IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

ZWANENBERG FOOD GROUP (USA) INC., Plaintiff, v. TYSON REFRIGERATED PROCESSED MEATS, INC. Defendant.	Civil Action No. 1:08-329 SLR

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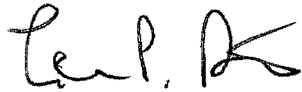
MEMORANDUM OPINION

February 27, 2009
Wilmington, Delaware



STARK, U.S. Magistrate Judge

This case arises out of a contract to buy inventory and equipment used to manufacture canned luncheon meat for private label customers. It involves a dispute over the selling manufacturer's contractual obligations with regard to its former largest customer. Plaintiff Zwanenberg Food Group (USA), Inc. ("ZFG") seeks: (1) a declaratory judgment that it does not owe defendant Tyson Refrigerated Processed Meats ("Tyson") a $500,000 Transition Payment contemplated by a contract executed between the parties; (2) an award of $549,019.65 plus interest for Tyson's alleged breach of contract; (3) "damages in an amount greater than $1,000,000, plus consequential damages" for Tyson's alleged breach of the implied covenant of good faith and fair dealing; (4) costs; and (5) attorneys' fees. (D.I. 1) Presently pending before the Court is Tyson's motion for a partial judgment on the pleadings with respect to ZFG's implied covenant claim. (D.I. 11) For the reasons set forth below, Tyson's motion will be denied.

BACKGROUND[1]

The parties

ZFG is an Ohio corporation and a producer and manufacturer of canned meats and other food products. (D.I. 1 ¶ 2) Tyson is a Delaware corporation and wholly-owned subsidiary of Tyson Foods Inc. *Id.* It is also a producer and manufacturer of food products. *Id.*

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[1]For purposes of the instant motion, the Court accepts the allegations in the Complaint as true, and views them in the light most favorable to plaintiff. *See Maio v. Aetna, Inc.*, 221 F.3d 472, 481-82 (3d Cir. 2000).

Tyson's "private label" business

In mid-2007, ZFG became interested in purchasing the tools (i.e., "certain inventory and equipment") used by Tyson in the production, manufacture, and sale of canned luncheon meat (the "Assets"). (D.I. 1 ¶ 7) Tyson sold canned meat to customers under its own registered trademarks – "Bacon Grill" and "American Pride" – and under private labels. *Id.* The private labels were owned by Tyson's customers, to whom Tyson sold canned meat it produced using the Assets. *Id.* Tyson's largest customer for the goods it produced using the Assets was Wal-Mart Stores, Inc. ("Wal-Mart"). (D.I. 1 ¶ 16) Wal-Mart's purchases accounted for 65.47% of Tyson's total revenues from the private label business. *Id.*

The Asset Purchase Agreement

ZFG sought to purchase Tyson's Assets and, by doing so, to begin producing and selling the same products to Tyson's private label customers that Tyson had been selling to those customers. (D.I. 1 ¶ 8) On November 8, 2007, the parties executed an Asset Purchase Agreement ("APA"), pursuant to which Tyson conveyed the Assets and certain other inventory to ZFG in exchange for cash consideration. (D.I. 1 ¶ 9) The APA provided that ZFG would pay Tyson $2,543,560.08 (the "Closing Payment") for the Assets at the time of closing. (D.I. 1 ¶ 12) In addition, ZFG would pay Tyson $500,000 (the "Transition Payment") when certain conditions set out in Section 5.6 of the APA were met. *Id.*

Section 5.6 of the APA provides:

> (a) Provided that Purchaser [ZFG] shall make a request of Seller [Tyson] for Transition Services within thirty (30) days after Closing, the Seller agrees to provide Transition Services as defined in subparagraph (b), below, to facilitate the transfer of the Businesses' relationships identified on Schedule 5.6 (hereinafter each such relationship referred to as "Transition Business" and, collectively, the "Transition Businesses") from the Seller to the Purchaser.
>
> (b) "Transition Services" shall include, and be limited to, the following:
>
> (i) Seller shall assist with Purchaser's first production run of the recipes transferred as part of the Assets;
>
> (ii) Seller, working in conjunction with the Purchaser's representatives, will contact each such Transition Business and [*sic*] to facilitate the establishment of Purchaser's relationship with such Transition Business.
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> (c) Upon completion of the Transition Services (provided that Purchaser has requested such) and Purchaser's receipt of orders for the first shipments of Inventory to each of the Transition Businesses (such receipt of orders referred to as the "First Orders"), the transactions contemplated by this Agreement shall be considered to be complete, and Seller shall be entitled to the Transition Payment, and such payment shall be paid by the Purchaser to Seller within two (2) business days after completion of the Transition Services or First Orders, whichever is later.

(D.I. 1 ¶ 15)

The APA further provided a listing of the customers "from which an aggregate of 95% of the Business's revenues for the preceding two years were derived," and their contact information. (D.I. 1 ¶ 14) The Transition Businesses were: Wal-Mart (accounting for 65.47% of Tyson's revenues from the business it was selling to ZFG), H.E. Butt Grocery ("HEB") (9.59%), Dollar

General Corporation (7.96%), and Castleberry/Bumble Bee Seafood (6.66%). (D.I. 1 ¶ 16)[2]

Tyson refuses to allow pre-closing contact between ZFG and the Transition Businesses

The Transition Businesses, Wal-Mart in particular, were "a vital part of the transaction to ZFG," such that ZFG "would be severely disadvantaged" if it was unable to continue the relationship with the Transition Businesses that Tyson had had with them. (D.I. 1 ¶¶ 17-18) Thus, before the APA closed, ZFG demanded (1) that Wal-Mart be informed that ZFG would begin selling the canned meat products that Wal-Mart had been purchasing from Tyson, and (2) that ZFG be permitted to contact Wal-Mart to establish a relationship and begin preparations for shipping products to Wal-Mart, including by filling Wal-Mart's then-existing orders. (D.I. 1 ¶ 19) Citing a desire to keep the transaction private, Tyson refused to allow ZFG to contact any of the Transition Businesses until the APA had closed. (D.I. 1 ¶ 20)

The transaction closes

The APA was executed on November 8, 2007. (D.I. 1 ¶ 9) ZFG made the required Closing Payment to Tyson. (D.I. 1 ¶ 21)

ZFG requests Tyson contact Wal-Mart

"Almost immediately after the closing" on November 8, 2007, ZFG sought Transition Services from Tyson, by requesting that Tyson contact Wal-Mart to help establish a relationship between Wal-Mart and ZFG. (D.I. 1 ¶ 22) Tyson did not seek to arrange such a meeting until

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[2]The percentages given add up to 89.78%, not 95%.

"[i]n or about late November 2007." (D.I. 1 ¶ 23) Scheduled to be present at the meeting were ZFG representatives; Tyson's Wal-Mart salesperson, Bill Creighton ("Creighton"); and Wal-Mart's buyer, Amanda Davis ("Davis"). *Id.* At some time before the meeting, Tyson reported to ZFG that Wal-Mart's Davis had been told of the sale and "was not concerned except to ask that the spec not be changed." (D.I. 1 ¶ 24)

<u>ZFG and Tyson meet with Wal-Mart</u>

ZFG and Tyson met with Wal-Mart on November 28, 2007. (D.I. 1 ¶ 25) At the meeting, Tyson described to Wal-Mart's Davis the sale of its business to ZFG, and revealed that ZFG "would be supplying [Wal-Mart's] already[-]ordered products." *Id.* Contrary to Tyson's prior representations, this appeared to ZFG to be the first time that anyone at Wal-Mart had heard of the transaction. *Id.*

<u>Wal-Mart rejects ZFG as supplier</u>

In a December 11, 2007 e-mail to ZFG, Davis outlined Wal-Mart's position as to how Tyson's sale of the Assets to ZFG affected Wal-Mart's "Great Value" line:

> Vendor agreements take a while to [get] cleared through the system. I warned you of that in our meeting. In all honesty, Tyson should have never "sold off" the Great Value business before discussing it with us or even warning Wal-Mart. It is not your brand to sell, we have not guaranteed any time or quantity commitments with you. It is our decision to award business as we see fit. Whenever we have a new supplier with GV, which Zwan[en]berg is, there are excessive quality checks that must be done in order to assure the quality is up to our standards. We are not going to rush this process and risk missing something potentially hazardous just because Tyson waited until the 11th hour to alert [Wal-Mart] of the change.

> While we never want run outs on product there is not much we can do to change this now. Looks like we will have outs for awhile based on Tyson's lack of inventory. With all the various businesses Tyson has with Wal-Mart they should have known better than to not collaborate and work with us as it would have made the transition a lot easier.

(D.I. 1 ¶ 26)

Upon receiving Davis' e-mail, ZFG concluded that it would not be permitted to ship those orders Wal-Mart had already placed with Tyson, "which would have effectively ended any chance of [ZFG] ever being approved as a Wal-Mart supplier." (D.I. 1 ¶ 27) Tyson then devised a plan whereby ZFG would manufacture meat products and deliver them to Tyson, which would then sell them to Wal-Mart to fill Wal-Mart's existing orders. (D.I. 1 ¶ 29)

On February 26, 2008, Wal-Mart informed Tyson that it would not be using ZFG to fill its orders for private label brands of canned meat products and would begin using another supplier on April 10, 2008. (D.I. 1 ¶ 31) Neither Wal-Mart nor HEB has placed a First Order with ZFG. (D.I. 1 ¶ 40)

<u>Tyson demands Transition Payment</u>

On May 12, 2008 and May 22, 2008, Tyson sent letters to ZFG demanding the $500,000 Transition Payment. (D.I. 1 ¶ 39) On May 23, 2008, ZFG responded in a letter stating, among other things, that the conditions precedent to Tyson receiving the Transition Payment had not been met. (D.I. 1 ¶ 41) Tyson did not reply to ZFG's letter. (D.I. 1 ¶ 42)

Procedural Background

ZFG filed the instant action on May 30, 2008. (D.I. 1) The case was initially assigned to Judge Sue L. Robinson and referred to a magistrate judge for all pretrial proceedings. (D.I. 30) Tyson moved for partial judgment on the pleadings on August 21, 2008. (D.I. 11) On February 18, 2009, the parties consented to the jurisdiction of a magistrate judge pursuant to 28 U.S.C. § 636. (D.I. 40)

LEGAL STANDARDS

The Court employs the same standard for evaluating a motion for judgment on the pleadings under Federal Rule of Civil Procedure 12(c) that it applies to motions to dismiss under Rule 12(b)(6). Evaluating a motion to dismiss under Rule 12(b)(6) requires the Court to accept as true all material allegations of the complaint. *See Spruill v. Gillis*, 372 F.3d 218, 223 (3d Cir. 2004). "The issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims." *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1420 (3d Cir. 1997) (internal quotation marks omitted). Thus, the Court may grant such a motion to dismiss only if, after "accepting all well-pleaded allegations in the complaint as true, and viewing them in the light most favorable to plaintiff, plaintiff is not entitled to relief." *Maio,* 221 F.3d at 481-82 (internal quotation marks omitted).

However, "[t]o survive a motion to dismiss, a civil plaintiff must allege facts that 'raise a right to relief above the speculative level on the assumption that the allegations in the complaint are true (even if doubtful in fact).'" *Victaulic Co. v. Tieman*, 499 F.3d 227, 234 (3d Cir. 2007) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955, 1965 (2007)). While

heightened fact pleading is not required, "enough facts to state a claim to relief that is plausible on its face" must be alleged. *Twombly,* 127 S. Ct. at 1974. At bottom, "[t]he complaint must state enough facts to raise a reasonable expectation that discovery will reveal evidence of [each] necessary element" of a plaintiff's claim. *Wilkerson v. New Media Technology Charter School Inc.*, 522 F.3d 315, 321 (3d Cir. 2008) (internal quotation marks omitted). Nor is the Court obligated to accept as true "bald assertions," *Morse v. Lower Merion School Dist.*, 132 F.3d 902, 906 (3d Cir. 1997) (internal quotation marks omitted), "unsupported conclusions and unwarranted inferences," *Schuylkill Energy Resources, Inc. v. Pennsylvania Power & Light Co.*, 113 F.3d 405, 417 (3d Cir. 1997), or allegations that are "self-evidently false," *Nami v. Fauver*, 82 F.3d 63, 69 (3d Cir. 1996).

DISCUSSION

Under Delaware law, every contract contains an implied covenant of good faith and fair dealing, requiring the parties to the contract "to refrain from arbitrary or unreasonable conduct which has the effect of preventing the other party to the contract from receiving the fruits of the contract." *HSMY, Inc. v. Getty Petroleum Mktg., Inc.*, 417 F.Supp.2d 617, 621 (D. Del. 2006) (internal citation omitted); *see also* Restatement (Second) of Contracts, § 205 (1981). Thus, a duty of good faith and fair dealing arises only in those instances where a contract has been formed, and is not imposed on parties during the contract negotiation period. *See In re Student Finance Corp.*, 2004 WL 609329, at *6 (D. Del. Mar. 23, 2004); *see also Novinger Group, Inc. v. Hartford Ins., Inc.*, 514 F.Supp.2d 662, 671-672 (M.D. Pa 2007) (dismissing claim for breach of implied covenant where allegations of misrepresentations and inducements by defendant

concerned negotiations leading up to contract formation). Delaware courts have consistently held that obligations based on the covenant of good faith and fair dealing should be implied only in rare cases. *See Aspen Advisors LLC v. United Artists Theatre Co.*, 861 A.2d 1251, 1259 (Del. 2004); *see also Rizzitielo v. McDonald's Corp.*, 868 A.2d 825, 831 (Del. 2005) ("[T]he implied covenant is to be narrowly construed. . . .").

In order to state a claim for breach of the implied covenant of good faith and fair dealing, a plaintiff must allege: "a specific implied contractual obligation, a breach of that obligation by the defendant, and resulting damage to the plaintiff." *Anderson v. Wachovia Mtg. Corp.*, 497 F.Supp.2d 572, 581-82 (D. Del 2007). It must be "clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith, had they thought to negotiate with respect to the matter." *Allied Capital Corp. v. GC-Sun Holdings, L.P.*, 910 A.2d 1020, 1032-33 (Del. Ch. 2006).

Tyson advances two arguments in support of its motion: first, that ZFG improperly seeks to state a claim for breach of the implied covenant based on Tyson's actions *prior* to contract formation; and, second, that ZFG seeks to impose obligations on Tyson that were not contemplated by the APA. (D.I.12 at 2; D.I. 20 at 1-2) Neither of these contentions is persuasive. Having viewed the allegations set forth in the Complaint in the light most favorable to ZFG, the Court concludes that ZFG has sufficiently alleged a claim for breach of the implied covenant.

With respect to Tyson's first argument, relating to the time frame for which ZFG seeks to recover, Tyson is correct that certain language in the Complaint seeks relief for Tyson's behavior with regard to Wal-Mart *before* the APA was executed. ZFG alleges that, "[d]ue to its long-

standing relationship with Wal-Mart . . . Tyson was well aware of the strict approval procedures and quality checks that Wal-Mart requires of its suppliers before they can start shipping product," but "[d]espite this knowledge, Tyson, in bad faith and in breach of the implied covenant of good faith and fair dealing, failed to give Wal-Mart sufficient prior notice of the transaction with ZFG and refused to let ZFG make direct contact with Wal-Mart prior to the closing of the APA." (D.I. 1 ¶¶ 62-63) ZFG cannot pursue a claim for breach of the implied covenant for actions Tyson took (or failed to take) prior to execution of the APA because Tyson was subject to no covenant at that time; there was nothing then for Tyson to breach.

This does not end the analysis, however, because other allegations in the Complaint plainly relate to conduct Tyson is purported to have engaged in *after* the execution of the APA. As accurately summarized in ZFG's brief, the Complaint alleges:

> It took Tyson weeks to arrange a meeting between ZFG, Tyson and Wal-Mart . . . despite the fact that ZFG requested that Tyson begin its Transition Services almost immediately after the November 8, 2007 closing.
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> It took three weeks after the closing for the meeting between ZFG, Tyson, and Wal-Mart to take place.
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> Before the November 28, 2007 meeting took place[], Tyson falsely advised ZFG that Wal-Mart had been made aware of the sale of the canned luncheon meat business to ZFG.
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> In fact, Wal-Mart was not advised of the transition of the business to ZFG until the November 28, 2007 meeting.
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> [Davis' post-closing email] demonstrates that Tyson was fully aware of Wal-Mart's quality checks vis-à-vis new potential suppliers such as ZFG and the time sensitive nature of Wal-Mart's procedures . . . yet Tyson chose to not only delay the meeting but did not advise Wal-Mart of the transition of the business to ZFG until weeks after the closing.

> Following the execution of the APA, Tyson devised a plan whereby ZFG would manufacture product to be shipped to Tyson so that Tyson, not ZFG, could sell the product to Wal-Mart, thereby preserving Tyson's relationship with Wal-Mart but only serving to further hinder ZFG's ability to conduct business with Wal-Mart.

(D.I. 19 at 10 (internal citations to D.I. 1 ¶¶ 22-29 omitted); *see also* D.I. 1 ¶ 55 (incorporating prior allegations by reference))

In order to prevail on its implied covenant claim, ZFG will have to prove a breach occurred after the parties executed the APA. Evidence of pre-contract conduct may be relevant. *See generally Horizon Holdings, L.L.C. v. Genmar Holdings, Inc.*, 244 F.Supp.2d 1250, 1268 (D. Kan. 2003) (applying Delaware law and stating that "evidence concerning what the parties discussed prior to executing the agreement, to the extent such evidence, as here, does not contradict the agreement, is entirely relevant to whether defendants breached the [implied] covenant . . . because the parties' reasonable expectations at the time of contract formation determine the reasonableness of the challenged conduct"). However, the fact that ZFG's potential recovery will be limited to post-contract bad faith by Tyson is not a basis to grant judgment at this time to Tyson because the Complaint adequately alleges post-contract conduct.

Tyson's second argument is that ZFG is seeking by its implied covenant claim to impose upon Tyson an obligation that was not contemplated by the parties in agreeing to the APA. The Delaware Supreme Court has held that "implied good faith cannot be used to circumvent the parties' bargain, or to create a free-floating duty . . . unattached to the underlying legal document." *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.3d 434, 441 (Del. 2005). Tyson notes that the APA provided no guarantee that ZFG would succeed in retaining Tyson's relationships with the Transition Businesses. (D.I. 12 at 8) Tyson also emphasizes that the meeting it set up among

ZFG, itself, and Wal-Mart occurred within the 30-day window the APA provided ZFG for requesting Transition Services from Tyson. (D.I. 20 at 4)

These contentions fail. ZFG is not claiming that ZFG's failure to obtain the Wal-Mart private label business is itself a breach; rather, ZFG is alleging that its failure to obtain Wal-Mart's business is a consequence of Tyson's breach of the implied covenant in unduly delaying the scheduling of the meeting ZFG requested.

Furthermore, the APA is silent as to how quickly Tyson was required to respond to a timely ZFG request for Transition Services. That the parties agreed that ZFG, as purchaser of the Assets, should be guaranteed 30 days from closing to request that Tyson contact each of the Transition Businesses on ZFG's behalf does not compel a conclusion – before any evidence has been introduced – about how rapidly the parties reasonably expected Tyson, as seller, would respond to the request. Although the APA explicitly guaranteed ZFG 30 days to request that Tyson reach out to Wal-Mart, it does not necessarily follow that the parties would have permitted Tyson an equally generous period to respond to such a request. The allegations in the Complaint are "plausible" (within the meaning of *Twombly*) and are consistent with the conclusion that Tyson's post-closing conduct – delaying the meeting, not telling Wal-Mart about the ZFG transaction until the meeting, and falsely advising ZFG that Wal-Mart had been told of the transaction prior to the meeting – would have been proscribed by the parties, had they thought to negotiate about these matters.

Finally, Tyson asserts that ZFG's claim is undermined by the lack of a plausible economic motive for its alleged bad faith conduct. ZFG's failure to obtain business from Wal-Mart could mean that Tyson would not receive the $500,000 Transition Payment from ZFG, so Tyson had a

financial incentive to assist ZFG, not work against ZFG. However, under the terms of the APA, it appears that Tyson's entitlement to the Transition Payment was always contingent on actions beyond Tyson's control, including ZFG's receipt of orders from each of the Transition Businesses. Even if Tyson immediately and fully provided every Transition Service ZFG requested, Tyson still might not be entitled to the $500,000 payment unless ZFG obtained orders.[3] Given this situation, Tyson's purported bad faith conduct might not have cost it any money that it was otherwise going to receive. In any event, Tyson's claims regarding its motives do not compel a conclusion that Tyson is entitled to judgment on the pleadings.

CONCLUSION

For the foregoing reasons, Tyson's motion for partial judgment on the pleadings will be denied. An appropriate order follows.

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[3]Nothing contained in this Memorandum Opinion is intended to express a view on the merits of ZFG's declaratory judgment claim with respect to whether it owes Tyson the Transition Payment.