IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

AVNET, INC.,	)	
	)	
Plaintiff/Counterclaim Defendant,	)	
	)	
v.	)	Civil Action No. 5266-VCP
	)	
H.I.G. SOURCE, INC.,	)	
	)	
Defendant/Counterclaim Plaintiff,	)	

MEMORANDUM OPINION

Submitted: July 16, 2010
Decided: September 29, 2010

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PARSONS, Vice Chancellor.

This matter involves a dispute between the parties to a merger agreement as to whether the purchaser's claim for an adjustment of the purchase price is subject to arbitration before an accounting firm in accordance with a provision of the merger agreement. The case is currently before the Court on the purchaser's motion for a judgment on the pleadings, compelling arbitration. That motion raises a threshold question regarding whether the Court or the arbitrator should decide if the underlying dispute is arbitrable. In particular, the purchaser contends the seller's grounds for opposing arbitration as to the purchase price involve questions, such as the timeliness of that claim and waiver, that raise issues of procedural arbitrability, which are to be decided by the arbitrator. The seller disagrees and frames the issue in terms of whether the purchase price dispute clearly falls within the ambit of the disputes the parties agreed to arbitrate. According to the seller, the answer is no and, in any event, the question is one of substantive arbitrability that is presumptively for the Court, and not the arbitrator, to decide.

For the reasons stated in this Memorandum Opinion, I conclude that whether the parties' dispute over the purchase price is arbitrable presents a question of substantive arbitrability that the Court must decide. Therefore, I deny the purchaser's motion for judgment on the pleadings. Accordingly, this Court retains jurisdiction over this matter and will determine, in due course, (1) whether the purchaser's claim is arbitrable and (2) if not, the merits of the underlying dispute.

I. BACKGROUND

A. The Parties

Plaintiff, Avnet, Inc. ("Avnet"), is a New York corporation with its principal executive offices in Phoenix, Arizona. Avnet is a global distributor of electronics parts, enterprise computing and storage products, and embedded subsystems.[1]

Defendant, HIG Source, Inc. ("HIG Source"), is a Cayman Islands company with its principal place of business in Miami, Florida.

Avnet and its subsidiary Avnet Source Co. ("Avnet Source") executed an Agreement and Plan of Merger (the "Agreement"), under which Avnet acquired an affiliate of HIG Source, Source Acquisition Corp. ("Source" or the "Company"). Source was in the business of providing custom programming services for integrated circuits.[2] Pursuant to the Agreement, Avnet acquired Source in June 2008 by a reverse subsidiary transaction under which Avnet Source merged with and into Source and Source became a wholly-owned subsidiary of Avnet.

HIG Source is the designated representative of the former Source stockholders and is a party to the Agreement. The Agreement vests HIG Source with the authority to negotiate and resolve matters arising under the Agreement, including disputes relating to the determination of the Aggregate Merger Consideration.[3]

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1 Compl. ¶ 4.

2 Compl. Ex. A, the Agreement.

3 Terms in initial capitals are defined terms in the Agreement and have the meanings specified therein.

B. Facts

1. Language of the Agreement

The parties' dispute centers on the procedure prescribed in the Agreement for determining the Final Aggregate Merger Consideration after the Closing of the Merger. As illustrated by the cases discussed *infra*, adjustment procedures of this sort are relatively common in merger agreements. Parties typically adopt such procedures because, among other reasons, some of the merger consideration components, *e.g.*, working capital,[4] are constantly changing and, therefore, need to be estimated for purposes of the closing, subject to later adjustment. In addition, because the determination of some of the merger consideration components under generally accepted accounting principles is not a science, the parties' respective accountants may disagree on certain items.[5]

The Agreement between Avnet and HIG Source provided for such a purchase price adjustment mechanism. The purchase price was set at $63,000,000 but was subject to adjustment based on a number of factors.[6] These factors were referred to collectively as the Merger Consideration Components and included the Company's Indebtedness,

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[4] Working capital is calculated by subtracting current liabilities, which include accounts payable and short-term debt, from current assets, which include accounts receivable and inventory. SHANNON PRATT, THE LAWYER'S BUSINESS VALUATION HANDBOOK: UNDERSTANDING FINANCIAL STATEMENTS, APPRAISAL REPORTS, AND EXPERT TESTIMONY 422 (2000).

[5] *See* AMERICAN BAR ASS'N, MODEL STOCK PURCHASE AGREEMENT WITH COMMENTARY 44 (1995).

[6] Compl. Ex. A § 1.03.

Transaction Expenses, Cash of the Company, and Working Capital. Under the Agreement, the Company was required to submit to Avnet an estimate of these items at least two days before the Closing Date. These amounts were to be used to calculate the Estimated Aggregate Merger Consideration, which was to serve as a reference point for the parties in calculating the final purchase price that Avnet would pay to the selling shareholders. In particular, in § 1.04 of the Agreement, the parties prescribed a process in which Avnet, the purchaser, "as promptly as possible" after the Closing Date, would prepare and deliver a Closing Balance Sheet for the Company as of the end of the business day immediately preceding the Closing Date.[7] This also would serve as the basis for calculating the Merger Consideration Components and the resulting Aggregate Merger Consideration. To the extent any of the Merger Consideration Components differed from those estimated by the seller, such differences would be reflected in the revised Final Aggregate Merger Consideration.[8]

In § 1.04 of the Agreement, the parties established a detailed four-step process for determining the Final Aggregate Merger Consideration. First, Avnet was given a maximum of 60 days to deliver a Closing Balance Sheet and its calculation of both the Merger Consideration Components and the Aggregate Merger Consideration to HIG Source. Second, HIG Source was given up to 30 days (after receipt of all reasonably necessary supporting documents) to review Avnet's submissions. If HIG Source failed to

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7 *Id*. § 1.04(a).

8 *Id.* § 1.04.

file a Notice of Disagreement within that 30-day period, the Closing Balance Sheet, Merger Consideration Components, and Aggregate Merger Consideration were to "become final and binding."[9] Third, if HIG Source timely filed a Notice of Disagreement, the parties were to negotiate in good faith for up to 30 days in an effort to resolve their differences. Fourth, and last, to the extent the parties were unable to resolve their disputes, the Agreement provided that Grant Thornton, LLP, an accounting firm, would "resolve all remaining disputed items."[10] More specifically, Grant Thornton was empowered to review and resolve "all matters (but only such matters) that remain in dispute relating to the Closing Balance Sheet, Merger Consideration Components and Aggregate Merger Consideration."[11]

2. Post-Closing Actions of the Parties

The Merger closed on June 30, 2008. There is no indication, however, that Avnet took any action in the 60 days immediately following Closing to prepare and deliver a Closing Balance Sheet to HIG Source. Consequently, in the months following the Closing, the parties never took any of the other steps in the process for determining the Final Aggregate Merger Consideration specified in Section 1.04 of the Agreement. Therefore, the Closing Balance Sheet process arguably became final and binding on the parties by late 2008.

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9 *Id*. § 1.04(b).

10 *Id.* § 1.04(c).

11 *Id.*

In fact, it was not until more than a year after Closing that Avnet took any action regarding the Aggregate Merger Consideration. On August 6, 2009, Avnet received an e-mail from Mike Coutu, an employee of Avnet's subsidiary, Source, explaining that he made a mistake in estimating Source's cash immediately before the Closing Date. Coutu allegedly explained that instead of determining Source's cash based on the amount of cash reflected in its accounting records and financial statements, he used actual bank balances, which did not reflect payments made by Source that had not yet cleared.[12] Avnet alleges that, as a result of this error, the Aggregate Merger Consideration was overstated: it should have been $15,545,082.60, rather than the Estimated Merger Consideration of $17,437,267.97 that HIG Source calculated before the Closing. Therefore, Avnet contends it overpaid for Source by $1,892,185.37.

On November 23, 2009, a few months after receiving Coutu's e-mail, Avnet sent a letter to HIG Source, attaching what it called the Closing Balance Sheet for Source as of June 29, 2008 (the business day immediately preceding Closing).[13] Avnet also included in the letter its computation of the Aggregate Merger Consideration and the amount by which it fell short of Source's Estimated Aggregate Merger Consideration. The letter explicitly referred to § 1.04 of the Merger Agreement but provided no explanation for Avnet's delay in providing a Closing Balance Sheet.

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12 Compl. ¶ 13, Ex. B.

13 Compl. Ex. C.

In a letter dated December 22, HIG Source acknowledged its receipt from Avnet of what "purports to be a Closing Balance Sheet under Section 1.04 of the Merger Agreement."[14] HIG Source objected to Avnet's letter, however, stating:

> Purchaser's November 23, 2009 letter is untimely and without any force or effect under Section 1.04 of the Merger Agreement. The Representative [HIG Source] disputes that the documents enclosed with the November 23, 2009 letter constitute a Closing Balance Sheet under Section 1.04 of the Merger Agreement. The Representative has no obligation to review or to respond [sic: to] Purchaser's calculation of the Aggregate Merger Consideration and owes no further payment or performance to Purchaser under Section 1.04.[15]

Although Avnet disputes whether HIG Source's December 22 letter satisfies the requirements of a Notice of Disagreement, it responded in a January 5, 2010 letter.[16] In that letter, Avnet offered to work in good faith to resolve the dispute concerning the Closing Balance Sheet and the Aggregate Merger Consideration, as it claimed § 1.04 required.

Predictably, the parties were unable to come to a resolution within the following 30-day period. Invoking § 1.04 and related provisions of the Agreement, Avnet then filed its Complaint on February 12, 2010, seeking to compel HIG Source to participate in an arbitration proceeding before Grant Thornton to resolve their dispute.

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14 Compl. Ex. D.

15 *Id.*

16 Compl. Ex. E.

C. Procedural History

Avnet's Complaint against HIG Source asserts only one count and seeks an order compelling arbitration. On March 2, 2010, HIG Source filed its Answer and a Counterclaim. In those pleadings, HIG Source denied that Avnet's actions compelled it to arbitrate their dispute and sought declaratory judgment to that effect. HIG Source also seeks to recover its reasonable attorneys' fees and costs. In its Reply to the Counterclaim, Avnet likewise seeks reimbursement for its expenses and costs.

Avnet also has moved for a judgment on the pleadings compelling HIG Source to arbitrate this dispute over the Aggregate Merger Consideration. The parties have briefed and argued that motion. This Memorandum Opinion reflects my ruling on it.

II. ANALYSIS

A. Standard for Judgment on the Pleadings

Under Court of Chancery Rule 12(c), a motion for judgment on the pleadings will be granted when there are no material issues of fact and the movant is entitled to judgment as a matter of law.[17] This standard is "almost identical" to the standard for a Rule 12(b)(6) motion to dismiss.[18] As such, the Court must assume the truthfulness of all well-pleaded facts, draw all reasonable inferences in favor of the nonmoving party, and otherwise accord that party the same presumptions afforded a plaintiff resisting a Rule

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[17] *Ross Hldg. & Mgmt. Co. v. Advance Realty Gp., LLC*, 2010 WL 1838608, at *5 (Del. Ch. Apr. 28, 2010) (citing *McMillan v. Intercargo Corp.*, 768 A.2d 492, 499 (Del. Ch. 2000)).

[18] *Id.* (citing *Cantor Fitzgerald, L.P. v. Cantor*, 2001 WL 1456494, at *4 (Del. Ch. Nov. 5, 2001)).

12(b)(6) motion.[19] The court views the facts in the "light most favorable to the nonmoving party, and the moving party has the burden of demonstrating that there is no material question of fact."[20] The nonmoving party, however, "must set forth specific facts showing that there remains a genuine issue for trial."[21] Viewing the evidence in the light most favorable to the nonmoving party, if "a rational trier of fact could find any material fact that would favor the non-moving party in a determinative way . . . summary judgment is inappropriate."[22] In addition, as with a Rule 12(b)(6) motion, the court need not accept as true conclusory statements contained in the pleadings that are unsupported by factual allegations.[23]

B. Procedural Versus Substantive Arbitrability

In order for Avnet to succeed on its motion for judgment on the pleadings, it must show that the issues raised in the underlying dispute with HIG Source are to be decided by an arbitrator, in this case Grant Thornton. In determining whether Avnet's claim must be submitted to an arbitrator, I first must decide whether the questions presented involve

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19 *Id.* (citing *McMillan*, 768 A.2d at 500).

20 *Banet v. Fonds de Regulation*, 2009 WL 529207, at *3 (Del. Ch. Feb. 18, 2009) (citing *LaPointe v. AmerisourceBergen Corp.*, 2007 WL 1309398, at *4 (Del. Ch. May 1, 2007) (quoting *Elite Cleaning Co. v. Capel*, 2006 WL 1565161, at *3 (Del. Ch. June 2, 2006))).

21 *Id.*

22 *Id.* (citing *Acro Extrusion* Corp. *v. Cunningham*, 801 A.2d 345, 347 (Del. 2002)).

23 *Id.* (citing *Interactive Corp. v. Vivendi Universal, S.A.*, 2004 WL 1572932, at *8 (Del. Ch. July 6, 2004)).

issues of "procedural arbitrability" or "substantive arbitrability."[24] Matters that are procedural in nature generally are decided by an arbitrator.[25] Indeed, a presumption exists that questions of procedural arbitrability will be handled by the arbitrators and not by the courts.[26] Courts will presume, however, that the parties intended issues of substantive arbitrability to be decided by a court, absent evidence that the parties "clearly and unmistakably" intended otherwise.[27]

Procedural questions are those for which the issue involves whether the parties have complied with the terms of the arbitration clause.[28] Courts have characterized as procedural issues such as "whether prerequisites such as time limits, notice, laches, estoppel, and other conditions precedent to an obligation to arbitrate have been met,"[29] as well as "allegation[s] of waiver, delay, or a like defense to arbitrability."[30]

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24 *See James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 79 (Del. 2006).

25 *SBC Interactive, Inc. v. Corporate Media P'rs*, 714 A.2d 758, 761-62 (Del. 1998).

26 *See Willie Gary*, 906 A.2d at 79.

27 *Id.*

28 *Brown v. T-Ink, LLC*, 2007 WL 4302594, at *10 (Del Ch. Dec. 4, 2007).

29 *RBC Capital Mkts. Corp. v. Thomas Weisel P'rs, LLC*, 2010 WL 681669, at *7 (Del. Ch. Feb. 25, 2010) (citing *Howsam v. Dean Witter Reynolds, Inc*., 537 U.S. 79, 84 (2002)); s*ee AT&T Broadband, LLC v. Int'l Bhd. of Elec. Workers*, 317 F.3d 758, 762 (7th Cir. 2003).

30 *Id*. (citing *Howsam*, 537 U.S. at 84 (quoting *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 (1983))).

By contrast, substantive arbitrability is more nuanced and requires analysis into both the "scope of an arbitration provision" and the broader issue of whether the contract or arbitration clause is valid.[31] When examining substantive arbitrability, the underlying question is "whether the parties decided in the contract to submit a particular dispute to arbitration."[32]

C. Parties' Contentions

The parties agree that the sole question to be resolved on the pending motion is whether this Court or the arbitrator should decide HIG Source's challenge to the arbitration.[33] Avnet argues that the arbitrator, Grant Thornton, should decide that challenge because it involves a question of procedural arbitrability. Indeed, Avnet effectively concedes that if I conclude that HIG Source's challenge involves an issue of substantive arbitrability, then I should deny its motion for judgment on the pleadings and hold that this Court, and not the arbitrator, must decide whether Avnet's underlying claim is subject to arbitration under § 1.04 of the Agreement.[34]

For its part, HIG Source contends first that this Court, not an arbitrator, should decide whether the parties agreed to arbitrate Avnet's claim because that question is one

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31 *RBC Capital Mkts.*, 2010 WL 681669, at *8.

32 *Id*.

33 Pl.'s Reply Br. ("PRB") 1. Similarly, Plaintiff's Opening Brief and Defendant's Answering Brief are referred to as "POB" and "DAB," respectively.

34 In that regard, Avnet has not advanced any basis for departing from the usual presumption that the parties intended a court to decide issues of substantive arbitrability. *See* PRB 1 n.2.

of substantive arbitrability. Second, HIG Source urges the Court to retain jurisdiction over the underlying dispute over the Aggregate Merger Consideration.

For purposes of Avnet's motion, I need decide only the first issue. That is, I must determine if it is for this Court or the arbitrator to decide whether the parties agreed to arbitrate the underlying dispute. If I determine that the issue is one of procedural arbitrability, I will grant Avnet's motion and compel HIG Source to arbitrate its challenges to Avnet's claims. On the other hand, if I conclude HIG Source's challenge raises an issue of substantive arbitrability, I will deny Avnet's motion for judgment on the pleadings and retain jurisdiction to decide, at a minimum, whether the parties, in fact, agreed to arbitrate the underlying dispute.

In arguing that this case involves only procedural arbitrability, Avnet emphasizes that its underlying claim relates to the Closing Balance Sheet and the resulting adjustment to the Aggregate Merger Consideration. According to Avnet, the Agreement makes clear that the arbitrator is empowered to resolve such disputes by stating:

> The Parties ***shall*** submit to the Accounting Firm for review and resolution of all matters (but only such matters) that remain in dispute relating to the Closing Balance Sheet, Merger Consideration Components and Aggregate Merger Consideration. . . .[35]

In addition, Avnet notes that Defendant's Answer and Counterclaim seek to preclude it from proceeding with arbitration on a number of grounds. Those grounds include that Avnet's arbitration claim is untimely and barred by laches as well as estoppel, waiver,

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[35] POB 6-7 (quoting the Agreement § 1.04(c)).

and the "failure of a condition precedent," all of which Avnet characterizes as procedural issues.[36]

HIG Source insists the issue before me is whether the parties agreed to arbitrate the claim for an adjustment to the Closing Balance Sheet asserted by Avnet, which, according to HIG Source, is entirely outside the intended scope of § 1.04. Because that is an issue of substantive arbitrability, HIG Source contends the Court must decide it.

D. Does Avnet's claim fall within Section 1.04 of the Agreement?

HIG Source's first line of defense is that Avnet's claim does not come within § 1.04 at all. In arguing to the contrary, Avnet essentially equates any dispute relating to an aspect of the Closing Balance Sheet or Aggregate Merger Consideration to one arising under § 1.04. That argument is unpersuasive. Section 1.04 describes a specific procedure to be employed roughly contemporaneously with the Closing for the parties to identify and resolve disagreements between them regarding the Closing Balance Sheet, Merger Consideration Components, and Aggregate Merger Consideration. As previously discussed, the purchaser, Avnet, was allotted 60 days after the Closing to investigate those items and identify any problems it perceived. If Avnet sought some form of adjustment, it had to notify HIG Source by presenting it with a Closing Balance Sheet together with any revisions to the Merger Consideration Components and Aggregate Merger Consideration. HIG Source then had 30 days to file a Notice of Disagreement

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[36] PRB 2-3; DAB 6.

regarding the requested adjustments. If, thereafter, the parties failed to resolve all of their differences, the remaining disputes would be presented to Grant Thornton for resolution.

The Merger closed at the end of June 2008. Avnet did not invoke the process prescribed in § 1.04 until more than 16 months after the Closing, when it sent its November 23, 2009 letter to HIG Source, stating that it was submitting the Closing Balance Sheet pursuant to § 1.04. For purposes of the pending motion, there is no dispute that Avnet's claim falls well outside of the time limits specified in § 1.04. Nevertheless, Avnet contends that because the underlying issue relates to the Closing Balance Sheet and Aggregate Merger Consideration, it can still invoke those procedures and have any unresolved disagreements with HIG Source resolved by Grant Thornton. Whether that is a reasonable interpretation of the Agreement strikes me as debatable. In any event, it does not constitute the only reasonable interpretation. In denying the arbitrability of Avnet's claim, Defendant posits a construction that is at least as reasonable: that a claim such as Avnet's, which arises well after the period for post-closing adjustments has ended based on an alleged mistake or misrepresentation by one of the persons involved in the preparation of the Estimated Aggregate Merger Consideration, falls outside the scope of § 1.04.[37] Thus, I find the Agreement ambiguous as to whether the parties intended a claim like Avnet's to be presented to Grant Thornton,

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[37] Under Delaware law, a contract that is subject to two or more reasonable interpretations is ambiguous. *Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1196 (Del. 1992) (citing *Hallowell v. State Farm Mut. Auto. Ins. Co.*, 443 A.2d 925, 926 (Del. Super. 1982)).

the accountant-arbitrator, because it is subject to at least two reasonable interpretations. Resolution of that ambiguity involves a question of substantive arbitrability, which the parties agree must be decided by the Court, not the arbitrator.

Moreover, even if the Agreement were not ambiguous and the only issues involved whether Avnet's claim under § 1.04 was filed in a timely way, barred by laches, or waived, I still would hold that this Court, and not Grant Thornton, should decide those issues. I base this conclusion on my determination that the questions presented involve substantive arbitrability and on this Court's decisions in *Nash v. Dayton Superior Corp.*,[38] *HDS Investment Holding, Inc. v. Home Depot, Inc.*,[39] and *AHS New Mexico Holdings, Inc. v. Healthsource, Inc.*[40]

Like this case, the dispute in *Nash* arose out of a disagreement over the final price to be paid in a merger agreement. In *Nash*, the purchase price was also subject to post-closing adjustment based on a Closing Balance Sheet; if the Closing Balance Sheet showed a "net worth less than the benchmark amount, the selling stockholders agreed to repay the difference."[41] The merger agreement outlined a four-step process to resolve any disagreements over the purchase price: (1) within 60 days of closing, the buyer's independent auditors were to prepare a closing balance sheet for the target; (2) the selling

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38 728 A.2d 59 (Del. Ch. 2008).

39 2008 WL 4606262 (Del. Ch. Oct. 28, 1998).

40 2007 WL 431051 (Del. Ch. Feb. 2, 2007).

41 *Nash*, 728 A.2d at 60.

stockholders were given 45 days to deliver to buyer a notice of disagreement with that balance sheet; (3) the parties were to attempt to resolve their disputes in good faith; and (4) if any issues could not be resolved, the parties were to "submit to an independent national accounting firm . . . for 'review and resolution' of 'any and all matters which remain in dispute and which were properly included in the Notice of Disagreement.'"[42]

The parties in *Nash* disagreed as to the final calculation of the target's net worth as of the closing date. While it was undisputed that the parties followed the first two steps of the resolution process in a timely manner, the seller alleged that during the third step the buyer improperly had "interject[ed] certain 'New Items.'"[43] The issue before the Court, therefore, was whether the parties intended to submit questions about the propriety of the New Items to arbitration. Only upon a clear expression of such an intent would a court compel arbitration.[44] The Court in Nash ultimately decided on a motion to dismiss that the "'attempt to revise the Closing Balance Sheet with the New Items' did not 'on its face fall [ ] within the arbitration clause of the contract'" and, thus, was not "clearly arbitrable."[45] The Court further stated that:

> There is, at least potentially, a factual question as to whether the parties intended the arbitration process to permit Dayton Superior to revise the Closing Balance Sheet in response to objections raised by the Notice of Disagreement. For this

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42 *Id.*

43 *Id.* at 61.

44 *SBC Interactive*, 714 A.2d at 761.

45 *Id.* at 63-64.

> reason, and in the present posture of the matter, I am unable to conclude that the New Items claim is clearly arbitrable.[46]

Thus, the Court faced an issue of substantive arbitrability.

The facts and circumstances in *Nash* closely parallel those in this case. In both cases, the underlying disputes involved a disagreement over closing balance sheets and almost identical four-step resolution processes. The key question in this case, as in *Nash*, is whether the arbitration clause of the contract encompasses actions taken that do not closely conform with the process agreed upon by the parties for preparation of the Closing Balance Sheet and resolving disputes about it. In *Nash*, new items were raised at an arguably inappropriate point in the four-step process. In this case, Avnet's November 23, 2009 submission fell outside of the time limits prescribed for it to deliver a Closing Balance Sheet under § 1.04 of the Agreement. Although the Court in *Nash* did not definitively conclude that such an issue was not arbitrable, it treated the question as one of substantive arbitrability for the Court to decide. For similar reasons, I find that Avnet's dispute with HIG Source regarding whether the November 23 submission falls within the scope of § 1.04 and the process it prescribes raises a question of substantive arbitrability.

HDS also supports this conclusion. The dispute in that case also arose out of a disagreement over a post-closing purchase price adjustment process. The seller, The Home Depot, Inc., was to provide a calculation of the working capital of the target, HDS,

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[46] *Id.*

as of five days before closing. This amount was to serve as the baseline for the purchase price. The merger agreement also included a four-step process for finalizing the purchase price: (1) the buyer was to submit a closing statement within 90 days after closing; (2) the seller then had 90 days to notify the buyer of any objections; (3) the parties next would attempt to resolve their differences within a 30-day window; and (4) if the parties failed to resolve their differences, they were to submit "all amounts remaining in dispute . . . to Ernst & Young."[47]

HDS sent a closing statement to the sellers within the stipulated 90-day period. Home Depot objected to two items included in the submission and invited HDS to submit a revised closing statement omitting those numbers. HDS delivered to Home Depot a revised closing statement more than three months later and Home Depot objected, arguing that the revised closing statement was not timely submitted. The question presented for the Court was whether an arbitrator or the Court should decide if the revised closing statement could be considered by the neutral auditor (or arbitrator) under the applicable agreement. Chancellor Chandler, after engaging in a thorough analysis of the arbitration provision described above, concluded that the parties had agreed to submit only a limited range of disputes to the accountant-arbitrator, relating to the Applicable Amount (essentially the working capital) of the target.[48] Because the revised closing statement was not clearly included within the scope of the arbitration provision, the Court

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47 *HDS*, 2008 WL 4606262, at *5.

48 *Id.*

ruled that whether the revised closing statement could be considered by the arbitrator was an issue for the Court, and not the arbitrator, to decide.[49]

The parallels between *HDS* and the current dispute are striking. As with the *Nash* case, both disputes relate to post-closing purchase price adjustments and include four-step resolution processes, culminating in a submission of any remaining disputes to an accountant-arbitrator. Notably, in *HDS*, the Chancellor cited the selection of an accounting firm as evidence that the parties "did not intend the arbitration provision to encompass legal disputes arising out of other clauses in the [a]greement."[50] The most relevant portion of the *HDS* case pertains to the revised closing statement. In determining that the Court, and not the arbitrator, should decide whether that revised statement could be considered by the neutral auditor because it presented a contractual issue, the Chancellor explained:

> [T]he arbitration provision in the Agreement is narrow and thus the Court should only send to arbitration those issues that the parties expressly agreed to arbitrate. The neutral auditor is charged with resolving disputes regarding the calculation of the Applicable Amount that remain after the Resolution Period. Nothing in the arbitration provision indicates that the parties agreed that the neutral auditor would determine contractual issues regarding whether a revised or delayed Closing Statement could be considered by the neutral auditor. I will not expand the arbitration agreement beyond the express intent of the parties. Therefore, I will resolve the

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49 *Id.* at *8.

50 *Id.* at *5.

> Revised Closing Statement issue presented in Count II of the complaint.[51]

I have reached a similar conclusion on Avnet's pending motion as to the scope of what the parties intended to submit to arbitration: it seems unlikely that the parties agreed to submit a broad range of legal issues to the accountant-arbitrator. Rather, the accountant-arbitrator was only empowered to decide those disputes clearly within the ambit of the arbitration clause. As in *HDS*, Avnet and HIG Source agreed to submit only a limited range of issues to the arbitrator, Grant Thornton. In *HDS* the range of issues related to the Applicable Amount. Here, the spectrum is limited to those issues related to the Closing Balance Sheet, Merger Consideration Components, and Aggregate Merger Consideration that remain unresolved after the third step of the process prescribed in § 1.04 of the Agreement. Thus, as in *HDS*, I conclude that whether Avnet's underlying claim for an adjustment to the purchase price and HIG Source's arguments that such a claim is barred based on untimeliness, laches, and waiver can be considered by Grant Thornton is a contractual issue that should be decided by the Court.

An additional case that provides substantial support for my decision is *AHS*.[52] That case, like the others previously discussed, involved a dispute over a post-closing purchase price adjustment. The initial purchase price was based on an interim balance sheet prepared by the seller, Healthsource. To finalize the purchase price, the parties

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[51] *Id.* at *8 (footnotes omitted).

[52] *AHS N.M. Hldgs., Inc. v. Healthsource, Inc.*, 2007 WL 431051 (Del. Ch. Feb. 2, 2007).

again agreed on a four-step resolution process: (1) seller had 60 days from the closing date to submit a closing balance sheet; (2) buyer had 60 days from its receipt of the closing balance sheet to raise any objections; if it did not, the closing balance sheet would be deemed to be accepted;[53] (3) the parties would attempt for up to 30 days to resolve any disputes in good faith; and (4) either party could submit any "disputed determination" to an independent accountant for resolution.[54]

After Healthsource submitted its closing balance sheet, AHS raised certain objections in a notice of disagreement. When the parties were unable to resolve their disagreement, the buyer, AHS, sought to submit the dispute to the accountant-arbitrator. The range of issues AHS sought to arbitrate, however, was broader than what it had presented in its notice of disagreement. Therefore, the question presented was whether issues that had been raised outside of the strictures of the resolution process could be submitted to an arbitrator. In *AHS*, I concluded that question raised an issue of substantive arbitrability. In particular, I decided that the parties had agreed to submit only a discrete set of issues to the arbitrator for resolution, and that the contract unambiguously stated that only those issues timely raised could be submitted to

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[53] Similarly, in this case, § 1.04 of the Agreement provides that the Closing Balance Sheet, Merger Consideration Components, and Aggregate Merger Consideration "shall become final and binding upon the Parties" 30 days after HIG Source's receipt of all supporting documentation for Avnet's submission, unless HIG Source submits a Notice of Disagreement.

[54] *Id.* at *2.

arbitration. Therefore, I held that any issues not raised within the parameters of the resolution process could not be considered by an arbitrator.

The reasoning in *AHS* comports with my analysis here. In both cases there was a clearly defined period during which parties could take certain steps to contest the final purchase price. Each agreement required that a closing balance sheet be submitted within a certain time, that objections be raised by a certain date, that the parties attempt to resolve their differences through negotiations, and that any remaining disputes be submitted to an accountant-arbitrator for decision. Furthermore, the agreements in both *AHS* and this case contained language to the effect that if no objections were raised to the closing balance sheet within the time allotted, the balance sheet would become final and binding. Therefore, consistent with my determination in *AHS*, I hold that it is for this Court to decide whether an accountant-arbitrator may consider Avnet's November 23 submission because it constitutes an issue of substantive arbitrability.

E. The Cases Relied Upon by Avnet do not Support a Contrary Result

In arguing that the underlying dispute in this action involves only questions of procedural arbitrability, Avnet principally relies on two cases: *Mehiel v. Solo Cup Co.*[55] and *Aveta Inc. v. MMM Hldgs., Inc.*[56] For the reasons stated below, neither of those cases supports Avnet's position.

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55 2005 WL 1252348 (Del. Ch. May 13, 2005).

56 2008 WL 5255818 (Del. Ch. Dec. 11, 2008).

The dispute in *Solo Cup* arose out of a merger in which Solo acquired Sweetheart, whose shareholders were represented by Mehiel. Anticipating a dispute over the pre- and post-closing calculations of working capital, the parties agreed to certain provisions designed to protect their respective interests. Those provisions established a process under which the seller would first submit an estimate of Sweetheart's working capital at least two days before closing. Next, the purchaser, Solo, was to deposit $15 million into an escrow account for disbursement to the seller in accordance with an agreed upon schedule. If the working capital was determined to be less than the seller estimated, the escrow deposit would be reduced on a dollar-for-dollar basis. Solo also was given unfettered access to the books, records, and employees of Sweetheart involved in making its estimate. In the event of a disagreement over the calculation of working capital, either party could submit the dispute to a neutral auditor.

Solo and Mehiel could not agree on the working capital, so they agreed to submit their dispute to Ernst & Young for resolution. A disagreement arose, however, as to whether Ernst & Young had the discretion to order discovery as part of the arbitration proceeding. The arbitration clause in the merger agreement simply provided that "'all amounts remaining in dispute shall be submitted to . . . the [neutral auditor].'"[57] Chancellor Chandler construed this to mean the parties unambiguously agreed to submit the substance of their dispute to an arbitrator. Having made this determination, he then

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[57] *Solo Cup*, 2005 WL 1252348, at *6.

concluded that the "scope of the arbitrator's authority to compel discovery is a procedural question and one that must be addressed by the arbitrator."[58]

The key difference between *Solo Cup* and the dispute between Avnet and HIG Source is that, in *Solo*, the parties clearly had agreed to submit their dispute to an arbitrator. In fact, it was only after they got into the thick of arbitration proceedings that disagreement arose as to the rules of the game. Moreover, the Chancellor found that the parties in *Solo* also unambiguously had agreed in the merger agreement to arbitrate such a dispute over discovery. Here, there is not the same level of clarity. As discussed *supra* Part II.D, I have concluded that an issue exists as to whether the parties agreed to arbitrate the underlying issue in question. Hence, while it is appropriate for an arbitrator to decide the rules of an arbitration proceeding where the parties clearly agreed to arbitrate a particular issue, this case turns on the more fundamental issue of whether an agreement to arbitrate encompasses a particular kind of dispute in the first place, not merely what the rules of the proceeding will be. Because I find that to be the nature of the dispute before me, I conclude that it constitutes a question of substantive arbitrability for the Court to decide.

The second case relied upon by Avnet, *Aveta*, also involved a merger and acquisition, for which the agreement delineated a process for making post-closing adjustments. As part of this procedure, the buyer was required to deliver certain financial statements of the target to the representatives of selling shareholders within a defined

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58 *Id.*

period of time after the closing so they could make a final calculation of the purchase price. The selling shareholders' representative continuously complained that he had not been provided with enough information, while the buyer claimed it had fully satisfied its obligations. The buyer ultimately submitted a notice of intent to arbitrate.

The selling shareholders' representative argued that the buyer's alleged failure to supply adequate documentation constituted a substantive issue for the Court to decide. Vice Chancellor Lamb disagreed, however, noting that whether a condition precedent is met constitutes a procedural question because it "relates not to the subject matter of the dispute but rather the entitlement of the plaintiffs to seek relief."[59]

Avnet's attempt to frame the issue presented here as merely one of timeliness or whether a condition precedent has been met is oversimplified. This case is readily distinguishable from *Aveta*. There, the court concluded that it was clear "that the disputed issues are within the ambit of the arbitration provision, even narrowly construed."[60] The same cannot be said in this case. To be sure, Avnet's November 23, 2009 letter self-servingly states that it is pursuant to § 1.04 of the Agreement and relates to a claim for an adjustment of the Aggregate Merger Consideration. But, Avnet's claim otherwise has nothing to do with the process prescribed in § 1.04, under which, for example, the Closing Balance Sheet and Aggregate Merger Consideration arguably became "final and binding on the Parties" more than a year earlier. In these

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59 *Aveta*, 2008 WL 5255818, at *2, 4.

60 *Id*.

circumstances, I cannot conclude on a motion for judgment on the pleadings that the underlying disputes simply involve matters of procedural arbitrability that the parties clearly intended to arbitrate.

In *Aveta*¸ there was no question that the buyer made its submissions in an effort to comply with the terms of the resolution process. The only matter to be resolved was whether the documents the buyer supplied to the sellers in connection with that process conformed to the requirements in the agreement. That is, the sellers did not dispute their obligation to arbitrate if the documents submitted by the buyer were deemed to have met the threshold required by the agreement. Rather, the sellers disputed only whether this condition had been met. The question here is not just one of whether a condition precedent has been met; rather, it involves whether the parties have agreed to arbitrate the issues presented by Avnet's November 23 submission at all.

In summary, therefore, I hold that HIG Source's challenge to the arbitrability of Avnet's claim presents questions of substantive arbitrability for the Court to resolve. Hence, I will deny Avnet's motion for judgment on the pleadings in its favor compelling arbitration of this matter.

III. CONCLUSION

For the reasons stated, I deny Avnet's motion for judgment on the pleadings.

IT IS SO ORDERED.