IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

TWA RESOURCES., formerly known as APPALACHIAN WELL SERVICES, INC., a Pennsylvania corporation,	)	
Plaintiff,	)	C.A. No. N11C-08-100 MMJ CCLD
v.	)	
COMPLETE PRODUCTION SERVICES, INC., a Delaware corporation and AWS, INC., a Delaware corporation,	)	
Defendants.	)	

Submitted: March 4, 2013
Decided: March 28, 2013

On Defendants' Motion for Summary Judgment
DENIED

MEMORANDUM OPINION

Joseph C. Schoell, Esquire, Drinker, Biddle & Reath, Wilmington, Delaware, Attorneys for Plaintiff

Seth A. Niederman, Esquire, Fox Rothschild LLP, Wilmington, Delaware, Daniel F. Shank (Argued), James A. Collura, Jr., Houston, Texas, Attorneys for Defendants

JOHNSTON, J.

STATEMENT OF FACTS[1]

Background of the Parties and the Transaction

Appalachian Well Services, Inc. ("Appalachian") was founded by Jackie Albert ("Albert") and Douglas Henson ("Henson") in 1987. In 2006, Appalachian acquired Titan Wireline Service, Inc. ("Titan"). Appalachian was an oil field services company in the business of performing fracturing and cementing services related to oil and natural gas extraction. Through its subsidiary, Titan, Appalachian also supplied coiled tubing, perforation, and logging services in the Allegheny Plateau region of the northern Appalachian Basin.

Within the last decade, developments in technology have led to increased interest by the oil and gas industry in the Appalachian Basin, due to deposits of natural gas located in the Marcellus Shale. The Marcellus Shale[2] is a large geographic formation that stretches from Ohio and West Virginia into Pennsylvania and Southern New York, and contains large quantities of natural gas. Due to the depth and tightness of the shale, however, it was cost-prohibitive to exploit these deposits until recently. Developments and advancements in drilling technology,

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1 The facts are set forth in the light most favorable to the non-moving party - Plaintiff TWA Resources, Inc.

2 For purposes of clarity, in this opinion, the term "Marcellus Shale" will be used to refer to the area also variously defined in the relevant documents as the "Appalachian region" or the area encompassing the states of Pennsylvania, Ohio, West Virginia and New York.

specifically horizontal drilling and high pressure, multi-stage hydraulic fracturing (often called "fracking" or "fracing"),[3] have made access to these large deposits of natural gas more cost-efficient.

Prior to 2008, Appalachian engaged in "shallow market" fracturing, performing fracturing jobs in formations located at a shallower depth than the Marcellus Shale. Appalachian was unable to exploit the deposits located in the deeper shale without more powerful equipment. Appalachian sought a potential partner with whom to explore fracking in the Marcellus Shale, and approached Complete Production Services, Inc. ("CPX"). In 2008, Henson contacted Adam Zylman of SCF Partners,[4] who referred Henson to Jose Bayardo. At the time, Bayardo was Vice President of Corporate Development for CPX.[5] During the discussions with CPX, Henson sent financial information regarding Appalachian to Bayardo. Included within this financial information was a *Pro Forma* containing Henson's speculative forecast. Appalachian's and Titan's various expenses and sources of revenue for years 2008-2012.

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3 Fracking involves pumping fluids into formations of rock, thereby creating a conduit through which natural gas can flow, enabling larger quantities to be extracted more easily.

4 At the time, SCF Partners was the largest shareholder of CPX.

5 Bayardo became Chief Financial Officer of CPX in October 2008.

In early June 2008, CPX made a presentation to Albert and Henson summarizing the benefits of a transaction between CPX and Appalachian. CPX purported to have significant hydraulic fracturing assets, as well as relationships with large customers who expected to develop oil and gas resources in the Marcellus Shale. During the presentation, these assets and customers were presented as CPX assets and customers. CPX further indicated that its objective for a transaction with Appalachian would be to establish a strong platform for CPX in the Marcellus Shale, as well as to expand Appalachian's service offerings. To realize this goal, CPX proposed in its presentation that Appalachian's principals - Henson and Albert - would assume the responsibility for developing CPX's business in the Marcellus Shale. CPX would support the business by providing capital expenditures, technical expertise, and access to established relationships with parties entering the Marcellus Shale market.

Letter of Intent and Asset Purchase Agreement

The parties negotiated a letter of intent ("LOI") that was finalized in early August 2008. CPX created a wholly-owned subsidiary, AWS, Inc. ("AWS"). Under the terms of the LOI, AWS (the buyer) acquired the assets of Appalachian (including Appalachian subsidiary Titan). Appalachian (the seller) became known as TWA Resources, Inc. ("TWA").

AWS agreed to pay $48 million in cash, $12 million in CPX common stock with value determined based upon an average fifteen days' trading prices at closing, and up to $5 million in contingent consideration. The combined maximum consideration was $65 million. Additionally, AWS agreed to pay $8.2 million of the $12 million purchase price for the Marcellus high pressure frac fleet.[6]

The $5 million contingent consideration was subject to certain performance targets for CPX's Marcellus Shale business as calculated from the time of the transaction through December 31, 2010. ***First***, TWA would receive a Milestone Payment of a maximum of $1 million if the earnings before interest, taxes, depreciation, and amortization ("EBITDA") from e-line operations exceeded $4 million per year during 2009 or 2010. ***Second***, TWA would receive a Milestone Payment of a maximum of $3 million if "Pressure Pumping and Coiled Tubing Operations" generated EBITDA of $14 million or more over any consecutive twelve-month period during 2009 and 2010. ***Third***, TWA would receive an additional $1 million Milestone Payment if certain targets were achieved in "New Services Lines."[7]

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6 A "frac fleet" is a number of pump trucks, sand haulers, manifolds, and other equipment necessary to conduct fracking.

7 "New Services Lines" include: services, capital requirements, and targets to be agreed upon during the development of an integration and growth plan.

On October 4, 2008, the parties executed the Asset Purchase Agreement (the "APA") and the transaction closed. Albert and Henson became Vice Presidents of AWS, which began operating as a division of CPX. In these roles, Albert and Henson reported to Brian Moore, President of AWS and President and Chief Operating Officer of CPX.

Section 2.05 of the APA contained the same terms relating to earn-outs (or Milestone Payments) and Growth Oriented Capital Expenditures as were included in the LOI. For Pressure Pumping and Coiled Tubing Operations, TWA is entitled to an earn-out of up to $3 million - governed by a stated formula - if EBITDA for the operations is in excess of $14 million over a consecutive twelve-month period. TWA is entitled to the maximum earn-out of $3 million if EBITDA from Pressure Pumping and Coiled Tubing Operations reaches $20 million for a consecutive twelve-month period. The minimum EBITDA threshold for an earn-out and the maximum EBITDA cap subject to an earn-out were to be adjusted based on investment by CPX in "Growth Oriented Capital Expenditures" related to AWS's operations. If EBITDA were not in excess of the minimum EBITDA threshold, however, no Milestone Payment would be owed.

The APA also provided an additional earn-out of up to $1 million through the offering of new services in the Marcellus Shale. By the terms of the APA, both

parties were required to negotiate in good faith concerning a "New Services Milestone." If the parties could not reach an agreement, however, the APA included a "fall back" whereby the New Services Milestone would be calculated as a proportion of the other two earn-outs paid or payable.

Section 2.05(d) of the APA required Buyer to deliver a Milestone Statement detailing the calculation of the Milestone Payments to Seller prior to March 1, 2010 and 2011. Following delivery of the Milestone Statement, Seller had ten business days to deliver a disagreement statement. If the parties are unable to negotiate a final determination of appropriate Milestone Payments, they must jointly select an independent auditor of recognized national standing to resolve any disagreement concerning the calculations of the Milestone Payments.

Post-Closing Actions of CPX and AWS

Section 6.02(a) of the APA contains a covenant whereby TWA, Titan and their shareholders agree not to perform fracing services in the Marcellus Shale. The employment agreements entered into by Albert and Henson, in their roles as Vice Presidents of AWS, contain similar covenants not to compete. These covenants only prohibit TWA and its shareholders - Albert and Henson - from competing with AWS. The agreements do not contain reciprocal language explicitly prohibiting CPX, or any division of CPX such as Pumpco, from

competing with AWS in the Marcellus Shale high pressure fracing business. The employment agreements also permit AWS to either reassign Albert and Henson to work with any subsidiary or affiliate of AWS engaged in the business of AWS, or to terminate Albert's and/or Henson's employment at will.

Pumpco is a wholly-owned subsidiary of CPX[8] and operates as a division of CPX. During the course of the negotiation and ultimate approval of the LOI and APA, Pumpco had been attempting to establish relationships with customers, and was bidding for contracts to perform fracing services in the Marcellus Shale.

During 2009, AWS was able to perform only three fracing jobs. On two of the three jobs, serious complications occurred. The first job began in January 2009, and was a two-stage fracing job for XTO Energy. During this job, a joint of pipe ruptured causing an "iron failure."[9] Following the iron failure, AWS was unable to secure additional work from XTO Energy. In July and November of 2009, AWS secured multi-stage frac jobs with East Resources. On the November

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8 Pumpco is wholly-owned by Integrated Production Services, Inc., which in turn is wholly-owned by CPX.

9 An iron failure occurs when a piece of metal tubing ruptures or explodes under high pressure. Iron failures are considered catastrophic events in the oil and gas industry, as flying iron shrapnel can cause extensive equipment damage and personal injury.

2009 job, AWS suffered its second iron failure, which led to serious injuries to multiple employees and an OSHA investigation.

In September 2009, CPX transferred a Pumpco high pressure pumping frac fleet from Texas to the Marcellus Shale in Pennsylvania. This fleet performed five frac jobs throughout the remainder of 2009. Gross revenues were $4,426,000.00. In November 2009, CPX transferred AWS's high pressure frac fleet to Texas. Albert and Henson both agreed to this transfer. After being transferred to Texas, the AWS fleet was broken up and used to supplement Pumpco's other operations. Shortly after the transfer, Mark Songer, then-President of Pumpco, estimated that Pumpco would require from one and one-half fleets, to three fleets in the Marcellus Shale for 2010.

Dispute over Calculation of 2009 Milestone Payment

In December 2009, Moore proposed that the New Services Milestone be calculated as EBITDA for the 2010 plans of CPX's affiliates operating in the Marcellus Shale. Henson rejected this proposal, and instead suggested that the New Services Milestone be based on a $0 EBITDA threshold. Further, Henson rejected both a proposal to reduced EBITDA based on the value of the AWS equipment transferred from the Marcellus Shale to Texas, as well as a proposal to include EBITDA from Pumpco's high pressure pumping frac work in the Marcellus Shale for

the purpose of calculating a milestone. On January 15, 2010, Albert and Henson were terminated from AWS. Songer, the former President of Pumpco, became President of AWS.

CPX delivered a Milestone Statement for 2009 on February 26, 2010, accompanied by a cover letter from Bayardo. The 2009 Milestone Statement included all Pumpco revenue and EBITDA from the Marcellus Shale in calculating the earn-out. For 2009, CPX calculated a Pressure Pumping and Coiled Tubing Threshold of $15,466,895, and a Pressure Pumping and Coiled Tubing Cap of $21,466,895. Because CPX did not have a positive EBITDA from Pressure Pumping and Coiled Tubing Operations for 2009, CPX determined that it did not owe an earn-out.

Additionally, because no New Services Milestone had been agreed upon by the parties, CPX contended that the New Services Milestone should be calculated based upon the default formula contained in Section 2.05(c) of the APA, which would result in no Milestone Payments for new services. On March 12, 2010, TWA sent a Disagreement Statement to CPX, pursuant to Section 2.05(d) of the APA, challenging certain aspects of the 2009 Milestone Statement.

On May 4, 2010, the parties met in an attempt to resolve the disagreement regarding the Milestone Payment for 2009, but were ultimately unsuccessful. CPX then proposed that an independent auditor be selected to review the matter pursuant

to Section 2.05(e) of the APA. TWA rejected this proposal.

Dispute over Calculation of 2010 Milestone Payment

Throughout 2010, CPX added three additional frac fleets to the Marcellus Shale in response to improving economic conditions and growing demand. For 2010, CPX's fracking operations in Pennsylvania earned in excess of $100 million in revenue, and EBITDA of $34 million. In initially preparing the 2010 Milestone Statement, CPX included the results of Pumpco's entire operation in the Marcellus Shale, as CPX had done when it prepared the 2009 Milestone Statement. With EBITDA calculated for combined operations for 2010 year as $34 million, TWA would have been entitled to the maximum Pressure Pumping and Coiled Tubing earn-out payment of $3 million. Bayardo determined, however, that Pumpco assets should not be included for the 2010 Milestone Statement. Therefore, EBITDA earned solely by AWS would be $0.3 million. Under this approach, EBITDA had not met the minimum threshold, and TWA was not entitled to any earn-out payment.

As an alternative method of calculation, Bayardo proposed the "replacement fleet" calculation. Under this approach, CPX would include revenue from the first Pumpco fleet deployed to the Marcellus Shale in 2009, but would not include any additional Pumpco operations. This approach was fair, argued CPX, since at the time of the APA, AWS only had a single frac fleet. To give Plaintiff credit for multiple

Pumpco fleets would be to give TWA credit for operations it had not achieved. In response, TWA argued that the various Pumpco assets in the field were working on the same project and, therefore, were inseparable.

The parties attempted to mediate this dispute in July 2011, but were unsuccessful. TWA brought this action claiming breach of the APA, and breach of the implied covenant of good faith and fair dealing, by CPX and AWS. TWA asserts that CPX and AWS refused to pay earn-outs mandated under the APA.

Following discovery, Defendants CPX and AWS moved for summary judgment. Defendants argue that they are entitled to judgment as a matter of law, pursuant to Delaware Superior Court Civil Rule 56(c), because no facts support the application of the implied covenant of good faith and fair dealing.

ANALYSIS

Summary Judgment Standard of Review

Summary judgment is granted only if the moving party establishes that there are no genuine issues of material fact in dispute and judgment may be granted as a matter of law.[10] All facts are viewed in a light most favorable to the non-moving

[10] Super. Ct. Civ. R. 56(c).

party.[11] Summary judgment may not be granted if the record indicates that a material fact is in dispute, or if there is a need to clarify the application of law to the specific circumstances.[12] When the facts permit a reasonable person to draw only one inference, the question becomes one for decision as a matter of law.[13] If the non-moving party bears the burden of proof at trial, yet "fails to make a showing sufficient to establish the existence of an element essential to that party's case," then summary judgment must be granted against that party.[14]

Parties' Contentions

Defendants CPX and AWS argue that the implied covenant of good faith and fair dealing is not triggered because TWA lacked any reasonable expectation at the time of contracting: that AWS would be the only CPX affiliate performing high pressure pumping frac jobs in the Marcellus Shale high pressure pumping market; or that AWS would be in charge of all of CPX's high pressure pumping frac operations in that market. Additionally, the APA does not restrict any CPX division from

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11 *Hammond v. Colt Indus. Operating Corp.*, 565 A.2d 558, 560 (Del. Super. 1989).

12 Super. Ct. Civ. R. 56(c).

13 *Wootten v. Kiger*, 226 A.2d 238, 239 (Del. 1967).

14 *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

providing services in the Marcellus Shale similar to those performed by AWS, or from transferring the AWS frac fleet to Texas.

Defendants also contend that the implied covenant is not triggered by the alleged failure to negotiate a New Services Milestone. Further, a covenant cannot be implied because the undisputed facts demonstrate that CPX did not act arbitrarily or unreasonably. Finally, the APA requires that TWA's allegations - that CPX improperly valued the assets and manipulated the accounting in connection with the 2010 Milestone Statement - must be addressed by an independent auditor.

TWA responds that it has offered substantial evidence that Defendants breached the implied covenant of good faith and fair dealing. At least, when viewing the record in the light most favorable to the non-moving party, TWA has raised genuine issues of material fact. These issues include: whether TWA reasonably anticipated that CPX would compete against AWS through CPX's other subsidiaries; whether CPX acted in contravention of its assurances that CPX would use its resources to assist AWS in entering the Marcellus Shale frac market; whether the parties' intention in drafting the APA was to include Pumpco EBITDA in the milestone payment calculations; and whether Defendants breached the APA by failing to negotiate a New Services Milestone.

Implied Covenant of Good Faith and Fair Dealing

The purpose of implying a covenant of good faith and fair dealing is to "honor the parties' reasonable expectations" under the contract.[15] Nevertheless, Delaware courts "will only imply contract terms when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected."[16] "This implied covenant is a judicial convention designed to protect the spirit of an agreement when, without violating an express term of an agreement, one side uses oppressive or underhanded tactics...."[17]

The covenant "is not an equitable remedy for rebalancing economic interests after events that could have been anticipated, but were not, that later adversely affected one party to a contract. Rather the covenant is a limited and extraordinary legal remedy."[18] There may be a breach of the implied covenant

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[15] *Dunlap v. State Farm Fire & Cas. Co.,* 878 A.2d 434, 447 (Del. 2005).

[16] *Nemec v. Shrader,* 991 A.2d 1120, 1126 (Del. 2010).

[17] *Chamison v. Healthtrust, Inc.,* 735 A.2d 912, 920 (Del. Ch. 1999), *aff'd*, 748 A.2d 407 (Del. 2000).

[18] *Nemec,* 991 A.2d at 1128.

without violating an express term of the contract.[19] However, the covenant will not be implied "to give plaintiffs contractual protections that they failed to secure for themselves at the bargaining table."[20]

Questions of Law

Was the APA Modified?

TWA argues that even if the APA's earn-out provisions, as originally drafted, are found to be limited solely to AWS operations, Defendants nevertheless should be bound by their "repeated commitments to [TWA] that Pumpco's Appalachian region revenue would be included in the milestone determination." TWA claims that the parties reached an independent, enforceable agreement about how the milestones would be computed. Then in February 2011, CPX "abruptly changed course and breached that agreement."

TWA bases this argument on evidence including the following.

(1) In an email dated December 21, 2009, CPX President and Chief Operating Officer wrote: "[T]he following reflects my view of how the milestone payments should be treated in accordance with the [APA]: Pressure Pumping Milestones All CPX pressure pumping and

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[19] *PAMI-LEMB I Inc. v. EMB-NHC, LLC,* 857 A.2d 998, 1016 (Del. Ch. 2004).

[20] *Winshell v. Viacom Int'l, Inc.,* 55 A.3d 629, 636-37 (Del. Ch. 2011).

coiled tubing operations in the Northeast (PA, NY, WVA, etc.) are subject to Section 2.05(b) including Pumpco pressure pumping operations and IPS coiled tubing operations."

(2) The 2009 Milestone Statement delivered February 26, 2010 provides: "Since [the AWS fleet] was removed from AWS, CPX will allow the performance of its other subsidiary's pressure pumping operations (Pumpco) in the Appalachian region to count toward potential milestone payments."

(3) In an email dated January 5, 2011, CPX's Bayardo stated: "In order to comply with the reporting requirements associated with the [APA], over the next several weeks, we will need to compile information associated with all of our operations in the Appalachia region."

(4) The CPX officer who calculated the Milestone Payments due under Section 2.05, used the same methodology to prepare both the 2009 and 2010 Milestone Statements. However, contrary to the officer's calculations, the 2010 Milestone Statement sent to TWA did not include all CPX activities in the Appalachian region, which would have resulted in an earn-out payment of $3.75 million.

The party relying upon oral modification of a written contract must prove the change with "specificity and directness as to leave no doubt of the intention of the parties to change what they previously solemnized by formal document."[21] An oral modification has the same requirements as a written agreement - mutual agreement and consideration.[22]

It is clear to the Court that there was no mutual agreement to modify the APA on this issue. TWA claims that CPX made certain representations throughout December 2009 that Pumpco's EBITDA from high pressure pumping Marcellus Shale frac operations would be included in Milestone Payment calculations. A CPX employee used the same calculations for the 2009 and 2010 Milestone Statements. Nevertheless, the CPX officers, who made the final decision, issued the 2010 Milestone Statement without including Pumpco's EBITDA. Additionally, TWA issued a "Disagreement Statement" in response to the 2009 Milestone Statement. Correspondence during 2010 reflects that TWA disputed the calculation methodology.

The record demonstrates that the earn-out calculations were subject to dispute from at least the time TWA issued the Disagreement Statement. There

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[21] *Cont'l Ins. Co. v. Rutledge & Co., Inc.,* 750 A.2d 1219, 1230 (Del. Ch. 2000).

[22] *Id.* at 1232.

was never a meeting of the minds sufficient to constitute the mutual agreement and specificity required for oral modification of a written contract. TWA has failed to present a *prima facie* case for the existence of an independent, enforceable agreement about milestone computation.

Is Section 2.05(c) of the APA Enforceable?

Section 2.05(c) of the APA provides in part:

> (c) New Services Offering. Buyer and Sellers shall negotiate in good faith to agree upon an additional milestone relating to new service offerings of the Business (the "*New Services Milestone*") no later than December 31, 2009. The New Services Milestone, if any, shall provide for a maximum milestone payment of $1.0 million. If the parties do not reach an agreement on the New Services milestone by December 31, 2009, then, in lieu of a new Services Milestone, Buyer shall pay to Sellers [amounts calculated according to the provided formula].

TWA argues that Defendants breached the APA by failing to negotiate a New Services Milestone, as required by Section 2.05(c). TWA claims that CPX simply decided that it would not comply with Section 2.05(c). In an email dated October 9, 2009, a CPX officer stated:

> Regarding the earn-out/milestone payments, there is provision 2.05.c giving us until 12/31/2009 to negotiate a "new Services" milestone OR have $1 million prorated based on the other milestone payments. I'd [sic] don't intend to establish a new services milestone and don't

> think we need to do anything to conform to PA requirements regarding this provision.

Defendants assert that CPX did attempt to negotiate in good faith regarding the New Services Milestone. CPX proposed that the New Services Milestone be EBITDA for the 2010 Plans of CPX's affiliates with operations in the Marcellus Shale territory. However, TWA rejected this proposal and offered a counterproposal.

Defendants contend that Section 2.05(c) is unenforceable because it constitutes an "agreement to agree in the future without any reasonably objective controlling standards provided."[23] TWA counters that an agreement to negotiate in good faith is enforceable under Delaware law.[24]

The Court finds that an express agreement to negotiate in the future, in good faith, is enforceable. Nevertheless, TWA has not requested any specific relief based on Defendants' alleged breach of Section 2.05(c). Therefore, the Court need not decide any Section 2.05(c) issues at this juncture. It is clear that no New Services Offering agreement was reached. Depending on the resolution of other issues in this case, the default provision of Section 2.05(c) may apply.

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[23] *Hammond & Taylor, Inc. v. Duffy Tingue Co.,* 161 A.2d 238, 239 (Del. Ch. 1960).

[24] *PharmAthene, Inc. v. SIGA Techs., Inc.,* 2011 WL 4390726, at *2 (Del. Ch.).

Is the APA Ambiguous?

Section 2.05(b) provides that if, during a defined period of time the "Pressure Pumping and Coiled Tubing Operations generate EBITDA" and exceed certain thresholds or caps, Sellers shall be entitled to Milestone Payments. The APA defines "Pressure Pumping and Coiled Tubing Operations" as "the pressure pumping and coiled tubing operations of Sellers." "Sellers" are Appalachian Wells Services, Inc. and Titan Wireline Service, Inc.

TWA argues that the parties contemplated that the operations used to reach milestones would include "Growth Oriented Capital Expenditures" to augment operations transferred to AWS. Because "Sellers" had no operations during the earn-out period, the APA is ambiguous. Thus, TWA contends, summary judgment is inappropriate.

Defendants assert that the "Pressure Pumping and Coiled Tubing Operations" "look only to operations of AWS, not anyone else." During negotiation of the APA, the parties contemplated separating operations into categories including: non-Marcellus stimulation operations, Marcellus stimulation operations, "Shallow Markets," and "Marcellus Markets." Having elected to omit these designations from the APA, Defendants argue that TWA lacked any

reasonable expectation that it would have operational control in the Marcellus Shale market.

The question is: what happens when there are no "Seller" "Pressure Pumping and Coiled Tubing Operations" in the Marcellus Shale? The Court finds that the APA is silent on this question.

Silence in a contract does not necessarily create ambiguity. Provisions not included in an agreement are not the equivalent of ambiguous terms. However, the parties' course of performance "may be used to aid a court in interpretation of an ambiguous contract, [or] it may also be used to supply an omitted term when a contract is silent on an issue."[25] The Court concludes that the APA is not ambiguous on this issue.

Is There a Gap in the APA That Must be Filled, by the Implied Covenant of Good Faith and Fair Dealing, to Achieve the Reasonable Expectations of the Parties?

"The implied covenant of good faith and fair dealing involves a 'cautious enterprise,' inferring contractual terms to handle developments or contractual gaps that the asserting party pleads neither party anticipated."[26] If the conduct at issue

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[25] *In re Mobilactive Media, LLC,* 2013 WL 297950, at *16 n.195 (Del. Ch.) (quoting *City of Wilmington v. Wilmington FOP Lodge #1,* 2004 WL 1488682, at *7 (Del. Ch.) (citing Restatement (Second) Of Contracts § 223 & cmt. b. (1979))).

[26] *Nemec v. Shrader,* 991 A.2d 1120, 1125 (Del. 2010) (citing *Dunlap v. State Farm Fire & Cas. Co.,* 878 A.2d 434, 441 (Del. 2005); *Cincinnati SMSA Ltd. P'ship v. Cincinnati Bell*

is authorized by the agreement, the covenant will not be implied. Contract terms only will be added "when the party asserting the implied covenant proves that that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain...."[27]

The contracting parties' reasonable expectations at the time of contracting control the analysis. Agreements cannot be judicially revised to assist parties who later discover that they have made a disadvantageous deal. "The implied covenant only applies to developments that could not be anticipated, not developments that the parties simply failed to consider...."[28]

In *O'Tool v. Genmar Holdings, Inc.,*[29] the United States Court of Appeals for the Tenth Circuit applied Delaware law to an analogous set of facts. The plaintiffs in *O'Tool* sold a boat manufacturing business, and a portion of the sale price was earn-out consideration. Plaintiffs claimed that the buyer's conduct frustrated plaintiffs' ability to realize an earn-out. Buyer's disputed conduct

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Cellular Sys. Co., 708 A.2d 989, 992 (Del. 1998); *E.I. DuPont de Nemours & Co. v. Pressman,* 679 A.2d 436, 443 (Del. 1996)).

[27] *Nemec,* 991 A.2d at 1126.

[28] *Id.*

[29] 387 F.3d 1188 (10th Cir. 2004).

included renaming and then discontinuing plaintiffs' brand of boats, removing plaintiffs from operational control of the business, shifting operations to a different product line, and shutting down facilities.[30]

The *O'Tool* defendants argued that their actions were expressly contemplated and permitted by the relevant agreements. The Tenth Circuit rejected defendants' assertions. Instead, the *O'Tool* Court found in part: the buyers' restructuring of production priorities was not expressly contemplated in the contract; the spirit of the agreement was to give plaintiffs a fair opportunity to maximize earn-out consideration; nothing in the contract expressly prevented buyer from shutting down facilities; and there was evidence that buyer intended to prevent seller from entitlement to earn-out by acting with a dishonest purpose and an ulterior motive to remove a potentially significant competitor from the market. Viewing the agreement as a whole, the Tenth Circuit affirmed the jury's award of damages to plaintiffs under the implied covenant of good faith and fair dealing.[31]

As this Court previously has found in this opinion, there is silence in the APA as to earn-out consideration under the circumstances alleged by TWA. This

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[30] *Id.* at 1191-95.

[31] *Id.* at 1196-97.

silence constitutes a gap in the APA. The question to be answered by the jury is whether TWA can prove that Defendants have acted arbitrarily or unreasonably, thereby frustrating the parties' reasonable expectations at the time of executing the APA.[32] In making this determination, the jury must consider whether this case involves developments that could not have been anticipated, rather than developments that the parties simply failed to consider.[33]

Therefore, the Court finds that TWA has established a *prima facie* case for application of the implied covenant of good faith and fair dealing. Summary judgment must be denied.

Genuine Issues of Material Fact

In order to determine whether a covenant of good faith and fair dealing should be implied, and if so, what such a covenant should entail, the jury must decide a number of genuine issues of material fact.

What Were the Reasonable Expectations of the Parties to the APA?

In order to augment the APA through the implied covenant of good faith and fair dealing, TWA first must prove that Defendants' conduct frustrated the

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[32] *Nemec,* 991 A.2d at 1126.

[33] *Id.*

reasonable expectations of the parties to the APA.[34] The jury must consider whether the events affecting calculation of the earn-out were developments that could not have been anticipated, or whether these were developments that the parties simply failed to consider.[35]

TWA has proffered a *prima facie* case on this issue, including the following:

- CPX made certain statements prior to entering into the APA that indicate that CPX intended to use best efforts to expand CPX Marcellus Shale business through AWS.

- The 2009 Milestone Statement, provided by Defendants, states:

> In December of 2009 CPX moved the Marcellus Frac Spread from the Appalachia region to Texas. Since this group of assets was removed from AWS, CPX will allow the performance of its other subsidiary's pressure pumping operations (Pumpco) in the Appalacian region to count toward potential milestone payments.

- All operations in the Marcellus Shale were included in the initial calculations of the 2010 earn-out provisions.

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[34] *Dunlap v. State Farm Fire & Cas. Co.,* 878 A.2d 434, 442 (Del. 2005).

[35] *Nemec,* 991 A.2d at 1126.

- Correspondence among the parties indicates ongoing discussions about whether, in light of the transfer of AWS equipment to Texas, Pumpco revenue in the Appalachian region should be counted toward earn-out.

- Correspondence suggests that the events leading to the decision to transfer the AWS equipment were not anticipated at the time the APA was executed.

- The Disagreement Statement with regard to the 2009 Milestone Statement documents TWA's continued position that the earn-out calculations did not include revenues consistent with the parties' intentions to fairly compensate TWA through earn-out.

Defendants vehemently dispute (along with other factual issues) that TWA reasonably could have expected at the time of contracting: that AWS would be the only CPX affiliate performing high pressure pumping frac jobs in the Marcellus Shale; or that AWS would be in charge of all of CPX's high pressure pumping frac operations in that market. Additionally, the terms of the APA: did not restrict CPX or any of its divisions from participating or providing services in the Marcellus Shale similar to those provided by AWS; and did not prohibit the transfer of the AWS high pressure pumping frac fleet to another territory. Therefore, Defendants conduct could not have frustrated the reasonable expectations of TWA.

The jury will have to resolve these issues.

Was Defendants' Conduct Arbitrary and Unreasonable?

If TWA succeeds in demonstrating that its reasonable expectations under the APA have been thwarted, in order to benefit from the implied covenant of good faith and fair dealing, TWA next must prove that Defendants have acted arbitrarily or unreasonably.[36]

Questions of material fact include: whether in response to economic realities CPX acted reasonably in transferring ASW equipment out of the Marcellus Shale; whether CPX acted reasonably in allegedly preventing ASW management from maximizing its profitability; whether CPX was reasonable in allegedly competing against AWS through CPX's other subsidiaries; whether CPX acted in contravention of its alleged assurances that CPX would use its resources to assist AWS in entering and expanding AWS presence in the Marcellus Shale frac market; and whether Defendants' position in excluding Pumpco revenues from the 2010 earn-out calculations was arbitrary or unreasonable.

What Should be Included in the Calculation of Milestone Payments?

If TWA proves that CPX's Milestone Payment calculations are not consistent with the reasonable expectations of the parties to the APA; and also

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[36] *Nemec,* 991 A.2d at 1126.

demonstrates that Defendants have acted arbitrarily and unreasonably, the jury next must consider what should be included in the earn-out calculations.

The questions of fact on this issue for the jury are whether the following should be included in the Milestone Payment calculations: all CPX operations in the Marcellus Shale; all Pumpco operations in the Marcellus Shale; only the production of one fleet, to substitute for the single fleet transferred out of the region; or no operations because Seller's fleet was moved out of the Marcellus Shale.

Although the jury will determine what should be included or excluded from the calculations, the actual calculations must be performed according to the APA provisions. If the parties cannot agree on these calculations, the matter must be referred to the independent accountant auditor pursuant to Section 2.05(e) of the APA.

CONCLUSION

TWA has failed to present a *prima facie* case for the existence of an independent, enforceable agreement about milestone computation. The Court finds, as a matter of law, that the APA has not been modified in this respect.

Because TWA has not requested any specific relief based on Defendants' alleged breach of Section 2.05(c), the Court need not decide any Section 2.05(c) issues at this juncture.

The Court finds that the APA is silent on he question of what happens when there are no "Seller" "Pressure Pumping and Coiled Tubing Operations" in the Marcellus Shale. Silence, however, does not render the APA ambiguous. There is a gap in the APA as to earn-out consideration under the circumstances alleged by TWA. TWA has raised genuine issues of material fact as to whether Defendants have acted arbitrarily or unreasonably, thereby frustrating the parties' reasonable expectations at the time of executing the APA. The Court finds that TWA has established a *prima facie* case for application of the implied covenant of good faith and fair dealing.

THEREFORE, Defendants' Motion for Summary Judgment must be **DENIED.**

IT IS SO ORDERED.

/s/ *Mary M Johnston*
The Honorable Mary M. Johnston