

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

LDC PARENT, LLC,)
)
 Plaintiff,)
)
 v.) C.A. No. N20C-08-127 MMJ CCLD
)
 ESSENTIAL UTILITIES, INC. f/k/a)
 Aqua America, Inc.,)
)
 Defendant.)
)
 _____)
)
 ESSENTIAL UTILITIES, INC. f/k/a)
 Aqua America, Inc.,)
)
 Counterclaim Plaintiff,)
)
 v.)
)
 LDC PARENT, LLC,)
)
 Counterclaim Defendant.)

Submitted: February 3, 2021

Decided: April 28, 2021

On Plaintiff's Motion for Judgment on the Pleadings

DENIED

Defendant's Cross-Motion for Judgment on the Pleadings

GRANTED IN PART

OPINION

Christopher N. Kelly, Esq., Kevin R. Shannon, Esq., Potter Anderson & Corroon LLP, Wilmington, Delaware, John E. Schreiber, Esq. (Argued), James P. Smith III, Esq., Winston & Strawn LLP, New York, New York, *Attorneys for LDC Parent, LLC.*

A. Thompson Bayliss, Esq. (Argued), Adam K. Schulman, Esq., Abrams & Bayliss LLP, Wilmington, Delaware, *Attorneys for Essential Utilities, Inc. f/k/a Aqua America, Inc.*

JOHNSTON, J.

FACTUAL AND PROCEDURAL CONTEXT

Parties

This case arises from a dispute over the calculation of a post-closing purchase price adjustment. Plaintiff/Counterclaim Defendant LDC Parent, LLC (“LDC” or “Seller”) is a Delaware limited liability company with its principal place of business in Wilmington, Delaware.¹ Defendant/Counterclaim Plaintiff Essential Utilities, Inc. (“Essential” or “Buyer”) is a Pennsylvania corporation with its principal place of business in Bryn Mawr, Pennsylvania.² LDC and Essential contractually agreed that Delaware would have personal jurisdiction over them for disputes arising out of the Purchase Agreement.³

The Parties Execute the Purchase Agreement

On October 22, 2018, the parties executed a Purchase Agreement whereby Essential agreed to purchase from LDC all of the issued and outstanding membership interests of LDC Funding, LLC, a Delaware limited liability company (the “Company”).⁴ The parties agreed to a base purchase price (“Base Price”) of \$4,275,000,000.00.⁵ However, this price could be adjusted after closing. Section 2.1(c)(i)(B) states that the Base Price shall be:

¹ Compl. ¶ 14.

² *Id.* ¶ 15.

³ *Id.* Ex. A § 11.10(a).

⁴ Compl. ¶ 1.

⁵ *Id.* Ex. A § 2.1(b)(i).

increased, dollar for dollar, by the total amount that actual aggregate Capital Expenditures, excluding any Commercial Growth Capex, by the Regulated Utility Subsidiaries from November 1, 2018 through the Measurement Time exceed the Budgeted Capital Expenditure Amount, or decreased, dollar for dollar, by the total amount that actual aggregate Capital Expenditures, excluding any Commercial Growth Capex, by the Regulated Utility Subsidiaries from November 1, 2018 through the Measurement Time are less than the Budgeted Capital Expenditure Amount for such period (a “Capital Expenditure Adjustment”).⁶

In other words, the Base Price will be adjusted upwards in favor of LDC if the actual Capital Expenditures exceeded the Budgeted Capital Expenditure Amount. Conversely, it will be adjusted downwards in favor of Essential if the actual Capital Expenditures were less than the budgeted amount. “Capital Expenditures” are defined in the Purchase Agreement as “out-of-pocket expenditures actually paid or payable (and, if payable, reflected as a current liability in Working Capital) by the Regulated Utility Subsidiaries that are properly capitalized in accordance with U.S. GAAP.”⁷

Under the terms of the Purchase Agreement, Essential has 45 days after closing to prepare, and deliver to LDC, a Preliminary Closing Adjustment Schedule reflecting its calculation of the value of any adjustments to the Base Price.⁸ LDC then has 45 days after receipt of Essential’s schedule to review the

⁶ *Id.* § 2.1(c)(i)(B).

⁷ *Id.* § 1.1.

⁸ *Id.* § 2.1(c)(ii).

specified amounts.⁹ LDC is required to notify Essential in writing of any objections to items on the Preliminary Closing Adjustment Schedule.¹⁰

In the event that LDC has any objections, the parties have 30 days to attempt to resolve the dispute.¹¹ If the parties cannot resolve their dispute, they “shall, within ten (10) days thereafter, cause the Independent Accounting Firm to promptly review [the] Agreement and the remaining Disputed Items for purposes of resolving the Disputed Items in accordance with [the] Agreement and calculating the Final Closing Adjustment Amount.”¹² The accountant’s decision shall be final and binding upon the parties.¹³

The Parties Disagree on the Post-Closing Price Adjustment

On April 29, 2020, Essential delivered to LDC a Preliminary Closing Adjustment Schedule.¹⁴ In the schedule, Essential deducted \$19,990,666 (the “Disputed Item”) from the calculation of the Company’s Capital Expenditures.¹⁵ On May 4, 2020, LDC asked Essential to “explain and provide support” for the deduction.¹⁶ Two weeks later, on May 20, 2020, LDC wrote to Essential a second

⁹ *Id.* § 2.1(c)(iii).

¹⁰ *Id.*

¹¹ *Id.* § 2.1(c)(iv).

¹² *Id.*

¹³ *Id.*

¹⁴ Compl. ¶ 4.

¹⁵ *Id.*

¹⁶ *Id.* ¶ 26.

time to again inquire about Essential's reasons for deducting the Disputed Item.¹⁷

On May 26, 2020, Essential answered that “[t]he adjustment of \$19,990,666 represents the payable and accrued capital expenditures as of October 31, 2018 subsequently paid in November 2018 that were reflected as a current liability in Working Capital.”¹⁸ On May 27, 2020, LDC informed Essential in writing that LDC believed the deduction was incorrect because the Disputed Item was actually paid after November 1, 2018.¹⁹ LDC also provided its revised Capital Expenditure calculations.²⁰

Essential responded on June 2, 2020 and rejected LDC's revised calculations.²¹ The parties spoke via telephone on June 4, 2020, but were unable to resolve the dispute.²² On June 11, 2020, LDC provided Essential with a formal notice of objection to, among other things, the \$19,990,666 deduction.²³ The parties again attempted to resolve the dispute but were unsuccessful.²⁴

The Parties Attempt to Engage the Independent Accounting Firm

Pursuant to the terms of the Purchase Agreement, Essential invoked the

¹⁷ *Id.* ¶ 27.

¹⁸ *Id.* ¶ 28.

¹⁹ *Id.* ¶ 29.

²⁰ *Id.* ¶ 30.

²¹ *Id.* ¶ 33.

²² *Id.*

²³ *Id.* ¶ 34.

²⁴ *Id.* ¶ 36.

Independent Accounting Firm dispute resolution process on July 20, 2020.²⁵ On July 27, 2020, the parties agreed that BDO USA, LLP (“BDO”) would be a suitable Independent Accounting Firm.²⁶ The parties reached out to BDO on the same day.²⁷ BDO sent a draft engagement letter to the parties on August 6, 2020.²⁸ The parties have not formally engaged BDO because there are disputes over whether BDO would be an “arbitrator” and whether BDO could render a decision before this Court addresses the issues in this case.²⁹

Procedural Context

LDC filed suit in this Court on August 17, 2020. LDC seeks a declaratory judgment that the \$19,990,666 amount “constitutes a Capital Expenditure under the Purchase Agreement for purposes of calculating the Capital Expenditure Adjustment.”³⁰

Essential filed its Answer and Counterclaim on October 5, 2020. Essential requests a declaratory judgement that the parties must submit the question of whether the Disputed Item is or is not a Capital Expenditure to the Independent Accounting Firm. Essential additionally asserts that LDC breached the contract by seeking Superior Court declaratory relief.

²⁵ *Id.* ¶ 37.

²⁶ Counterclaim ¶ 50.

²⁷ *Id.* ¶ 51.

²⁸ *Id.* ¶ 52.

²⁹ *Id.* ¶¶ 53-57.

³⁰ Compl. ¶ 44.

LDC filed a Motion for Judgment on the Pleadings on November 9, 2020. LDC seeks (1) declaratory judgment and (2) dismissal of Essential’s Counterclaim. Essential filed a Cross-Motion for Judgment on the Pleadings on December 1, 2020. Essential seeks (1) declaratory judgment and (2) dismissal of LDC’s claim.

STANDARD OF REVIEW

In a Rule 12(c) Motion for Judgment on the Pleadings, the Court must consider whether the movant is entitled to judgment as a matter of law.³¹ Such a determination by the Court can only be made where there are no material issues of fact.³² The Court must view the facts in the light most favorable to the non-moving party.³³ The Court also must accept as true all of the well-pleaded factual allegations.³⁴ Finally, exhibits attached to the pleadings or incorporated by reference may be considered.³⁵

ANALYSIS

LDC’s Contentions

LDC argues that whether the Disputed Item is a “Capital Expenditure” is a purely legal issue. LDC asserts that the relevant question is when the amount at issue was “actually paid.” LDC relies on the Court of Chancery’s decision in

³¹ *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1205 (Del. 1993) (internal citations omitted).

³² *Id.*

³³ *Id.*

³⁴ *OSI Sys., Inc. v. Instrumentarium Corp.*, 892 A.2d 1086, 1090 (Del. Ch. 2006).

³⁵ *Id.*

*Cypress Associates, LLC v. Sunnyside Cogeneration Associates Project*³⁶ for the proposition that the use of non-accounting words like “actual” suggests that the parties intended to base the meaning of ‘capital expenditure’ on the actual payment of money. As the interpretation of a contractual term is a legal issue not involving accounting principles or expertise, LDC maintains that there is no need to engage in the Section 2.1(c)(iv) dispute resolution process. However, even if the parties engage in that process, LDC argues that the Independent Accounting Firm should act as an expert because the Purchase Agreement only grants it a limited amount of authority to review technical accounting questions.

Essential’s Contentions

Essential argues in response that this issue cannot be properly resolved by the Court. Essential contends that the timing of capitalization of the Disputed Item is vital to a final determination. Because the Disputed Item was capitalized before November 1, 2018, it does not fall under the “Capitalized Expenditure” definition for purposes of determining the post-closing price adjustment amount. Essential maintains that because the issue of whether the Disputed Item is a capital expenditure or not relies on the application of GAAP principles, the dispute must be resolved by the Independent Accounting Firm. Finally, Essential argues that the Independent Accounting Firm should function as an arbitrator because the parties

³⁶ 2007 WL 148754, at *11 n. 15 (Del. Ch.).

agreed to submit all disputes surrounding the Capital Expenditure Adjustment to the Independent Accounting Firm for a final and binding decision.

Capital Expenditures

It is undisputed that the \$19,990,666 amount was payable as of October 31, 2018 and actually paid after November 1, 2018. Essential focuses on when the amount was “payable” to exclude it from the Capital Expenditures. LDC focuses on when it was “actually paid” to include it in the Capital Expenditures. The question before this Court is whether the parties’ dispute constitutes a purely legal question that can be resolved by the Court or an accounting question that must be referred to the Independent Accounting Firm.

Chancery Case Law

The parties relied heavily on two similar cases. First, in *Ray Beyond Corporation v. Trimaran Fund Management, L.L.C.*,³⁷ the Court of Chancery looked at a dispute arising from a merger agreement. When Ray Beyond acquired a company named ChanceLight, Inc. from Trimaran, \$23.1 million was placed in escrow.³⁸ Release of the escrow funds depended on a ChanceLight subsidiary company entering into a post-closing contract with the Chicago Public Schools.³⁹ The merger agreement between Ray Beyond and Trimaran delegated certain

³⁷ 2019 WL 366614, at *1 (Del. Ch.).

³⁸ *Id.*

³⁹ *Id.*

matters related to the release of the escrow funds to an independent accounting firm.⁴⁰ When a dispute arose over whether the ChanceLight subsidiary had entered into a qualifying post-closing contract, Ray Beyond and Trimaran disagreed over how it should be resolved.⁴¹

To decide whether or not the matter was required to be submitted to the independent accounting firm, the Court of Chancery focused on the language in the merger agreement that stated the firm would be “an expert, not an arbitrator.”⁴² The Court noted that “[a] typical expert determination provision limits the decision maker's authority to deciding a specific factual dispute within the decision maker's expertise.”⁴³ Therefore, the language in the merger agreement that explicitly stated that the independent accounting firm was to act as an “expert” showed that the parties intended for the non-lawyer neutral to only decide accounting, not legal, issues.⁴⁴ The Court found that the legal question of whether the ChanceLight subsidiary had entered into a qualifying contract would not be submitted to the independent accounting firm.⁴⁵

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at *6.

⁴⁴ *Id.*

⁴⁵ *Id.* at *9.

In *Stone v. Nationstar Mortgage, LLC*,⁴⁶ Nationstar purchased all of the equity interest in a company.⁴⁷ Under the terms of the purchase agreement, Nationstar was to pay the sellers a Closing Payment Amount and potential post-closing earn-out payments.⁴⁸ The Closing Payment Amount was to be calculated using certain “accounting practices, policies[,] and methodologies” specified in an exhibit to the purchase agreement.⁴⁹ Within 60 days after closing, Nationstar was required to submit an Adjustment Statement “setting forth the Company’s balance sheet as of immediately prior to the Closing, Nationstar’s own calculations of the Closing Payment Amount, and its supporting calculations[.]”⁵⁰ Any unresolved disputes over the items set forth in the Adjustment Statement were to be submitted to a third-party decision maker.⁵¹

After closing, the parties disagreed over the calculations made by Nationstar in its Adjustment Statement.⁵² The Court of Chancery was asked to determine whether various issues related to the calculation of the Adjustment Statement should be resolved by the Court or the Independent Accounting Firm. In Count I of its complaint, Nationstar alleged “that the Sellers prepared and submitted to

⁴⁶ 2020 WL 4037337, at *1 (Del. Ch.).

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ *Id.* (alteration in original).

⁵⁰ *Id.* at *2 (internal quotation marks and citation omitted).

⁵¹ *Id.*

⁵² *Id.* at *3.

Nationstar an Estimated Closing Payment Amount in which Sellers refused to apply the objective formula specified in ... the Accounting Principles for calculating the value of the Company's mortgage servicing rights."⁵³ In Count II, Nationstar alleged "that the Sellers used the wrong closing date in calculating the Closing Date Members' Equity."⁵⁴ In Count III, Nationstar alleged "that the Sellers improperly increased the Closing Date Members' Equity by purporting to include certain transaction costs in that amount that should have been excluded."⁵⁵

Nationstar argued that that the Court could resolve Counts I, II, and III because the claims "raise[d] legal issues requiring the application of contract interpretation principles."⁵⁶ After considering the arguments, the Court of Chancery stated:

Although all of the premises of Nationstar's argument are true, the result Nationstar seeks does not follow. At bottom, Nationstar's argument elevates form over substance. In substance, Counterclaims I, II, and III raise issues necessary to determine the amount of any Disputed Items, an issue contractually delegated to the Independent Accountant for resolution. They all involve accounting methodology issues that fall squarely within an accounting firm's expertise. That Nationstar and the Sellers disagreed concerning the application of contractually called-for accounting principles in the first instance does not strip the Independent Accountant of the authority to resolve their disputes. Nationstar's attempts to plead around this reality [are] unsuccessful. Delaware courts have rejected contractual parties' efforts to plead around the scope of a third-party decision-maker's authority

⁵³ *Id.* at *5 (omission in original) (internal quotation marks omitted).

⁵⁴ *Id.*

⁵⁵ *Id.* The additional counts in Nationstar's complaint are not relevant to the present case.

⁵⁶ *Id.* at *7.

by couching delegable disputes in questions of law. So too does the Court here.⁵⁷

Referral is Required under the Purchase Agreement

The Court finds *Nationstar* controlling on the issue of referral. LDC’s argument—that whether or not the Disputed Item falls under the definition of “Capital Expenditures” is a purely legal question of contract interpretation—appears to be nothing more than “couching delegable disputes in questions of law.”⁵⁸

Interpretation of Section 1.1 “Capital Expenditures” necessarily involves the application of GAAP principles. LDC’s position ignores that the plain language of the Capital Expenditures definition considers whether expenditures are “paid *or payable*.” The Disputed Item was clearly payable before November 1, 2018. Therefore, under Section 1.1, there must be a determination of whether the Disputed Item was “reflected as a current liability in Working Capital” and “properly capitalized in accordance with U.S. GAAP.”

The Court finds that the timing of capitalization is an issue that, pursuant to Section 1.1., must be resolved in consideration of and in accordance with GAAP. This is not a question of law, but rather a question that requires accounting

⁵⁷ *Id.* at *8.

⁵⁸ *See id.*

expertise. Therefore, the Section 2.1(c)(iv) dispute resolution process is implicated, and the dispute must be referred to the Independent Accounting Firm.

Independent Accounting Firm's Role

The parties argued in-depth about whether referral of this dispute to the Independent Accounting Firm would result in the firm functioning as an expert or as an arbitrator. On this issue, the Court of Chancery in *Nationstar* stated:

It is true that, under Delaware law, an expert's scope of authority is "limited to deciding a specific factual dispute concerning a matter within the special expertise of the decision maker, usually concerning an issue of valuation."

It is also true that the Independent Accountant is an expert and not an arbitrator, although the language of the Purchase Agreement does not expressly state this. The Dispute Resolution Provisions do not bear the hallmarks of an arbitration provision; they do not include procedural rules mimicking the judicial process, broadly encompass all legal disputes, or speak to issues typically resolved by legal professionals. Thus, it is safe to conclude that a contractually-designated accountant is intended to serve as an expert, not an arbitrator.⁵⁹

The Court finds that the parties' dispute will fall under the Independent Accounting Firm's authority notwithstanding whether the firm has broad authority to handle all disputes, or limited authority to only handle accounting disputes. Regardless of the scope of authority, referral of the Disputed Item makes the accountant a finder of fact applying accounting principles. No legal question will be referred. Nevertheless, the Purchase Agreement requires that the accountant,

⁵⁹ *Id.* at *7-8 (internal citations omitted).

when reviewing the agreement, construe the terms in accordance with the laws of Delaware.⁶⁰ The terms of the Purchase Agreement additionally provide that the accountant's conclusion will be "final and binding."⁶¹ In light of the parameters agreed upon by the parties, the Court finds that the precise issue of whether the Independent Accounting Firm will act as an "expert" or as an "arbitrator" need not be resolved at this time.

CONCLUSION

"Capital Expenditures," as defined in the Purchase Agreement, are those items that are "actually paid or payable," reflected in Working Capital, and "properly capitalized in accordance with U.S. GAAP." Whether something counts as a "Capital Expenditure" is a question of fact that requires the application of accounting principles. Therefore, the issue of whether the disputed \$19,990,666 amount is subject to the "Capital Expenditure Adjustment" must be referred to the Independent Accounting Firm pursuant to the narrow dispute resolution procedure in Section 2.1(c)(iv).

The Court declines to decide, at this time, whether the Independent Accounting Firm will act as an expert or an arbitrator. For now, the Court finds it

⁶⁰ Compl. Ex. A §§ 2.1(c)(iv), 11.10(a).

⁶¹ *Id.* § 2.1(c)(iv).

sufficient that the accountant is a third-party decision maker bound by the decision-making parameters set forth in the Purchase Agreement.

THEREFORE, LDC's Motion for Judgment on the Pleadings is hereby **DENIED**. Essential's Cross-Motion for Judgment on the Pleadings is hereby **GRANTED** as to participation in the price adjustment dispute resolution process. The parties have 30 days from the date of this order to meet and confer regarding further proceedings to address Essential's breach of contract claim.

IT IS SO ORDERED.

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