Companies are subject to claims from various jurisdictions for failure to properly escheat unclaimed property. For example, Buyer on behalf of certain of its subsidiaries

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13 *Id*.

14 Clark Decl. Ex. G.

> recently reached an agreement to pay the State of Colorado over $1 million.[15]

The November 4 letter also provided further details about the claim for misstated finances. It stated that Arias's financial statements:

> [W]ere not prepared in accordance with GAAP primarily as a result of the failure to properly recognize revenue as required by the Securities and Exchange Commission's Staff Accounting Bulletin No. 101, *Revenue Recognition in Financial Statements* ("SAB 101"). This failure to properly report revenue caused numerous line items of the Financial Statements to be misstated, and caused the Financial Statements to fail to present fairly in all material respects the financial position, results of operations, retained earnings and cash flows, as applicable, of Arias and the Operating Companies.
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> * * * *
>
> While our investigation is ongoing, we believe for example that proper application of SAB 101 would result in deferral of approximately $14.7 million of revenue, net of deferred acquisition costs and deferred tax expense, for the year ended December 31, 2001. Accordingly, net income should have been reported as a loss of at least approximately $2.4 million for the year ended December 31, 2001. Other periods represented in the Agreement are similarly misstated.[16]

None of these claims, other than the unclaimed property claim as to Colorado, is expressly quantified in the sense of providing a final number for potential damages to HBW. Nor does it appear that any of the tax claim notices were issued in conjunction with a written assessment of potential liability authored by a governmental authority.

D. The Parties' Contentions

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15 *Id*.

16 *Id*.

Plaintiffs' Complaint purports to assert seven separate, but somewhat overlapping, causes of action. Count I is an overarching declaratory judgment claim covering all of the issues with respect to the SALT claims, the unclaimed property claims and the financial misstatement claim. Counts II through IV each allege breach of contract. Count II asserts a breach based on deficient notice, bad faith, and HBW's failure to mitigate damages with respect to the unclaimed property claims. Further, Count II asks this Court to determine whether the unclaimed property claims fall within the definition of "taxes" within the terms of the SPA. Count III is a breach of contract claim alleging insufficient notice of the financial misstatement claim and that HBW made the claim in bad faith. Count IV accuses HBW of breach of contract based on deficient notice, bad faith, and its failure to mitigate damages with respect to the SALT claims. Additionally, Count IV asks this Court to determine whether the SALT claims are "taxes" within the terms of the SPA. Count V alleges that HBW breached an implied duty of good faith and fair dealing. Count VI seeks a declaratory judgment that the $27 million HBW attributed to the noncompetition agreements it received from the individual Plaintiffs should be treated as consideration for the SPA. Count VII asks this Court to reform the contract between the parties to reflect that the entire purchase price was consideration for the Arias stock.

Plaintiffs seek two primary forms of relief based on those allegations: 1) to have the $25 million released from escrow, and 2) a declaratory judgment that the $27 million HBW attributed to the noncompetition agreements should be treated instead as consideration for HBW stock.

Defendants have moved to dismiss all the counts of the Complaint based on three arguments. First, Defendants argue that Plaintiffs' Complaint should be dismissed because HBW's claim notices fully comply with all the relevant requirements of both the SPA and the EA. Second, in Defendants' view, Plaintiffs have failed to allege that any of HBW's claim notices were made in bad faith. Finally, Defendants maintain that both the SALT claims and the unclaimed property claims should be dismissed in favor of arbitration pursuant to SPA § 6.2(d).

Plaintiffs respond to the current motion by arguing that HBW's claim notices are governed by Section 3(b) of the EA rather than Section 7.6 of the SPA, and that under Section 3(b), the notices are inadequate as a matter of law. Plaintiffs additionally maintain that they have sufficiently pled bad faith to survive a motion to dismiss, having alleged the particulars of an "unlawful scheme to deprive the Former Arias Stockholders of $25 million of escrowed funds now due them" under the SPA.[17] Finally, Plaintiffs dispute Defendants' suggestion that the unclaimed property claims are subject to arbitration, urging that those claims do not fall within the definition of "taxes" contained in the SPA.

II. PROCEDURAL HISTORY

The procedural background of this dispute is somewhat complex, and is briefly summarized here. Plaintiffs filed the Complaint in this action on November 10, 2004. On July 12, 2005, Defendants moved to stay discovery, pending resolution of their co-pending motion to dismiss. On September 20, 2005, the Court granted in part and denied

[17] Compl. ¶ 1.

in part Defendants' motion to stay. Specifically, the Court essentially stayed all discovery as to the merits of the underlying disputes at issue in this case relating to the indemnification and escrow related claims, but allowed discovery otherwise, including discovery as to the various procedural issues, such as the adequacy of notice under either Section 3(b) of the EA or Section 7.6 of the SPA.[18] On August 3, 2005, Defendants formally initiated arbitration proceedings with respect to the SALT claims and the unclaimed property claims. On August 23, 2005, Defendants moved to compel arbitration. That motion has been briefed, but not yet argued.

Concurrently, on August 24, 2005, HBW filed suit against the current Plaintiffs in the United States District Court in the District of Delaware, seeking indemnification for losses in excess of $25 million based on the financial misstatement claim. That suit, however, was voluntarily dismissed on September 26, 2005, as a result of this Court's decision on Defendants' motion to stay discovery.

III. ANALYSIS

A. Standards

When considering a motion to dismiss under Court of Chancery Rule 12(b)(6), the court must assume the truthfulness of all well pled facts in the complaint and view those facts and all reasonable inferences drawn from them in the light most favorable to the nonmoving party.[19] Conclusory allegations that are unsupported by facts contained in the

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[18] *Bonham v. HBW Holdings, Inc.*, 2005 Del. Ch. LEXIS 143 (Del. Ch. Sept. 20, 2005).

[19] *Anglo American Sec. Fund, L.P. v. S.R. Global Int'l Fund, L.P.*, 829 A.2d 143, 148-49 (Del. Ch. 2003).

complaint, or any documents integral to the complaint and incorporated by reference therein, will not be accepted as true.[20] Dismissal is appropriate under Rule 12(b)(6) only when it appears with reasonable certainty that the plaintiff would not be entitled to relief under any reasonable set of facts properly supported by the complaint and any integral documents incorporated by reference therein.[21]

B. Contract Interpretation

The interpretation of a contract is a matter of law.[22] Contract language that is clear and unambiguous should be given its ordinary and usual meaning.[23] If an ambiguity exists, the court must construe the contract language against the drafter.[24] A contract is ambiguous, however, only when the provisions in controversy are reasonably or fairly susceptible to different interpretations or may have two or more different meanings. The standard of interpretation is that of a reasonable person in the position of the parties.[25]

1. Adequacy of Notice

Defendants' position in this case is that the claim notices that they provided to Plaintiffs on March 25, October 12, and November 4, 2004 are adequate as a matter of law to establish legitimate claims in excess of $25 million against the escrow. This

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20 *Id.*

21 *Id.*

22 *See Hudson v. State Farm Mut. Ins. Co.*, 569 A.2d 1168, 1170 (Del. 1990).

23 *See Rhone-Poulenc Basic Chem. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195 (Del. 1992).

24 *Id.* at 1196.

25 *Id.*

position is based, fundamentally, on Defendants' contention that the form of notice due to Plaintiffs is governed by Section 7.6 of the SPA, which requires that the notice provide a reasonable description of the claim, and that possible damages be set out only "if then known." Under these requirements, say Defendants, HBW's letters setting out its claims fully satisfy the SPA, and thus Plaintiffs' breach of contract claims based on inadequacy of notice must be dismissed. Further, Defendants assert that Section 3(b) of the EA, which does not contain the "if then known" qualification, requires essentially the same claim notice as Section 7.6 of the SPA. Therefore, Defendants argue, HBW's notices meet its contractual obligations even if the court exclusively applies the requirements of the Escrow Agreement.

Plaintiffs' position is more complex. As to nontax claims, Plaintiffs argue that Section 3(b) of the EA rather than Section 7.6 of the SPA governs the form of notice due to Plaintiffs. This is significant because Section 3(b) requires both a reasonable description of the claim as well as a reasonably detailed analysis of possible damages. This, Plaintiffs argue, differs significantly from the language of the SPA, which requires designation of the "amount or method of computation" only "if then known." Plaintiffs claim that the notice of HBW's nontax, financial misstatement claim fails to satisfy the requirements of EA § 3(b) in terms of damages.[26]

Plaintiffs assert that Section 3(b) applies equally to HBW's tax claims. In addition, however, Plaintiffs maintain that Sections 6.2(b) and (c) of the SPA require that tax claims against the escrow must be accompanied by a "written assessment for taxes for

[26] Plaintiffs concede that HBW's notice of the financial misstatement claim adequately describes the nature of the claim. Pls.' Ans. Br. at 19.

a taxable period within the scope of the Former Arias Stockholders' period of responsibility." Plaintiffs' Complaint challenges the adequacy of HBW's notices of its SALT claims and unclaimed property claims because they included no written assessment, and failed to provide a sufficient description of the claims and of damages.

Both parties acknowledge that a certain tension exists between the differing notice provisions of the SPA and the EA. Defendants urge the Court to conclude that the "if then known" language in SPA § 7.6, qualifying the requirement for a claim notice to address damages, should be read into Section 3(b) of the EA as well. Plaintiffs disagree, arguing that the absence of that language in Section 3(b) reflects the parties' intention to require damages information for an effective claim notice against the escrow account. For purposes of Defendants' motion to dismiss, the Court need not resolve this dispute conclusively. On a motion to dismiss, all Plaintiffs must show is that EA § 3(b) is reasonably or fairly susceptible to the interpretation they advance from the viewpoint of a reasonable person in their position. If that is true, the Court ultimately will either adopt Plaintiffs' position or conclude that the meaning of EA § 3(b) is ambiguous. Either way however, the Court would not be able to reject Plaintiffs' construction of Section 3(b), and adopt Defendants' position, at the pleading stage.

In my opinion, Plaintiffs' construction of Section 3(b) is at least sufficiently plausible to warrant applying it in the context of Defendants' motion. The perceived tension between Section 7.6 and Section 3(b) is easily resolved by applying the notice requirement found in Section 7.6 to indemnification claims, and the notice requirement in

Section 3(b) to claims against the escrow.[27] Under the plain language of the SPA, if HBW makes a claim for indemnification, it is required to satisfy only the somewhat lesser requirements of Section 7.6. To use that claim against the escrow, however, HBW is required to set forth a clearer explanation of the claim and the possible damages it entails. This difference is not only consistent with the contract language, but it is also commercially reasonable. Holding funds in escrow that are meant to be paid to the Seller is a significant step that the contracting parties reasonably surrounded with heightened procedure. In contrast, fewer such protections would logically appear to be necessary if HBW chooses not to rely upon a claim as a basis to preclude disbursement of escrow funds.[28] In that case, for example, the time period in which HBW could bring its claims would be, in some circumstances, longer than the two year escrow period.[29]

A similar interpretation resolves the parties' dispute as to the requirement of a written assessment for tax claims. Reading the plain language of the SPA, it is clear that Sections 6.2(b) and (c) of the Agreement are not meant to describe the content of a claim notice against the escrow. Rather, 6.2(c) of the SPA is designed to ensure that once a

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[27] The Court does not mean to suggest, however, that Defendants' reliance on SPA § 7.6 is anything other than in good faith.

[28] The same would be true if at the time HBW provided notice of its indemnification claim, the information available to it was not sufficiently definitive to support tying up the escrow funds. Based on the Complaint, it appears that such an indemnification claim might still survive, but it would lack the security provided by the escrow.

[29] Section 7.5(b) of the SPA states that the indemnification provided for in Article 7 of the SPA shall terminate two years after the closing date, except that each party's indemnification obligations will continue past that date for certain enumerated claims. Among these, the Agreement provides that claims as to covenants made by the other party will continue indefinitely. SPA § 7.5(b)(i).

governmental authority sets formal tax proceedings underway against Sellers by issuing a written assessment, Sellers are given the opportunity to defend, settle, or otherwise resolve the claim made by the governmental authority. Section 6.2(c) also imposes certain time limitations, so that the parties can determine who intends to defend or challenge the assessed tax claim. When the issue simply involves whether funds will continue to be held in escrow, however, Section 3(b) of the Escrow Agreement governs the parties' behavior, and no written assessment is required.

Applying only EA Section 3(b) to the issue of the adequacy of notice, therefore, the Court concludes that Plaintiffs have pled sufficient facts to survive a motion to dismiss, at least in part, on all their claims. As to the SALT claims, the Court cannot say that HBW's notice that Arias "may have $2 million in unpaid state and local tax liability" from several states, some of which presumably are not identified, is sufficient as a matter of law.[30] Nor can the Court conclude that HBW was sufficiently forthcoming in estimating damages under the financial misstatement claim for some unknown sum in excess of $25 million. As to the unclaimed property claims, the Court holds that Plaintiffs cannot further challenge the adequacy of HBW's notice of damages as they relate to the approximately $1 million Colorado claim set out in HBW's letter of October 12, 2004. The Court does not grant Defendants' motion to dismiss as to the unclaimed property claims, however, because Plaintiffs may still show that any claim for damages in excess of that figure was improperly noticed, and that the description of the claims

[30] Clark Decl. Ex. D. Moreover, the notice provides little detail about the exact type of state and local tax claims HBW has against Plaintiffs, stating only that "the Department of Revenue of the State of Arkansas has contacted HBW with respect to sales taxes owed by Home Buyers Resale Warranty Corporation."

themselves were deficient. In sum, the Court cannot find at this early stage of the litigation that HBW satisfied the requirements of the Escrow Agreement in providing notice to the former shareholders of Arias of its intention to hold escrow funds past November 8, 2004. The Court, therefore, will await further factual development on the various notice issues.

2. The Tax and Nontax claims

Even if identical notice requirements apply to tax and nontax claims, the issue of whether certain claims are "tax claims" under the SPA remains important to this case. One reason is because the SPA provides that all tax claims are subject to mandatory arbitration.[31]

Preliminarily, the parties do not dispute that the SALT claims are tax claims under the SPA. The Court agrees, and notes that they appear subject to mandatory arbitration. The Court further notes that it has already ruled, in its September 20, 2005 letter, that the question of whether the parties reached an agreement as to the allocation of the Arias purchase price is not a tax dispute.[32] Similarly, the financial misstatement claim is not a tax claim, and neither party contends otherwise.

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[31] An additional reason that the tax or nontax status of a claim might be of importance is the liability "basket" established by Section 7.5(c)(ii) of the SPA. That section provides that an indemnified party is only indemnified to the extent that the aggregate amount of all claims made against the Seller or Buyer exceeds $2,500,000. The basket does not apply, however, to losses with respect to the breach of any "Covenant" contained in the Agreement. Plaintiffs allege that HBW is attempting to avoid the basket by recharacterizing unclaimed property claims as "Taxes" within the meaning of the SPA. Compl. ¶ 66.

[32] *Bonham*, 2005 Del. Ch. LEXIS 143, at *11.

This leaves, therefore, only the unclaimed property claims. As a threshold matter, Defendants first argue that this Court lacks jurisdiction to decide whether the unclaimed property claims are tax claims subject to mandatory arbitration. Defendants explain their suggestion that the Court must leave the interpretation of the contract provisions compelling arbitration to the arbitrator itself with the claim that Delaware law requires precisely such a liberal construction of the arbitration clause. Even if the Court takes up the question of whether the unclaimed property issue is subject to arbitration, however, Defendants' position is that this claim is plainly a tax issue under the broadly written definition of "taxes" in the SPA, and is therefore subject to arbitration. Plaintiffs oppose both positions.

As to the jurisdictional issue raised by Defendants, it is a matter of black letter law that this Court has jurisdiction to determine whether any of these claims implicate "taxes" subject to arbitration. Arbitration is a matter of contract, and a party cannot be required to submit to arbitration any dispute which they have agreed not to submit.[33] Although there is a "liberal federal policy favoring arbitration agreements," equally followed in

[33] *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002). The Defendants rely on *Univ. of Del. v. Wyman Elec. Serv. Co.*, 1994 Del. Ch. LEXIS 153, at *7 (Del. Ch. Aug. 11, 1994), for the proposition that "the scope of an arbitration agreement ordinarily is determined by the arbitrator and not by a Court." Therefore, Defendants argue, the Court should compel arbitration where the arbitrability of an issue is in question. As that case also acknowledges, however, "the question of arbitrability of a dispute is normally an issue for judicial determination." *Id.* In certain rare cases of factual ambiguity, where the party resisting arbitration has raised defenses that go to the merits of the issue to be arbitrated, it is true that some courts have referred the matter of arbitrability to the arbitrator. The present case, however, does not present the kind of facts that justify deviating from the general rule long established by Delaware precedent that the arbitrability of an issue is a question for judicial determination.

Delaware, "there is an exception to this policy: the question whether the parties have submitted a particular dispute to arbitration, i.e., the question of arbitrability, is an issue for judicial determination unless the parties clearly and unmistakably provide otherwise."[34] Finding no indication that the parties in this case intended to submit the question of arbitrability itself to the arbitrator, the Court considers the issue of whether the unclaimed property claims are subject to arbitration one that must be addressed in this litigation.

Delaware law sets out a clear standard as to that issue. Where the arbitrability of a claim is in dispute, the Court must first assess the scope of the arbitration clause, and then determine whether the claim falls within the scope of arbitrable contractual provisions.[35] "Any doubt as to arbitrability is to be resolved in favor of arbitrability."[36] Where it determines that the parties intended to commit their disagreements to arbitration, this Court will not accept jurisdiction over claims reflecting those disagreements.

The question of whether unclaimed property claims involve "taxes" under the SPA is one which implicates both the usual meaning of the word "tax" as well as its specific definition in the Agreement. As a matter of normal usage, unclaimed property claims do not appear to be manifestations of the state's power to tax. Rather, state unclaimed property statutes find their origins in escheat, a traditional power that allows states to

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34 *Id.*

35 *Town of Smyrna v. Kent County Levy Court*, 2004 WL 2671745, at *2 (Del. Ch. Nov. 9, 2004).

36 *IMO Indus., Inc. v. Sierra Int'l Inc.*, 2001 WL 1192201, at *3 (Del. Ch. Oct. 1, 2001).

reclaim lands or property otherwise abandoned. Under the traditional definition of tax, therefore, the Court probably would find an unclaimed property claim to be a nontax claim, and therefore not subject to mandatory arbitration.

The definition of tax in Section 9.6(n) of the SPA, however, is expansive. That section, which controls the meaning of tax for purposes of the mandatory arbitration required by 6.2(d), describes tax in the following way:

> (i) all taxes, assessments, charges, duties, fees, levies or other charges, including all federal, state, local or other income, unitary, business, franchise, capital stock, real property, personal property, intangible, withholding, FICA, unemployment compensation, disability, transfer, sales, use, excise, and other taxes, assessments, charges, duties, fees or levies of any kind whatsoever imposed by a Governmental Authority (whether or not requiring the filing of Tax Returns), and all deficiency assessments, additions to tax, penalties and interest thereon and (ii) any liability for any amounts described in clause (i) of any other person as a successor, by contract, as a result of filing combined consolidated, affiliated or unitary Tax Returns or otherwise.[37]

This definition appears to be very broad; indeed, it may include not only the unclaimed property claims at issue in this case, but any number of other colloquially nontax fees imposed by governmental authorities. At this stage of the litigation, however, the Court cannot determine the reach of "tax" as used in the SPA. The definition above, for example, may include terms of art that would dramatically change the term's apparent meaning. In addition, "tax" as used in the SPA is at least arguably ambiguous in terms of whether it covers unclaimed property claims. Thus, extrinsic evidence may be relevant on such questions as whether unclaimed property claims

[37] SPA § 9.

generally are treated as tax claims by accountants, lawyers, and other tax professionals with experience in this field. In view of this uncertainty, the Court does not consider it appropriate or possible to decide on a motion to dismiss whether the unclaimed property claims are tax claims. This issue can be addressed in later proceedings, on a more developed record and with the benefit of discovery.

3. Bad Faith

Plaintiffs' Complaint contains two, somewhat different, invocations of the duty of good faith. First, the Complaint alleges that Defendants violated their contractual duties of good faith, expressly made part of the SPA under Section 9.1 of the Agreement. In addition, however, the Complaint also alleges a violation of the implied covenant of good faith and fair dealing, which purportedly inures to every Delaware contract.

In both cases, Defendants deny that Plaintiffs have alleged sufficient facts to support any finding of bad faith on the part of HBW. As to the implied covenant claim, however, Defendants also argue that this Court should dismiss any claims based on an implied covenant of good faith and fair dealing because the parties expressly accounted for the concept of "good faith" in connection with their obligations under the SPA in Section 9.1. Defendants argue that because good faith forms part of the contractual agreement, it cannot be the basis of a claim for breach of an implied covenant.

The Court disagrees with Defendants on that point. As an initial matter, the Delaware cases cited by Defendants establish only that existing contractual terms control, and that the implied duty of good faith cannot be used to create a "free-floating duty. . .

unattached to the underlying legal document."[38] Thus, one generally cannot base a claim for breach of the implied covenant of good faith on conduct specifically authorized by the terms of an agreement.[39] The SPA does not specifically set out remedies, or authorize the actions that form the basis of the Complaint's allegations that Defendants breached their duties of good faith. Therefore, the Court concludes as a matter of law that Plaintiffs can pursue their claims for breaches of both contractual and implied duties of good faith and fair dealing. At this early stage of the proceedings, however, it is unclear what substantive force, if any, maintaining both of these arguably duplicative claims adds to Plaintiffs' Complaint. Contrary to the suggestion in Plaintiffs' brief, the Court is not yet convinced that there is some additional duty that attaches to an implied covenant of good faith, as discussed in the *Dunlap* case,[40] for example, that is lacking in the analagous contractual right under the SPA.[41] Nonetheless, Plaintiffs may, after discovery, be able to show some independent breach of good faith that falls outside the strict lines of the express contractual duty. For that reason, the Court declines to dismiss Count V of the Complaint.

As a matter of law, a finding of bad faith requires "conduct so fraudulent, frivolous, vexatious, wanton or oppressive as to amount to egregiousness."[42] Further,

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38 *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 441 (Del. 2005).

39 *Id.*

40 *Id.*

41 Pls.' Ans. Br. 26.

42 *Reagan v. Randell*, 2002 Del. Ch. LEXIS 84, at *9 (Del. Ch. June 21, 2002).

under Court of Chancery Rule 9(b) "malice, intent, knowledge and other condition of mind" can be "averred generally."

Plaintiffs make several allegations which, if true, could conceivably lead this Court to find a breach of either the implied or contractual duties of good faith and fair dealing. For example, the Complaint alleges that HBW failed to notify Plaintiffs of the misstated finances claim when PricewaterhouseCoopers first reviewed those figures for HBW in 2002, and discovered at that time the irregularities now at issue. If Plaintiffs are able to show at trial that Defendants long possessed highly relevant information and held it secret in order to secure strategic advantages relating to the escrowed funds, that conceivably could support a claim of bad faith. Further, if Plaintiffs succeeded in proving their allegations that Defendants' noticed claims are entirely baseless, and that they were only introduced in order to deprive Plaintiffs of funds due to them under the SPA, then those facts, too, could support a breach of good faith. The Court cannot resolve such issues on a motion to dismiss.

Furthermore, the Court affirms its previous decision to stay discovery in this Court on Plaintiffs' allegations of bad faith based on the lack of merit of both the SALT claims and the unclaimed property claims until the resolution of any arbitration of those claims. A primary purpose of such a stay is to effectuate the parties' intent to submit tax issues to arbitration. If the Court rules later that the unclaimed property claims are not tax issues, of course, this stay will be lifted, and bad faith allegations as to those claims will be open to full discovery. As to claims that are subject to arbitration, it suffices to conclude now that the status of Plaintiffs' bad faith claims after arbitration will depend at the very least on a judgment in favor of Plaintiffs in those proceedings. If Plaintiffs succeed in

arbitration, but fail to obtain in that forum all the relief they seek for Defendants' allegedly bad faith, they may then renew their efforts to obtain redress in this court.

IV. CONCLUSION

In sum, the Court finds that based on the Complaint it is conceivable that Plaintiffs will prevail on their construction of EA Section 3(b) as regarding the inclusion of damages information in all claim notices filed by HBW against Plaintiffs for the purpose of prolonging the duration of the escrow. Second, the Court denies Defendants' motion to dismiss as to the notice aspects of Counts I, II, III, and IV. Third, the Court finds that it has jurisdiction to decide which claims are subject to mandatory arbitration, and rules that the SALT claims are tax claims, that the allocation and misstatement claims are not tax claims, and that further development of the record is required to determine whether the unclaimed property claims are tax claims. Fourth, the Court holds that Plaintiffs may assert both their contractual and implied claims for breaches of the duty of good faith, and denies Defendants' motions to dismiss on all breach of good faith elements for Counts I, II, III, IV, and V. Additionally, the Court maintains the stay of discovery for all bad faith allegations relating to the merits of the SALT and unclaimed property claims, pending possible arbitration. Finally, the Court denies Defendants' motion to dismiss as to Counts VI and VII for the reasons stated in its September 20, 2005 letter opinion. For the reasons stated in this opinion and order, therefore, Defendants' motion to dismiss is DENIED.

IT IS SO ORDERED.