**IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE**

**IN AND FOR NEW CASTLE COUNTY**

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| MATRIA HEALTHCARE, INC., | : | |
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| Plaintiff, | : | |
| | : | |
| v. | : | **C.A. No. 2513-N** |
| | : | |
| CORAL SR LLC, individually and as Attorney-in-Fact for the Stakeholders of CorSolutions Medical, Inc., | : | |
| | : | |
| Defendant. | : | |

**MEMORANDUM OPINION**

Date Submitted: January 10, 2007
Date Decided: March 1, 2007

Adam Balick, Esquire of Bifferato, Gentilotti & Balick, LLC, Wilmington, Delaware, and William N. Withrow, Jr., Esquire, A. William Loeffler, Esquire, and Charles R. Burnett, Esquire of Troutman Sanders LLP, Atlanta, Georgia, Attorneys for Plaintiff.

Richard D. Heins, Esquire and Richard L. Renck, Esquire of Ashby & Geddes, Wilmington, Delaware, and Michael M. Conway, Esquire, Dewey B. Crawford, Esquire, and Joanne Lee, Esquire of Foley & Lardner LLP, Chicago, Illinois, Attorneys for Defendant.

NOBLE, Vice Chancellor

In construing contracts, the function of the Court is to ascertain the shared intentions of the contracting parties when they entered into their agreement. The first level of analysis is deceptively simple: give the words chosen by the parties their ordinary meaning. Disputes over a contract negotiated by sophisticated parties typically fall into three broad categories. First, the parties did not anticipate and provide for future events. Thus, the contract fails to address (or to address fully) the responsibilities of the parties in a particular factual setting. Second, the parties (or their lawyers) understand that there are drafting imperfections, perhaps because the parties cannot devise a mutually acceptable resolution to certain issues. The parties do not want what (at that time) are viewed as minor impediments to derail the transaction. They hope that the identified risks will not materialize and trust that, if the unlikely events occur, some judge will fill in the gaps in a way that substantially preserves the benefits of the bargain for each side. Finally, there are disputes like the one now pending. The words, when fairly read and given their ordinary meaning, lead to a result that the Court cannot believe is what reasonable parties would have intended. In a sense, one party's argument boils down to a plea of: "We couldn't have been that obtuse (or worse)." The result reached here is, in large part, unpalatable; it is the product, however, of words chosen by sophisticated

parties who drafted a complex and comprehensive agreement. More importantly, it is not for some judge to substitute his subjective view of what makes sense for the terms accepted by the parties.

## I. BACKGROUND

### A. *The Merger*

A subsidiary of Plaintiff Matria Healthcare, Inc. ("Matria") merged with CorSolutions Medical, Inc. ("CorSolutions") on January 19, 2006.[1] The Agreement and Plan of Merger (the "Merger Agreement"), entered into on December 14, 2005, established the Escrow Fund to satisfy certain potential post-closing adjustments contemplated by the Merger Agreement.[2] Defendant Coral SR LLC ("Coral"), as representative of the stakeholders in CorSolutions, was authorized to address claims against the Escrow Fund.[3]

### B. *The Merger Agreement*

The Merger Agreement provides broadly for arbitration of disputes, involving Matria's claims to the Escrow Fund. Four specialized arbitration forums

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[1] The term "Matria" may include its related entities, post-closing.

[2] The Initial Merger Consideration was $445 million. Of that, $20.3 million was set aside at Closing to fund the Escrow Fund. Capitalized terms, not otherwise defined here, follow the usage of the Merger Agreement.

[3] Merger Agmt. § 2.4(b)(iii). The term "Stakeholders," defined by Section 1.1 of the Merger Agreement, refers collectively to those holders of CorSolutions common and preferred stock, its options, and its warrants who are entitled to receive any portion of the aggregate merger consideration under the Merger Agreement. The balance, if any, in the Escrow Fund will be paid to the Stakeholders.

are prescribed to allow for claims to be heard before arbitrators with expertise in the area of dispute. For one category of arbitration, the Settlement Accountant, a major accounting firm, is empowered by Section 2.9 of the Merger Agreement to resolve post-closing disputes regarding balance sheet adjustments and the related computation of working capital, cash on hand, and indebtedness.[4] For example, the Agreement establishes a Target Working Capital Amount of $8,281,000. If the Final Working Capital Amount turns out to be less than the target, the deficiency will be funded by the Escrow Fund. The process is relatively straightforward. Matria submits its determination of working capital to Coral; Coral may then review the determination and present its objections. If the parties are unable to resolve their differences within a specified period, "then the matter shall be submitted as promptly as practicable to [the Settlement Accountant]," which is entitled to all of the "privileges and immunities of arbitrators."[5]

In contrast, disputes between Matria and Coral "relating to any Claim other than a Third Party Claim that is the subject of litigation ("Escrow Fund Dispute") or any claim subject to Section 5.12 or Section 7.5 . . . shall be exclusively and finally settled by arbitration in accordance with the Commercial Arbitration Rules

[4] The Closing Date Balance Sheet is to be prepared in accordance with United States generally accepted accounting principles ("GAAP") consistently applied. The Working Capital Amount is also subject to the procedures and definitions prescribed by Exhibit D to the Merger Agreement.
[5] Merger Agmt. § 2.9(b) & (k).

of the [American Arbitration Association ("AAA")] then in effect . . ."[6] A "Claim" may be a Third-Party Claim or a Direct Claim (*i.e.*, one which Matria could bring for its benefit and which does not involve a Third-Party Claim). A "Third-Party Claim" is "any Action . . . asserted or instituted by any Person (other than the parties to [the Merger Agreement]) which could give rise to Damages for which [Matria] may have a claim against the Escrow Fund under [the Merger Agreement] . . ."[7] "Action" is defined as "any litigation, suit, arbitration, proceeding or investigation by or before any Governmental Authority."[8]

The parties also "agree[d] that except for any claims seeking injunctive specific performance or other equitable relief . . . and except for claims involving fraud, from and after the Closing, the right to make a claim on the Escrow Fund provided for in this Article VII [of the Merger Agreement] pursuant to the provisions of this Article VII . . . shall be the exclusive remedy of [Matria] . . . for any breach of or inaccuracy in any representation or warranty, or any non-compliance with or breach of or default in the performance of any of the covenants or agreements contained in [the Merger Agreement]. . . ."[9]

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[6] Merger Agmt. § 7.4. The other two areas for specialized arbitration, neither of which is implicated here, are (1) tax-related matters (Merger Agmt. § 5.12) and (2) claims arising out of a demonstration agreement with the Centers for Medicare & Medicaid Services ("BIPA Claims") (Merger Agmt. § 7.5).
[7] Merger Agmt. § 7.2(a).
[8] Merger Agmt. § 1.1.
[9] Merger Agmt. § 7.3(d)(iv).

Apparently recognizing that disputes involving, for example, misrepresentations could, at least in theory, fit within both the arbitration provision for Claims and the arbitration provision for adjustments to be made by the Settlement Accountant, the parties included the following in the Merger Agreement:

> The items set forth on or reflected in the Company's Statement, the Closing Balance Sheet, the Determination, the Final Closing Balance Sheet or the Preliminary Working Capital Amount, the Final Working Capital Amount, . . . and any matters relating thereto that could have been subject to adjustment or dispute (other than matters not known prior to final resolution of the Final Working Capital Amount, the Final Closing Date Balance Sheet . . .), in each case pursuant to Article II . . . and any other amounts or items that were adjusted or disputed in the course of the Article II . . . process (such items so set forth or reflected, such matters relating thereto and such other amounts and items, collectively, the "Article II/Section 7.5 Items"), are subject solely to the adjustments set forth in Article II [*i.e.* by the Settlement Accountant] . . . and accordingly shall not be subject to any claim by [Matria] . . . on the Escrow Fund pursuant to this Article VII [*i.e.*, by AAA arbitrators]. *In no event shall any matter, facts or circumstances pertaining to any Article II/Section 7.5 Item, which would also constitute a breach of a representation, warranty, covenant or agreement relating to the Financial Statements or any other provision hereof, give rise to any claim by [Matria] on the Escrow Fund under this Article VII.*[10]

Finally, the parties reiterated their commitment to arbitration as the means of dispute resolution:

> For the avoidance of doubt, except for claims for specific performance arising after the date hereof and prior to the Closing, any claims arising out of this Agreement, or the breach, termination or validity

[10] Merger Agmt. § 7.3(c)(iii) (emphasis added).

> thereof, shall be finally and exclusively determined by arbitration in accordance with Sections 2.9 (Post-Closing Adjustment of Initial Merger Consideration), 5.12(h) (Tax Disputes), 7.4 (Escrow Fund Disputes) or 7.5 (BIPA Claims).[11]

C. *The Dispute Evolves*

Before the Merger, both Matria and CorSolutions engaged in the disease management and wellness enhancement business. The day after the closing of the Merger, one of CorSolutions' largest customers (the "Customer") informed Matria that it would undertake a clinical and financial audit of one of the disease management programs provided by CorSolutions. Although CorSolutions was aware of the Customer's concerns well before the Merger, it never divulged that information to Matria. For example, in August 2005, CorSolutions concluded its own internal audit of the disease management program for the Customer and ascertained that it was failing to satisfy its obligations in more than one-half of the cases. Another internal audit revealed in December 2005 that, out of 246 participants audited, CorSolutions had met its obligations with respect to only 26 participants. Finally, a few days before execution of the Merger Agreement, a member of ColSolutions' senior management received an e-mail in which the Customer questioned CorSolutions' ability to satisfy its contractual duties. That e-mail read in part, "[I]f we don't feel more comfortable and have questions that

[11] Merger Agmt. § 9.7.

have been raised answered by the end of December, we will opt all clients out of the program until we are satisfied with what is taking place."[12] Not only did CorSolutions not disclose any of these concerns to Matria, but its senior management also directed CorSolutions' employees not to share them with Matria.

CorSolutions' decision not to transmit the Customer's complaints to Matria raises several misrepresentation issues. CorSolutions represented in the Merger Agreement (and as brought forward to closing): no Material Adverse Effect had occurred (or was occurring); that it had incurred no liabilities (other than those disclosed on its balance sheet) that should have been disclosed on the balance sheet or in a note accompanying it; and that CorSolutions was not in default under any Material Contract except for breaches that either individually or in the aggregate would not reasonably be likely of causing a Material Adverse Effect.

In response to these complaints, Matria, without notifying Coral, negotiated with the Customer for approximately the next seven months. The Customer and Matria reached an agreement in October 2006. Matria agreed to pay the Customer $4 million. For that payment, Matria not only obtained a release of claims arising on CorSolutions' watch, but it also received a release of all claims that could have been asserted from the date of the Merger through the end of 2006; a two-year extension of its contract with the Customer, estimated to produce revenues of $20

[12] Verified Compl. ¶ 26.

million annually; a revision of the termination provision that now allows the Customer to terminate only "for cause"; and a cash payment of $1.5 million for a public relations campaign about services to the Customer's clientele. Thus, Matria resolved the Customer's concerns about CorSolutions' performance, and it obtained substantial additional benefits from the Customer at the same time.

While it was negotiating with the Customer, Matria was also carrying out its post-closing accounting work and preparing its claim against the Escrow Fund. On April 4, 2006, Matria submitted, in accordance with Section 2.9 of the Merger Agreement, its Closing Date Balance Sheet and Preliminary Working Capital Amount to Coral; this set forth its estimate of liability to the Customer of $1.5 million, an amount reflected on the "Accrued Miscellaneous" line. The parties exchanged information requests and information until May 30, 2006, when Coral submitted its statement of opposition which rejected the adjustments proposed (or claims asserted) by Matria. Following the ensuing thirty-day period for negotiations, the parties (either with Coral's participation or at its insistence) began preparation to submit the dispute to the Settlement Accountant. By July 31, 2006, Matria had concluded that its post-closing adjustment had increased to $3.5 million. On September 28, 2006, Matria notified Coral and advised that it was close to settling the Customer's claim for $4 million and that its Closing Date Balance Sheet and Preliminary Working Capital Amount would be revised again to

reflect that increase. On September 30, 2006, Coral responded and advanced the position that Matria was not seeking an accounting adjustment; instead, it argued that Matria was asserting a "Claim" under Section 7.2(b) of the Merger Agreement and that it had the right to investigate and defend the claim. Matria went forward with efforts to engage the Settlement Accountant. Coral, instead, filed a demand for arbitration with the AAA on October 13, 2006, under the dispute provisions of Section 7.4 of the Merger Agreement. Coral, on October 25, 2006, submitted, in response to Matria's proposal, a mark-up of the Settlement Accountant's engagement letter, but excluded those proposed adjustments for the Customer from the scope of the Settlement Accountant's authority. The Customer and Matria reached their agreement on October 11, 2006, and on October 30, 2006, Matria revised its demand for adjustment before the Settlement Accountant to $4 million.

Thus, Coral is prepared to arbitrate the consequences of Matria's resolution of the Customer's concerns before the AAA; by contrast, Matria seeks to have that adjustment arbitrated by the Settlement Accountant. Neither, of course, is willing to move forward in the arbitration forum proposed by the other.

## II. CONTENTIONS

Matria filed a five-count Verified Complaint. First, it seeks a declaration that its post-closing dispute (and, thus, its claim to the Escrow Fund) is governed by Section 2.9(b) of the Merger Agreement, which would require arbitration before

the Settlement Accountant. Second, it asks the Court to enjoin the arbitration brought by Coral before the AAA. Third, Matria wants an order compelling arbitration of the dispute before the Settlement Accountant. Fourth, it tenders a damages claim based on fraud. Fifth, it refines its damages claim to one for equitable fraud. Pending is Matria's motion to compel arbitration before the Settlement Accountant.

Coral has responded by moving to dismiss this action under Court of Chancery Rule 12(b)(6). According to Coral, Matria is seeking to assert a claim (including its fraud allegations) that must be arbitrated before the AAA. It also contends that the Customer's claim simply is not a proper accrual for the Closing Date Balance Sheet. In addition, it asserts that the Verified Complaint fails to allege fraud with the particularity required by Court of Chancery Rule 9(b).

## III. ANALYSIS

### A. *Applicable Standards*

Motions to dismiss and to compel arbitration are pending. Each, of course, is governed by a different standard. A motion to dismiss under Court of Chancery Rule 12(b)(6) may be granted if the Court, after accepting all of the well-pleaded factual allegations of the complaint and drawing all reasonable inferences in favor of the non-moving party, concludes, nonetheless, that the "plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances

susceptible of proof."[13] In contrast, a motion to compel arbitration may be reviewed under the standards of Court of Chancery Rule 56, which allows the Court to grant relief if the moving party is able to demonstrate that there are no material facts in dispute and that it is entitled to judgment as a matter of law.[14]

B. *A Few Words About Arbitration*

Matria and Coral agree on the basic principles.[15] Arbitration is a matter of contract. Public policy favors arbitration. A party may not be required to arbitrate a dispute if it did not agree to arbitrate the matter. As a general matter, questions of arbitrability are for the Court.[16]

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[13] *In re General Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (quoting *Savor, Inc. v. FMR Corp.*, 812 A.2d 894, 896-97 (Del. 2002)).

[14] *See, e.g.*, *Motorola, Inc. v. Amkor Tech., Inc.*, 849 A.2d 931, 935 (Del. 2004). The background section of this Memorandum Opinion is drawn largely, but not exclusively, from the Verified Complaint. The Court may also consider the provisions of the Merger Agreement because that document is referenced extensively in the Verified Complaint. *See Vanderbilt Income & Growth Assocs., L.L.C. v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 612-13 (Del. 1996). Some facts are taken from the affidavit submitted by Coral and from the declaration and the deposition of Matria's chief executive officer. Those facts are primarily for context and are not essential to the Court's decision on the motion to dismiss. With respect to the motion to compel arbitration, there are no facts in dispute that are material to the Court's decision. *But see* note 25, *infra*, for a factual dispute that might have been material if the Court had construed the Merger Agreement differently.

[15] This action is governed by the Federal Arbitration Act, 9 U.S.C. § 1, *et seq*. Because "Delaware arbitration law mirrors federal law," *James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 79 (Del. 2006), and because the parties have not suggested otherwise, the Court will be guided by both federal and Delaware decisional law on arbitration.

It should be noted that the Merger Agreement is to be construed under contract law principles found in the law of Delaware. Merger Agmt. § 9.6.

[16] *See, e.g.*, *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79, 83 (2002); *Parfi Holding AB v. Mirror Image Internet, Inc.*, 817 A.2d 149, 155-56 (Del. 2002); *DMS Properties-First, Inc. v. P.W. Scott Assocs., Inc.*, 748 A.2d 389, 391-92 (Del. 2000).

Parties may, however, agree to submit questions of arbitrability to the arbitrator. There must first be "clear and unmistakable" evidence that they did agree to arbitrate arbitrability. One way to demonstrate a clear and unmistakable intent is to incorporate the rules of the AAA. Even if incorporated, the rules of the AAA will not assure that arbitrability will be arbitrable. Incorporation of the AAA rules will result in arbitration of the arbitrability question "in those cases where the arbitration clause generally provides for arbitration of all disputes and also incorporates a set of arbitration rules that empower arbitrators to decide arbitrability."[17] Although Matria and Coral agreed to submit all disputes arising under the Merger Agreement to arbitration, they did not agree to submit all of the arbitration disputes to the AAA. Instead, the Merger Agreement establishes four separate arbitration processes; there is no "arbitration clause generally provid[ing] for arbitration of all disputes and also incorporate[ing] a set of arbitration rules." In the "catchall" arbitration provision (Section 9.7 of the Merger Agreement), there is no reference to a set of arbitration rules. Conversely, the arbitration provision referencing the Commercial Arbitration Rules of the AAA (Merger Agreement § 7.4) is not a clause providing for arbitration generally because of the matters which are expressly excepted from its scope. In addition, there was no express agreement to arbitrate arbitrability. Thus, because there is no "clear and

[17] *James & Jackson, LLC*, 906 A.2d at 80.

unmistakable" evidence of intent to arbitrate arbitrability, the task of ascertaining the parties' intent as to where to arbitrate a particular issue should be arbitrated remains with the Court.[18]

C. *A Few Words About Contract Construction*

When interpreting a contract, the Court's function is to "attempt to fulfill, to the extent possible, the reasonable shared expectations of the parties at the time they contracted."[19] The Court does this by initially looking to the contract's express terms. If the terms are clear on their face and reasonably susceptible to only one meaning, then the Court gives those terms the meaning that would be ascribed to them by a reasonable third party.[20] If, however, a contract's language is ambiguous, then the Court will look beyond the "four corners" of the agreement

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[18] The parties (putting aside for the moment the fraud claims asserted by Matria in Counts IV and V of its Verified Complaint) agree that arbitration is the proper dispute mechanism; they just disagree over which forum. That agreement—limited as it is—should be viewed, according to Coral, as the end of the Court's involvement, with the question of which arbitration forum left for the arbitrators. Coral, in substance, argues that, with the parties' agreement to arbitrate, only "procedural" questions remain, and they typically are for the arbitrator. *See, e.g.*, *SBC Interactive, Inc. v. Corporate Media Partners*, 714 A.2d 758, 761-62 (Del. 1998); *see also Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 452-53 (2003) (noting that arbitrators are well-suited to answer the question of what kind of arbitration was agreed to by the parties). The Settlement Accountant, however, has no rules or guidance for determining its jurisdiction, as contrasted with the Commercial Arbitration Rules of the AAA. *Cf. Country Life Homes, Inc. v. Shaffer*, 2007 WL 333075, at *4 n.21 (Del. Ch. Jan. 31, 2007).

[19] *Comrie v. Enterasys Networks, Inc.*, 837 A.2d 1, 13 (Del. Ch. 2003).

[20] *See, e.g.*, *BAE Sys. N. Am. v. Lockheed Martin Corp.*, 2004 WL 1739522, at *4 (Del. Ch. Aug. 3, 2004); *True N. Commc'ns, Inc. v. Publicis, S.A.*, 711 A.2d 34, 38 (Del. Ch. 1997), *aff'd*, 705 A.2d 244 (Del. 1997) (TABLE); *see also Rhone-Poulenc Basic Chems. Co. v. Am. Motorists Ins. Co.*, 616 A.2d 1192, 1195 (Del. 1992). Accordingly, a finding that a contract's disputed language is unambiguous compels the Court to rely solely on the clear, literal meaning of the words of the contract. *Energy Partners, Ltd. v. Stone Energy Corp.*, 2006 WL 2947483, at *13 (Del. Ch. Oct. 11, 2006);

to extrinsic evidence.[21] A contract is not ambiguous merely because the parties disagree as to its proper construction. Instead, ambiguity exists when the terms of a contract are reasonably susceptible to different interpretations or have two or more different meanings.[22] Also, when possible, the Court should attempt to give effect to each term of the agreement and to avoid rendering a provision redundant or illusory.[23]

D. *The Parties' Choice of Arbitration Forum*

The dispute before the Court grows out of the concerns of the Customer over CorSolutions' performance and whether those concerns should have been disclosed to Matria in advance of the Merger. At one time or another, this matter arguably could have been viewed as (1) a potential claim, serious enough to be reflected on CorSolutions' balance sheet; (2) a misrepresentation (*i.e.*, based on CorSolutions' failure to disclose) and, thus, a Direct Claim to be made by Matria as the alleged victim of the misrepresentation; and (3) a Third-Party Claim pursued by the Customer for relief from CorSolutions' malfeasance (or non-feasance).

The Merger Agreement provides that, at least in the absence of fraud, Matria's "exclusive remedy" for any misrepresentation would be a claim against

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[21] *See, e.g.*, *Eagle Indus., Inc. v. DeVilbiss Health Care, Inc.*, 702 A.2d 1228, 1232 (Del. 1997).
[22] *See, e.g.*, *Energy Partners*, 2006 WL 2947483, at *13; *BAE Systems*, 2004 WL 1739522, at *4; *Comrie*, 837 A.2d at 13.
[23] *O'Brien v. Progressive N. Ins. Co.*, 785 A.2d 281, 287 (Del. 2001).

the Escrow Fund, a claim to be arbitrated before the AAA.[24] There is no doubt that Matria's claim can fairly be characterized as one alleging misrepresentation. Coral disputes that any misrepresentation occurred. It suggests that unhappy customers—even those with legitimate concerns—are part of the ordinary course of business and that the Customer's complaint, even if it had some substance, could not fairly be characterized as material. The question of whether a misrepresentation occurred and whether that misrepresentation was material are questions typically submitted to arbitration before the AAA. They are not generally viewed as the kind of disputes that would be resolved by the person charged with "truing up" the books. In addition, the damages (if any) caused by the misrepresentation (if any) would typically be determined in arbitration's litigation analog; in this instance, before the AAA. In short, the language of Article VII of the Merger Agreement predicts the result that one would anticipate the parties intended: commercial matters generally or otherwise usually resolved through litigation (except for certain specifically excepted issues) would fall within the scope of AAA arbitration, just as Coral argues.[25]

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[24] Merger Agmt. § 7.3(d)(iv).

[25] Coral argues that the problems with the Customer constituted a Third-Party Claim. One cannot be confident of that based on the current state of the record. For there to be a Third-Party Claim, an "Action" must be "asserted or instituted" by a third person. No "Action" was instituted. Although in regular English usage one does not "assert" an "Action," the most (and perhaps only) plausible reading of the phrase is substantially "threatened an Action." "Action" here requires litigation or arbitration—some sort of adversary proceeding. It is debatable whether the Customer ever threatened an Action. The Customer apparently had economic power

Matria, however, invokes Section 7.3(c)(iii) of the Merger Agreement. For an item that could appear on the Final Closing Balance Sheet and, thus, would affect the Preliminary Working Capital Amount, the parties agreed to "adjust" the item through the process of Article II, that is, before the Settlement Accountant.[26] The claim of the Customer could have been—if fully disclosed before or at Closing—addressed as a balance sheet entry. An accountant might look at the "facts" and determine that no entry was necessary; that accountant might also come to a different conclusion and attempt to define and to quantify the appropriate entry on the balance sheet. Thus, there is a matter here which the Settlement Accountant could, in a manner consistent with the terms of the Merger Agreement, address.[27]

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by which it could withhold payment and withhold the assignment of additional work. Thus, if the dispute with the Customer had not been resolved without resort to adversary proceedings, it is more likely that it would have fallen on Matria to have commenced any Action. An Action commenced by Matria would not have satisfied the definition of a Third-Party Claim (at least in the absence of a counterclaim). On the other hand, the Customer raised serious concerns and demonstrated a willingness to pursue those concerns. Ordinarily, one could anticipate that such concerns would, if not resolved, lead to adversary proceedings. Because the record does not contain the full exchange between the Customer and Matria, the question of whether the Customer "asserted" an "Action" cannot be resolved on this record under a summary judgment standard. In light of the Court's conclusions with respect to the transcendency of Section 2.9(b) over Section 7.3(d)(iii) of the Merger Agreement, it is not necessary to do so.

[26] The Customer's concerns were known to CorSolutions before closing and known to Matria before "final resolution of the Final Working Capital Amount . . . ." Merger Agmt. § 7.3(c)(iii).

[27] Coral argues (Def.'s Br. in Supp. of its Mot. to Dismiss Pl.'s Verified Compl. at 14) that the facts simply do not provide sufficient grounds for an accountant to establish a reserve under GAAP and, therefore, that the Customer's concerns could not give rise to an accrual belonging on the Closing Date Balance Sheet. Coral may be correct in its argument, and, if so, it should prevail before the Settlement Accountant. Indeed, that may be one of the prices that Matria pays for its choice of arbitration before the Settlement Accountant instead of before the AAA. It is perhaps not too cynical to suggest that the true motivation behind Matria's choice of forum is

The question, accordingly, becomes: which arbitrator did the parties intend to resolve the dispute based on the Customer's concerns?[28] The Merger Agreement, unequivocally, and some might argue inexplicably, resolves the conflict. It expressly provides that no matter pertaining to an Article II item (which the dispute is under the terms of the Merger Agreement) which would also constitute a breach of representation (relating either to the Financial Statements or other provisions of the Merger Agreement) (which the dispute does) shall "give rise to any claim by

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avoiding the "liability basket" or minimum threshold for misrepresentation claims to be asserted against the Escrow Fund under Article VII. *See* note 28, *infra*.

[28] Resolution of the debate over whether this matter involves an accounting adjustment or misrepresentation has consequences beyond the choice of arbitration forum. In short, Matria gets the first dollar of a favorable accounting adjustment (*i.e.*, by the Settlement Accountant), but its ability to collect from the Escrow Fund for CorSolutions' misrepresentations is subject to a threshold or "liability basket" in excess of $4 million. More specifically, Section 7.3(a) of the Merger Agreement provides in part:

> Liability Basket. Notwithstanding anything in this Article VII to the contrary, (A) [Matria] shall not be entitled to make a claim on the Escrow Fund pursuant to Section 7.1(a), *unless and until* the aggregate amount of Damages incurred by [Matria] for which [Matria] is entitled to make a claim on the Escrow Fund pursuant to Section 7.1(a) . . . *equals or exceeds* an amount equal to Four Million Four Hundred Fifty Thousand Dollars ($4,450,000)(the "Liability Basket"); provided, however, that once the Liability Basket has been reached, [Matria] shall be entitled to make a claim on the Escrow Fund under Section 7.1(a) only for the amount of Damages *in excess* of the Liability Basket. Notwithstanding anything in this Article VII to the contrary, any claim on the Escrow Fund to which [Matria] shall become entitled as a result of a breach or inaccuracy of Sections 3.1, 3.2, 3.4, 3.10(f), 3.11 and 3.18 [all provisions not relating to the misrepresentations alleged by Matria] shall be available without regard to the Liability Basket. (emphases added)

Thus, even with Matria's expanded claim (that is, from the initial demand of $1.5 million to the current demand of $4 million), it would receive little or nothing if it prevailed before the AAA. Also, if the Customer's concerns were treated as a Third-Party Claim, Coral would have had the right to investigate and negotiate resolution. Merger Agmt. § 7.2. Coral had no meaningful participation in Matria's efforts to appease the Customer.

[Matria] on the Escrow Fund under this Article VII."[29] Coral, however, seeks to arbitrate Matria's claim against the Escrow Fund under Article VII which grants jurisdiction to the AAA tribunal. The parties established an arbitration hierarchy and, in this instance, that hierarchy assigns the responsibility for the pending dispute to the Settlement Accountant as the forum of express choice.[30] One may doubt that this is what the parties intended; the Court, however, cannot read the Merger Agreement otherwise.[31]

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[29] Merger Agmt. § 7.3(c)(iii).

[30] The Settlement Accountant is not charged with determining whether a misrepresentation occurred. Instead, its function is to assess the appropriate body of knowledge routinely relied upon by accountants and determine whether, as an accounting matter, an entry on the balance sheet should follow.

[31] Coral argues that it is unreasonable for a Settlement Accountant to resolve the merits of (and allocation of responsibility for) claims brought by, and negotiated and resolved with, an unhappy customer. A rather complex (*i.e.*, not only with the Customer being paid a sizeable sum, but also with Matria receiving other significant benefits in return) settlement cannot simply be entered as a balance sheet item. Indeed, so Coral argues, it is not clear that there was any viable claim that could have been asserted against CorSolutions and it is entitled to a merits-based analysis of the validity of any such claim. That is, according to Coral, this is the type of question routinely submitted to AAA arbitrators; it is not an accounting matter. It is hard to disagree with Coral's contention that one would expect a dispute of this nature—given an intent to submit the matter to arbitration—to be before the AAA. Yet, as set forth above, that is not what CorSolutions and Matria provided in the Merger Agreement. That a judge may believe that the AAA would be the preferable forum for resolution of the dispute does not (nor should it) trump the agreement of the parties.

One can, however, conjure up an argument as to why sophisticated parties might have selected the Settlement Accountant for the task. The purpose of the Closing Date Balance Sheet (and, of course, the related Final Working Capital Amount) is to reflect accurately and comprehensively the financial state of CorSolutions as of the date of the Closing. The problems with the Customer were known as of then. If knowledge of the problem had been shared, then an accountant might have been called upon to determine whether, consistent with applicable accounting standards, a reserve or other acknowledgement of the risks associated with the claim should have been posted to the balance sheet. The effect would have been to reduce the Working Capital Amount by the amount of the entry. The Merger Agreement, Section 7.3(c)(iii), provides that any knowledge informing the accounting decision, even if it is not learned until the time of the final work, may be used as part of the accountant's work in conforming the balance sheet.

Therefore, arbitration of this dispute must be, as the Merger Agreement requires, before the Settlement Accountant, and Matria has earned judgment to that effect.[32] Matria, accordingly, is also entitled to a declaratory judgment confirming that Section 2.9 of the Merger Agreement governs arbitration of the dispute and that it is not subject to arbitration under Section 7.4 of the Merger Agreement, and to a permanent injunction precluding Coral from pursuing its arbitration before the AAA.[33] It also follows that Coral's efforts to secure the dismissal of Counts I, II, and III of the Verified Complaint must be denied.

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The means by which an accountant would quantify the Customer's concerns (or, even if an accountant would deem that effort necessary), of course, is not for the Court to decide. This simply suggests that there is an explanation—one not found in the record—for why the parties may have structured this aspect of their dispute resolution methodology as they did.

[32] This case, in large measure, resembles *OSI Systems, Inc. v. Instrumentarium Corp.*, 892 A.2d 1086 (Del. Ch. 2006), where the parties disagreed over whether arbitration of disputes based on claims of misrepresentation should be resolved through the closing adjustment arbitration process before the independent accounting firm or through what the court characterized as legal arbitration, a process similar to that adopted by the parties in the Merger Agreement through the AAA. The Court concluded, based on both the terms of the controlling agreement and the policies suggesting that misrepresentation claims should be resolved, given their very nature, by legal arbitration, that the accounting firm was not the appropriate forum. In *OSI Systems*, however, there was no provision comparable to the last sentence of Section 7.3(c)(iii) of the Merger Agreement, which, of course, provides that when disputes involving misrepresentation which could be either before the Settlement Accountant or the AAA, the dispute would be resolved by the Settlement Accountant. Thus, the logic of *OSI Systems* suggesting that legal arbitration or AAA arbitration would inherently make more sense does not control here because the Court must honor the express written agreement of the parties. *Cf. id.* at 1094 n.22 (recognizing that the policy favoring arbitration does not supersede basic principles of contract interpretation and noting that "[t]his holds equally true when sophisticated parties decide on a scheme of dispute resolution that directs certain claims to one type of arbitration and other claims to a second type of arbitration"); *Mehiel v. Solo Cup Co.*, 2005 WL 3074723, at *3 (Del. Ch. Nov. 3, 2005) (declining to substitute its judgment for the parties' to an agreement that did not restrict a party's election of either arbitration forum).

[33] The conclusion does not render illusory the duty to arbitrate misrepresentation claims under Section 7.4 of the Merger Agreement. For example, that provision would, presumably, apply to misrepresentations uncovered after completion of the final accounting work.

E. *Matria's Fraud Claims*

In Counts IV and V of its Verified Complaint, Matria brings fraud and equitable fraud claims against Coral—not for Coral's conduct—but for the conduct of CorSolutions and the Stakeholders whom Coral was established to represent. Coral has moved to dismiss these claims because: (1) under the Merger Agreement, they must be arbitrated and (2) the Verified Complaint fails to allege fraud with the particularity required by Court of Chancery Rule 9(b).

By Section 9.7, the Merger Agreement, "[f]or the avoidance of doubt," provides that "except for claims for specific performance . . . any claims arising out of [the Merger] Agreement or the breach, termination or validity thereof, shall be finally and exclusively determined by arbitration in accordance with [the various arbitration provisions of the Merger Agreement]."[34] The fraud claims which Matria seeks to bring in this Court clearly "aris[e] out of [the Merger Agreement]."[35] To allow litigation between Matria and Coral (especially because Coral is before the Court as the representative of the Stakeholders with respect to Matria's claims to the Escrow Fund and not, at least as alleged in the Verified Complaint, as an attorney-in-fact for individual Stakeholders against whom claims

[34] Unlike Section 7.4 of the Merger Agreement, the exception for specific performance is not accompanied by an exception for claims involving fraud.

[35] The concept of "arising out of" is a broad one. *See, e.g.*, *Country Life Homes, Inc.*, 2007 WL 333075, at *4.

might, at least theoretically, have been asserted) Matria has brought its fraud claims in the wrong forum.

Matria points to the exclusive remedy portion of Section 7.3 of the Merger Agreement which provides in pertinent part:

> (iv) Exclusive Remedy. The parties agree that except for any claims seeking injunctive specific performance or other equitable relief . . . and except for claims involving fraud, from and after the Closing, the right to make a claim on the Escrow Fund provided for in this Article VII pursuant to the provisions of this Article VII . . . shall be the exclusive remedy of [Matria] . . . for any breach of or inaccuracy in any representation or warranty or any non-compliance with or breach of or default in the performance of any of the covenants or agreements contained in this Agreement . . . [Matria] shall [not] be entitled to a rescission of this Agreement or to any indemnification or other rights or claims of any nature whatsoever in respect thereof, all of which . . . [Matria] hereby irrevocably waive[s].[36]

[36] Merger Agmt. § 7.3(d)(iv). The language is less than clear. First, does the phrase "from and after the Closing" modify "claim involving fraud" or "the right to make a claim"? Second, does it encompass conduct at the closing or is it intended to be limited to those acts following the closing? Because the alleged misrepresentations were "updated" to the time of Closing, they also occurred "from" the closing. If "from" is construed to mean "subsequent to," then such an interpretation would render unnecessary the word "after" and fail to give it any independent substance. If one reads the phrase alone, it could modify either fraud or the right to bring a claim. The answer is provided by Section 7.1 of the Merger Agreement which provides: "From and after the Closing Date . . . , [Matria] shall be entitled to make a written claim against the Escrow Fund . . . ." The use of "from and after the closing" in a similar context in another section within the same article suggests that the drafters would have given it comparable meaning in both places. That suggests that phrase attaches to the right to make a claim. The question, of course, is not free from doubt because, before Closing, there was no Escrow Fund from which to seek payment. Thus, in a sense, the phrase adds little. Fortunately, although this has been a matter of debate between the parties, it is not critical to the resolution of the pending motion.

One might look to the language involving an exception for "claims involving fraud" and draw the conclusion that the parties intended to exclude fraud claims from the arbitration provisions. A comprehensive reading of the exclusive remedy provision, however, reveals that the exclusion for fraud is not to deprive a party of the right to arbitrate the fraud claim or, indeed, for Matria to seek relief from the Escrow Fund.[37] The "claims involving fraud" language ultimately modifies the scope of the waiver of various claims, including certain breaches of representation or warranty. That is the overriding purpose of this subsection. This reading is also consistent with Section 7.3(d)(ii) which provides that: "any claim or cause of action against any of the parties [to the Merger Agreement], or any of their respective directors, officers, employees . . . or representatives based upon, directly or indirectly, any of the representations or warranties, covenants or agreements contained in this [Merger Agreement] . . . may be brought only as expressly provided in this Article VII." In short, the parties have agreed that misrepresentation claims, regardless of whether they are serious enough to be characterized fairly as fraud, are to be resolved in the arbitration forum and not before a court.

Accordingly, because the relief sought in Counts IV and V of the Verified Complaint against the Escrow Fund established by the Merger Agreement must be

[37] Whether Matria's fraud claims are limited to the Escrow Fund is a question for the arbitrator.

brought in accordance with the parties' agreement to arbitrate, Counts IV and V do not state a claim upon which relief can be granted and, therefore, must be dismissed.[38]

## IV. CONCLUSION

For the foregoing reasons, Matria and Coral must arbitrate the dispute growing out of the Customer's concerns before the Settlement Accountant and not the AAA. In addition, Matria's claims asserted in this venue for fraud must be dismissed. Counsel are requested to confer and to submit a form of order to implement this Memorandum Opinion.

[38] With this conclusion, it is unnecessary to consider whether Matria's allegations of fraud satisfy Court of Chancery Rule 9(b).