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Transaction ID 52335380
Case No. 7975-VCP

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

ANVIL HOLDING CORPORATION, THOMPSON STREET CAPITAL PARTNERS II, L.P.,	)	
Plaintiffs,	)	C.A. No. 7975-VCP
v.	)	
IRON ACQUISITION COMPANY, INC. and INDIGO HOLDING COMPANY, INC.,	)	
Defendants.	)	

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

IRON ACQUISITION COMPANY, INC., a Delaware corporation, and INDIGO HOLDING COMPANY, INC., a Delaware corporation,	)	
Plaintiffs,	)	C.A. No. N12C-11-053-DFP [CCLD]
v.	)	
ANVIL HOLDING CORPORATION, a Delaware corporation, THOMPSON STREET CAPITAL PARTNERS II, L.P., a Delaware limited partnership, JEFFREY D. SMOCK, MICHAEL G. COLES, KYLE R. KLOPFER, CHRISTOPHER A. REED, and TERRY L. ROSS,	)	
Defendants.	)	

MEMORANDUM OPINION

Submitted: April 22, 2013
Decided: May 17, 2013

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PARSONS, Vice Chancellor.

The motion to dismiss before me is part of a dispute between the buyer and seller in a May 2011 transaction involving a Georgia limited liability company which has resulted in complaints being filed in this Court and in the Delaware Superior Court. The buyer purchased all of the Georgia's company's outstanding securities from its twenty-three security holders, which included the company's management. The seller filed a complaint in this Court to compel disbursement of funds that had been escrowed pursuant to the purchase agreement. The buyer claims a right to payment from the escrowed funds. It filed a complaint in the Superior Court asserting claims of (1) fraud against the company's management and (2) bad faith breach of contract against management and breach of contract against the sellers' representatives in their capacity as representatives of all the sellers based on alleged misrepresentations the company made in the purchase agreement.[1] In that agreement, the sellers undertook to indemnify the buyer for a breach of the company's representations and warranties subject to certain procedural limitations set forth in the agreement.

The sellers' representatives moved to dismiss both counts of the complaint filed in the Superior Court for failure to state a claim upon which relief can be granted. They contend that the buyer's fraud claim is not pled with particularity and is precluded by the language of the purchase agreement. The sellers' representatives also argue that the breach of contract claim should be dismissed because the buyer failed to follow the

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[1] As explained *infra* Part I.C, these two actions are proceeding in a coordinated fashion before me.

purchase agreement's stated procedural requirements for bringing a claim for breach of that agreement.

For the following reasons, I conclude that the buyer's complaint does state a claim for fraud and breach of contract. I conclude, however, that the complaint does not state a claim for bad faith breach of contract and that the buyer's failure to name all sellers as defendants warrants dismissal of its breach of contract claim without prejudice to its ability to amend the complaint in that regard.

I. BACKGROUND

A. The Parties

The plaintiffs in the Superior Court action are Iron Acquisition Corp., a Delaware corporation, and Indigo Holding Company, Inc., also a Delaware corporation (collectively, "Plaintiff" or the "Buyer"). Indigo Holding Company, Inc. is the sole stockholder of Iron Acquisition Corp. These companies purchased all of the outstanding units of Iron Data Solutions, LLC ("Iron Data" or the "Company").

Defendants Jeffrey D. Smock, Michael G. Coles, Kyle R. Klopfer, Christopher A. Reed, and Terry L. Ross were all unitholders of Iron Data at the time of the sale and also were the Company's managers, either at or before the time of the sale (the "Individual Defendants" or "Management"). Smock was the founder and a former chief executive officer ("CEO") of the Company. Reed became CEO in January 2011; his position was terminated in December 2011. Coles was the Company's former executive vice president and chief information officer. Klopfer was the chief financial officer and Ross was the chief operating officer of benefits determination.

Defendant Anvil Holding Corporation ("Anvil") is a Delaware corporation. Anvil held approximately 47% of the Company's units before the sale to Plaintiff. Smock and Coles own 100% of Anvil.

Defendant Thompson Street Partners II, L.P. ("Thompson Street," and collectively with Anvil and the Individual Defendants, "Defendants") is a Delaware limited partnership. Thompson Street held approximately 35% of the Company's outstanding units before the sale to Plaintiff. Anvil and Thompson Street were designated by the selling unitholders as the "Sellers' Representatives." The Buyer sued Anvil and Thompson Street in that capacity in this action.

In addition to the seven named Defendants, there were sixteen additional selling unitholders (collectively with Defendants, "Sellers").

B. Facts[2]

Iron Data provides software-based products to automate and manage complex processes for government and commercial customers. One of the Company's long-term customers is the Social Security Administration ("SSA"). The Company has processed

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[2] The facts are drawn from the complaint in Superior Court C.A. No. N12C-11-053-DFP (the "Superior Court Complaint" or "Complaint") and the exhibits to the complaint in Court of Chancery C.A. No. 7975-VCP (the "Court of Chancery Complaint"), including the Purchase Agreement, the Buyer's notice of claim, and the Sellers' response to the notice of claim. Neither party objects to the Court taking judicial notice of the Court of Chancery Complaint and its exhibits. I therefore consider these documents as evidence. *See In re Gen. Motors (Hughes) S'holders Litig.*, 897 A.2d 162, 169 (Del. 2006) (noting that, on a motion to dismiss under Rule 12(b)(6), "[t]he trial court may also take judicial notice of matters that are not subject to reasonable dispute").

more than 90% of the disability claims in the United States due to a sole source contract with the SSA. For approximately thirty years, the SSA has used a system known as the Disability Case Management, or DCM, system. The SSA recently replaced the DCM system with a new system, the Disability Case Processing System, or DCPS. In 2010, the SSA selected Lockheed Martin Corporation ("Lockheed") as the prime contractor to implement the new DCPS system. Iron Data has a subcontract agreement with Lockheed for this work. The subcontract provides for pricing on a "firm fixed price" basis. In fact, in the Company's more than twenty years of experience with the SSA, the SSA has awarded purchases of software products and related services only on a firm fixed price basis, as opposed to on a "time and materials" basis.[3]

Also in 2010, Iron Data determined to pursue potential acquirers. The Buyer ultimately purchased all outstanding securities of the Company from the Sellers for $175 million (the "Transaction"). These parties entered into a purchase agreement on May 9, 2011 (the "Purchase Agreement" or "Agreement"). The Purchase Agreement named Thompson Street and Anvil as "Sellers' Representatives." Among other things, it provided for indemnification by the Sellers in certain circumstances, including for a breach of Iron Data's representations and warranties. The parties placed approximately $10 million of the purchase price and certain shares of stock in escrow to cover any indemnification claims. The escrow funds are governed by a separate agreement (the "Escrow Agreement").

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[3] Compl. ¶¶ 1–2.

This dispute arises from the Buyer's alleged discovery that it was defrauded by the Sellers and, as a result, that it paid more for Iron Data than the Company was worth. The Buyer's main allegation is that the Individual Defendants knew that one of the Company's most important contracts, the subcontract with Lockheed, soon would change from a firm fixed price basis to a materially lower time and materials basis. In Section 3.25 of the Purchase Agreement, Iron Data had represented and warranted that

> no contractor . . . has notified the Company or any Company Subsidiary in writing (or, to the Knowledge of the Company, orally) of any intention to stop, materially decrease the rate or materially change the terms (whether related to payment, price or otherwise) with respect to buying or supplying as the case may be, materials, services, or products.[4]

The Purchase Agreement defines "Knowledge" to mean all facts actually known by, among others, the Individual Defendants.

According to the Buyer, the Individual Defendants: (1) knew that Lockheed intended to change from firm fixed pricing to time and materials pricing; (2) negotiated time and materials rates with Lockheed; (3) deliberately hid this information from the Buyer; and (4) delayed making any official arrangements with Lockheed until the Transaction had closed to induce the Buyer to purchase Iron Data based on the false assumption that the Lockheed contract would continue on a firm fixed price basis. Thus, the Buyer alleges that the Individual Defendants knew that the Company's representation and warranty in Section 3.25 was false when made.

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[4] Ct. of Chancery Verified Compl. ("Ct. Ch. Compl.") Ex. A, Purchase Agreement, § 3.25.

After learning these alleged facts, the Buyer sent the Sellers' Representatives notice of its claim to recover from the escrow fund for breach of the Purchase Agreement and potentially for fraud. The Sellers disputed the validity of the Buyer's claim and demanded release of the escrowed funds.

C. Procedural History

The Sellers' Representatives filed the Court of Chancery Complaint on October 23, 2012, seeking: (1) specific performance of the Purchase Agreement's requirement that the escrowed funds be released; (2) damages for breach of contract and breach of the implied covenant of good faith and fair dealings; and (3) a declaratory judgment that the Buyer is not entitled to indemnification under the Purchase Agreement. The Buyer filed its Complaint in the Delaware Superior Court in and for New Castle County on November 9, 2012, alleging (1) fraud and fraudulent inducement against Management and (2) breach of contract and bad faith breach of contract against Management and against Anvil and Thompson Street in their capacities as Sellers' Representatives. By way of relief, the Buyer seeks damages, punitive damages, and attorneys' fees.

On January 2, 2013, Chief Justice Steele entered an order designating me to sit on the Superior Court to hear and determine all issues in *Iron Acquisition Co., Inc. et al. v. Anvil Holding Corp. et al.*, C.A. No. N12C-11-053. I then entered a stipulated order coordinating the Buyer's cause of action in the Superior Court and Defendants' cause of action in the Court of Chancery. On January 25, Defendants moved to dismiss the

Buyer's Complaint pursuant to Delaware Court of Chancery Rules 9(b) and 12(b)(6).[5] After full briefing, I heard argument on the motion on April 22. This Memorandum Opinion constitutes my ruling on Defendants' motion.

II. ANALYSIS

When considering a motion to dismiss under Court of Chancery Rule 12(b)(6), the court must assume the truthfulness of the well-pled allegations in the complaint and afford the party opposing the motion "the benefit of all reasonable inferences."[6] If the well-pled allegations of the complaint would entitle the plaintiff to relief under any "reasonably conceivable" set of circumstances, the court must deny the motion to dismiss.[7] But, the court need not accept inferences or factual conclusions unsupported by specific allegations of fact.[8]

A. Count I – Fraud/Fraudulent Inducement Against Management

With this standard in mind, I begin by considering the motion to dismiss Count I for fraud and fraudulent inducement against the Individual Defendants. Defendants make

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5 Although Defendants moved to dismiss the Superior Court Complaint under Court of Chancery Rules 9(b) and 12(b)(6), I note that those rules are identical in relevant part to the corresponding Delaware Superior Court Rules of Civil Procedure.

6 *Superwire.com, Inc. v. Hampton*, 805 A.2d 904, 908 (Del. Ch. 2002) (citing *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35, 38 (Del. 1996)).

7 *Central Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011).

8 *Ruffalo v. Transtech Serv. P'rs Inc.*, 2010 WL 3307487, at *10 (Del. Ch. Aug. 23, 2010).

three main arguments for dismissing this Count: (1) the fraud claims are not pled with particularity; (2) the claims based on representations made in the contract, or "on-contract" representations, fail because there is no basis to hold the Individual Defendants liable for representations made by the Company; and (3) the claims based on extra-contractual, or "off-contract," representations, fail because the Buyer acknowledged in the Purchase Agreement that it was not relying on extra-contractual representations in deciding to enter into the Agreement. I consider each of these arguments in turn.

1. The fraud claims are pled with particularity

To state a claim for fraud, a plaintiff must allege that: "(1) the defendant falsely represented or omitted facts that the defendant had a duty to disclose; (2) the defendant knew or believed that the representation was false or made the representation with a reckless indifference to the truth; (3) the defendant intended to induce the plaintiff to act or refrain from acting; (4) the plaintiff acted in justifiable reliance on the representation; and (5) the plaintiff was injured by its reliance."[9] When a complaint alleges fraud, Court of Chancery Rule 9(b) requires that "the circumstances constituting fraud . . . shall be stated with particularity."[10] Intent and knowledge, however, "may be averred

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[9] *Abry P'rs V L.P. v. F & W Acq. LLC*, 891 A.2d 1032, 1050 (Del. Ch. 2006) (quoting *Crescent/Mach I P'rs, L.P. v. Turner*, 2000 WL 1481002, at *18 (Del. Ch. Sept. 29, 2000)).

[10] Ct. Ch. R. 9(b).

generally."[11] "[A] well [pled] fraud allegation must include at least the time, place and contents of the false representations . . . and what [was] obtained thereby."[12]

As an initial matter, the alleged misrepresentations relate to the assertion that Lockheed had not communicated to the Individual Defendants an intention to change to time and materials rates, or the omission of the known fact that Lockheed did intend to change to time and materials rates.[13] The alleged misrepresentations or omissions on this issue are the crux of both the Buyer's on-contract and off-contract claims. Therefore, if the Buyer has pled the relevant circumstances with particularity, the requirements of Rule 9(b) are met with regard to both iterations of the Buyer's fraud claims.

Defendants first argue that the allegations impermissibly lump all of the Individual Defendants together rather than alleging particular representations that each Individual Defendant made. Defendants cite *Steinman v. Levine* for the proposition that the Buyer must identify misrepresentations made by particular individuals and not "simply lump[]" all the individual defendants together. In *Steinman*, however, the complaint failed to assert with any specificity what documents or statements the plaintiff relied on and who produced them. The complaint referenced only "certain financial statements and other

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11 *Id.*

12 *Steinman v. Levine*, 2002 WL 31761252, at *14 (Del. Ch. Nov. 27, 2002).

13 In Section 3.25 the Company represented that no contractor has notified the Company "in writing, (or, to the Knowledge of the Company, orally) of *any intention to* . . . materially decrease the rate or materially change the terms" of buying services or products. Purchase Agreement § 3.25 (emphasis added).

documents that contained material misrepresentations."[14] Here, by contrast, the Complaint alleges that meetings took place on March 17 and May 9, 2011, and that each Individual Defendant attended one or both of those meetings.

At the March 17 meeting, Reed, Klopfer, and Ross allegedly participated in a conference call with representatives from the Buyer to discuss the Company's DCPS program. According to the Complaint, the Buyer asked "whether there was any prospect of time and materials work and the potential rates the Company would charge for such work," and Reed, Klopfer, and Ross "failed to disclose their discussions with Lockheed regarding the time and materials rates and represented that the Lockheed Agreement would continue on a firm fixed price basis."[15] At the May 9 meeting, which took place the day of closing, the Complaint alleges that the Buyer's representatives asked whether there was any prospect that Lockheed intended to change from firm fixed pricing to time and materials rates. In response, Smock, Coles, Klopfer, and Reed allegedly "continued affirmatively to conceal the Company's true relationship with Lockheed."[16]

These allegations provide the time, place, and contents of the alleged representation or omission. The Complaint also contains specific allegations, discussed *infra*, from which it is reasonable to infer that each Individual Defendant (1) knew of Lockheed's intention to change from firm fixed pricing to time and materials rates, (2)

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14 *Steinman*, 2002 WL 31761252, at *15.

15 Compl. ¶ 31.

16 *Id.* ¶ 39.

knew that this issue was important to the Transaction, and (3) had a duty to disclose that intention to the Buyer at the alleged meetings.[17] The averments in the Complaint also are sufficient to meet the criteria that the Complaint must allege "specific acts of individual defendants."[18] Thus, the Complaint satisfies the first required element of a fraud claim in that it contains particular allegations that each Individual Defendant falsely represented or omitted facts that they had a duty to disclose.

The second element of a fraud claim is that the defendant knew or believed that the representation was false. In this regard, the Complaint alleges that emails were exchanged among all the Individual Defendants that addressed Lockheed's intention to establish and use time and materials rates and reflected Defendants' determination to ignore the time and materials topic for the time being and not disclose Lockheed's intention to the Buyer.[19]

Defendant Cole was the recipient of only one such email, but in it Klopfer stated "[w]e have not mentioned this to [the Buyer] and they have asked about it, but we expect

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17 *See Overdrive, Inc. v. Baker & Taylor, Inc.*, 2011 WL 2448209, at *6 (Del. Ch. June 17, 2011) (denying defendant's motion to dismiss where the alleged misrepresentations related to specific provisions in the parties' agreement, went to the very core of the agreement, and, if proven, would frustrate the very purpose and nature of the agreement).

18 *Steinman*, 2002 WL 31761252, at *15.

19 *See* Compl. ¶ 29 (September 1 and October 13, 2010 emails among Klopfer, Smock, Ross, and Reed); *id.* ¶ 34 (March 24 and 28, and May 3, 2011 emails among Ross, Reed, Klopfer, and Smock); *id.* ¶ 35 (March 30, 2011 email among Reed, Ross, and Klopfer); *id.* ¶ 38 (February 17, 2011 email among Smock, Reed, Coles, Ross, and Klopfer).

[Lockheed] will push back on our rates, and we will need to stand firm."[20] In addition, the Complaint alleges that Cole was a former executive vice president of Iron Data, is the Company's chief technology officer, and received $22 million in the Transaction through his joint ownership with Smock of Defendant Anvil. Based on these alleged facts, and drawing all inferences in favor of Plaintiff, it is reasonably conceivable that the Buyer could prove that Cole knew that Lockheed intended to change from firm fixed pricing to time and materials rates and that he had a duty to disclose this information to Plaintiff at the May 9, 2011 meeting he allegedly attended. Indeed, Cole was a party to an email that stated "we have not mentioned this to [the Buyer] and they have asked about it." As a high-level executive of the Company, Cole would have realized the importance of the negotiations between the Company and the Buyer. It is therefore reasonable to infer that Cole knew the Buyer was receiving false information and took part in deceiving the Buyer through either affirmative misrepresentations or a failure to correct false information.[21]

Similarly, Individual Defendants Smock, Reed, Klopfer, and Ross each allegedly were parties to email discussions that directly addressed Lockheed's intent to use time and materials rates.[22] Additionally, in an email exchanged among Ross, Reed, and

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20 Compl. ¶ 38.

21 *See id.* ¶ 39.

22 *See id.* ¶ 29.

Klopfer, Ross allegedly stated his intent to "ignore the T&M topic for now."[23] Paragraph 34 of the Complaint avers that: "On March 24, 2011, the CFO [Klopfer] sent an e-mail to Smock, the CEO [Reed], and the COO [Ross], responding to a request from Lockheed to negotiate time and materials rates, stating '[t]ell [Lockheed] to get the agreement signed first. Then we will talk T&M rates.'"[24] Thus, the Complaint alleges that each of the Individual Defendants knew that Lockheed intended to use time and materials rates.

Defendants do not dispute the sufficiency of the pleadings under Rule 9(b) with respect to the remaining elements of a fraud claim, *i.e.*, that Defendants intended to induce Plaintiff to act or refrain from acting, that Plaintiff acted in justifiable reliance on the representations, and that Plaintiff suffered damages as a result. Therefore, I need not discuss the sufficiency of the pleadings with regard to those elements in detail. In the context of a stock purchase agreement, like the one at issue here, it is readily apparent that the alleged misrepresentations could have been made to induce the Buyer to act and that the Buyer conceivably could have justifiably relied on the alleged misrepresentations. Thus, the Complaint is sufficient in this regard. For example, Plaintiff alleges that "Management knew that Buyer's decision to invest in or acquire the Company would be based in large part on the misrepresented value of the Lockheed Agreement and the Company's relationship with Lockheed."[25]

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23 *Id.* ¶ 34.

24 *Id.*

25 *Id.* ¶ 49.

Based on these allegations, I find that Plaintiff has pled with particularity a claim against each Individual Defendant for fraud. Plaintiff's fraud claims, therefore, are not subject to dismissal for failure to satisfy Rule 9(b).

2. The Complaint states a claim for fraud against the Individual Defendants based on the Company's representations in Section 3.25

Defendants' second argument for dismissing Count I is that the Individual Defendants cannot be held liable for fraud based on the falsity of Section 3.25. They do not dispute that, "[u]nder Delaware law, a fraud claim can be based on representations found in a contract."[26] Rather, Defendants argue that the Individual Defendants cannot be held liable for fraud based on the representations in Section 3.25 because those representations were made by the Company, not the Individual Defendants. Defendants rely on Vice Chancellor Laster's recent transcript ruling in *M/C Venture Partners V, L.P. v. Savvis, Inc.*[27] to argue that there is no basis to hold the Individual Defendants liable for a representation they did not make. In *M/C Venture Partners*, however, the seller accused of fraud was not also part of the company's management team. Indeed, the Court expressly recognized that fraud claims might be brought against such a seller:

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[26] *Ameristar Casinos, Inc. v. Resorts Int'l Hldgs., LLC*, 2010 WL 1875631, at *11 (Del. Ch. May 11, 2010).

[27] C.A. No. 7359-VCL (Del. Ch. Jan. 17, 2013) (TRANSCRIPT) (dismissing a claim of fraud against M/C Ventures, a selling shareholder of the acquired company, Fusepoint, when the buyer alleged that Fusepoint committed fraud in the negotiations leading to the transaction, but did not allege that M/C Ventures engaged directly in the fraud).

> [A] seller might, by virtue of one's position and relationship with the company, know that contractual reps were false; by virtue of control or some other relationship, be effectively under some type of duty to speak in response to questions asked across the bargaining table, and yet remain silent. That would be knowing and intentional fraud of the concealment kind. . . . [W]here the seller itself lies[,] [t]hat is the intentional fraud kind.[28]

In that case, the Court ultimately concluded that the counterclaim *did* state a claim for fraud based on allegations of a false representation and warranty. Nevertheless, the Court dismissed the claim against the seller who was the named defendant because the counterclaim contained no allegations tying that seller to the alleged fraud. The facts in this case are different. Here, the Individual Defendants being accused of fraud were both sellers *and* managers of the Company. They also are the individuals whose knowledge allegedly makes the representations in Section 3.25 false. Importantly, and unlike the facts in *M/C Venture Partners*, the Complaint further alleges particular facts tying each Individual Defendant to the alleged fraud.

Based on the well-pled allegations in the Complaint, it is reasonably conceivable that Plaintiff could prove that the Company's representations in Section 3.25 were false when made and that the Individual Defendants not only knew the Company was making false representations and warranties, but actively concealed from the Buyer information that made those representations false. Furthermore, the Individual Defendants allegedly were the senior management of Iron Data. They attended meetings with the Buyer about

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[28] *Id.* at 39.

the Transaction, including a meeting on the day of closing. The Complaint also avers that it was important to Defendants to conceal from the Buyer Lockheed's intention to use time and materials rates. The allegations regarding the Individual Defendants' active concealment of Lockheed's intention, coupled with their participation in meetings leading up to the closing, are sufficient to make it reasonably conceivable that the Individual Defendants caused the Company to make a false representation in the Purchase Agreement. Thus, the allegations are sufficient to defeat the motion to dismiss Plaintiff's claims against the Individual Defendants for fraud related to the on-contract representation in Section 3.25.

3. The Buyer did not disclaim reliance upon extra-contractual statements

Defendants argue, lastly, that the Purchase Agreement precludes the Buyer from bringing claims for fraud based on off-contract representations. Defendants assert that in Sections 3.27 and 10.9 of the Purchase Agreement, the Buyer promised that it was not relying on extra-contractual statements in deciding to enter into the Agreement. At argument, but not in their briefs, Defendants also relied on Section 6.5 of the Agreement. The Buyer objected to this new argument because it had not had an opportunity to brief it. I decline to consider Defendants' argument to the extent it is based on Section 6.5 because I deem it waived for purposes of the pending motion to dismiss.[29]

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[29] *See Emerald P'rs v. Berlin*, 2003 WL 21003437, at *43 (Del. Ch. Apr. 28, 2003) ("It is settled Delaware law that a party waives an argument by not including it in its brief."). This ruling is without prejudice to Defendants' ability to raise its argument based on Section 6.5 at a later stage in the proceeding. Section 6.5 contains a lengthy representation and warranty by the Buyer that states, in part,

Section 3.27 states that, except for the representations and warranties in Articles III, IV, and V, neither the Company nor any Seller "makes any other express or implied representation or warranty with respect to the Company . . . or any Seller or the transactions contemplated by this Agreement." In Section 10.9, the parties agreed that

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that the Sellers neither made any representation or warranty, express or implied, beyond those expressly given in the Purchase Agreement nor made any representation "as to the accuracy or completeness of any information" regarding the Company or the transactions contemplated by the Purchase Agreement. This representation, in combination with Sections 3.27 and 10.9, appears to strengthen Defendants argument that the Buyer could not reasonably have relied on extra-contractual representations. *See RAA Management, LLC v. Savage Sports Hldgs., Inc.*, 45 A.3d 107, 119 (Del. 2012) (analyzing a non-disclosure agreement with similar language and holding that the clear and unambiguous language of the agreement precluded the fraud claims asserted by the potential acquiring company). In the absence of full briefing and argument on the meaning of Section 6.5 in the context of this Purchase Agreement, however, it is not clear that the same result as in *RAA Management* would hold here. That is, it appears reasonably conceivable that the Purchase Agreement does not preclude the Buyer's fraud claim to the extent that claim is based on misrepresentations or omissions by the Individual Defendants during meetings leading up to the closing of the Transaction. I consider, in particular, that the Individual Defendants are part of the Knowledge group whose alleged knowledge renders the contractual representation false, and that Purchase Agreement Section 9.6 states that "each Party hereto reserves all rights with respect to [Claims based on fraud or the bad faith of any Party]." *See Airborne Health, Inc. v. Squid Soap, LP*, 984 A.2d 126, 141 (Del. 2009) ("When drafters specifically preserve the right to assert fraud claims, they must say so if they intend to limit that right to claims based on written representations in the contract. I will not imply that limitation."); *Overdrive, Inc. v. Baker & Taylor, Inc.*, 2011 WL 2448209, at *6 (Del. Ch. June 17, 2011) (denying defendant's motion to dismiss plaintiff's fraud claim where the alleged misrepresentations and omissions were based on pre-contractual statements, but were related to contractual provisions, went to the very core of the agreement, and, if proven, would frustrate the very purpose and nature of the agreement). Furthermore, there is limited, if any, utility to limiting Plaintiff's fraud claim at this stage where I conclude that, based on the contractual representation in Section 3.25, Plaintiff has stated a claim both for fraud and for breach of contract.

"[t]his Agreement . . . constitutes the entire Agreement among the Parties (and the Sellers' Representatives) with respect to the subject matter of this Agreement and supersede[s] all other prior agreements and understandings, both written and oral, between the Parties with respect to the subject matter of this Agreement."

Delaware courts will honor clauses in which sophisticated parties disclaim reliance on extra-contractual representations. This Court, however, will not "give[] effect to so-called merger or integration clauses that do not clearly state that the parties *disclaim reliance* upon extra-contractual statements."[30] In order to bar a claim for fraud based on extra-contractual fraudulent representations, "[t]he integration clause must contain language that can be said to add up to a clear anti-reliance clause by which the plaintiff has contractually promised that it did not rely upon statements outside the contract's four corners in deciding to sign the contract."[31]

I do not find that Sections 3.27 and 10.9 of the Purchase Agreement reflect a clear promise by the Buyer that it was not relying on statements made to it outside of the Agreement to make its decision to enter into the Agreement. The Sections just quoted do not state that the parties *disclaim reliance* upon extra-contractual statements. They indicate that the Company represented that neither it nor any Seller was "making any other express or implied representation or warranty with respect to the Company" and

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30 *Abry P'rs V L.P., v. F & W Acq. LLC*, 891 A.2d 1032, 1058 (Del. 2006) (emphasis added).

31 *Id.* at 1058–59.

that the Purchase Agreement constitutes the entire agreement of the parties. The Buyer's fraud claim is not precluded by this promise. That is, there is no "double liar" problem where allowing the Buyer to prevail on its fraud claim would sanction its own fraudulent conduct in having falsely asserted that it was relying only on contractual representations.[32] In addition, the parties to this Purchase Agreement agreed to "reserve[] all rights with respect to" any claims based on fraud or the bad faith of any party.[33] Thus, other language in the Purchase Agreement provides further evidence that the parties intended that fraud claims could be based on extra-contractual representations. For both of these reasons, it is reasonably conceivable that Plaintiff can prevail on its claim for fraud predicated in part on extra-contractual representations.

Accordingly, I deny Defendants' motion to dismiss Count I.

B. Count II – Breach of Contract/Bad Faith Breach of Contract Against Management and Against Anvil and Thompson Street in Their Capacities as Sellers' Representatives

I turn next to Count II for breach of contract and bad faith breach of contract against Management and against Anvil and Thompson Street in their capacities as Sellers' Representatives. This claim is based on the Company's representation and warranty in Section 3.25. Section 3.25 appears in Article III of the Agreement, entitled

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[32] *See id.* at 1058 ("To fail to enforce non-reliance clauses is not to promote a public policy against lying. Rather, it is to excuse a lie made by one contracting party in writing—the lie that it was relying only on contractual representations and that no other representations had been made—to enable it to prove that another party lied orally or in a writing outside the contract's four corners.").

[33] Purchase Agreement § 9.6.

"Representations and Warranties of the Company." Each Seller made separate representations and warranties that are set forth in Article V, entitled "Representations and Warranties of Each Seller." Article V does not contain a representation and warranty analogous to that contained in Section 3.25.

In Section 3.25, the Company represents, in relevant part, that no contractor has notified it "in writing (or, to the Knowledge of the Company, orally) of any intention to stop, materially decrease the rate or materially change the terms . . . with respect to buying or supplying as the case may be, materials, services or products from or to the Company."[34] Knowledge is defined to mean all facts actually known by, among others, the Individual Defendants, after reasonable inquiry of the Company's employees who would reasonably be expected to have knowledge of the applicable item.[35] Here, it is the Individual Defendants' knowledge that allegedly makes the Company's representation false. Plaintiff's claim for breach of contract, however, is based on a breach *by the Company* of the representations in Section 3.25.

1. Sellers agreed to indemnify the Buyer for the Company's breach of an Article III representation and warranty

The Sellers—including each Defendant here and the sixteen additional Iron Data unitholders—agreed to indemnify the Buyer for any and all losses arising from a breach

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34 *Id.* § 3.25.

35 *See id.* § 1.1.

of the Company's representations and warranties in Article III, subject to the limitations in Article IX of the Purchase Agreement, entitled "Indemnification."

Defendants argue that Count II should be dismissed because the Buyer has not complied with the limitations in Article IX. Defendants acknowledge that the Sellers agreed to be liable for Company representations in certain circumstances. They contend, however, that the Sellers only agreed to indemnify the Buyer for Company representations in the limited circumstances where the procedural safeguards in Article IX are fully honored. Defendants argue that the Buyer's failure to comply with those procedural requirements is fatal to its Complaint.

The Buyer counters that Article IX's procedural requirements do not apply to their claims because that Article does not apply to "any Claims based on fraud or the bad faith of any Party."[36] In the alternative, the Buyer contends that it has complied with Article IX's procedural requirements.

2. The Buyer's bad faith breach of contract claim does not state a claim separate from its fraud claim

As an initial matter, the Complaint does not state a claim for "bad faith breach of contract." There are certain circumstances under which a party's bad faith may be relevant to a claim against it for breach of contract.[37] But, this is not such a case. As

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[36] *Id.* § 9.6.

[37] *See Clean Harbors, Inc. v. Safety-Kleen, Inc.*, 2011 WL 6793718, at *2 (Del. Ch. Dec. 9, 2011) (considering whether a company breached an option agreement that allowed the company to call the shareholders' options to shares for "Fair Market Value" on the date upon which the shares were called where the option agreement

stated in the cases relied upon by the Buyer, *e.g.*, *M/C Venture Partners*, an aggrieved party to a contract, such as the Purchase Agreement, has two paths to recovery: (1) suing contractually and going through the indemnification provisions or (2) suing for fraud.[38] Here, the Buyer has done both. In pressing its breach of contract claim, the buyer must take into account the Article IX procedural requirements. This makes sense because each Seller—not just those accused of fraud—potentially could be required to indemnify the Buyer. In pressing its fraud claim against the Individual Defendants, the Buyer is not required to comply with the indemnification regime in Article IX. No case the Buyer relies on, however, supports the argument that allegations of fraud against the Individual Defendants change the nature of the Buyer's breach of contract claim and allow the Buyer to avoid the bargained-for procedural protections in Article IX. Thus, to the extent Plaintiff asserts a bad faith breach of contract claim, I dismiss that claim as duplicative of

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defined "Fair Market Value" as "the fair market value of a Share as determined by the Committee *in its good faith discretion*, taking into account such factors as it deems appropriate." (emphasis added)).

[38] *See* Superior Ct. Pls.' Ans. Br. in Opp'n to Superior Ct. Defs.' Mot. to Dismiss the Superior Ct. Compl. ("Buyer's Opp'n Br.") 16–19 (citing, among others, *M/C Venture P'rs V, L.P. v. Savvis*, C.A. No. 7359-VCL, at 40 (Del. Ch. Jan. 7, 2013) (TRANSCRIPT) (interpreting an exclusive remedies provision and stating "one has two paths to recovery. One can sue contractually and go through the indemnification provisions, or one can sue for intentional fraud based on breach of written representations.")). In *M/C Venture Partners*, the Court found that the agreement limited fraud to explicit contractual representations. As discussed *supra*, I conclude that Plaintiff conceivably could succeed on its claim for fraud based both on contractual representations and extra-contractual representations.

Plaintiff's fraud claim.[39] Count II, therefore, will proceed as an ordinary breach of contract claim against the Individual Defendants and against Anvil and Thompson Street in their capacities as Sellers' Representatives subject to the requirement imposed by this ruling *infra* subsection 3.c that Plaintiff amend the Complaint to assert this claim against all Sellers as defendants. This breach of contract claim is subject to the indemnity regime in Article IX of the Purchase Agreement.

3. Compliance with Article IX

I consider lastly whether the Buyer met the requirements of Article IX in bringing its breach of contract claim against the Sellers' Representatives in their capacity as such. Section 9.3 sets forth the "Indemnification Procedure" when a party claims a right to indemnification under the Purchase Agreement. Subsection (c) sets forth the following procedure: (1) the Indemnified Party claiming a right to payment shall send written notice to the appropriate Indemnifying Party (defined as "Buyer or the Sellers' Representatives (on behalf of Sellers), whichever is the appropriate indemnifying Party"); (2) the notice shall specify in reasonable detail the basis for the claim; (3) the Indemnifying Party has twenty-five business days after receipt of the notice to respond to the claim and to state any objections in reasonable detail; (4) the parties must then negotiate for not less than twenty-five business days; (5) if the parties are unable to resolve the dispute, the parties shall establish the merits and amount of the Indemnified Party's claim by mutual

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[39] Plaintiff separately named Management in Count II as to its bad faith breach of contract claim only. *See* Superior Ct. Pls.' Answering Br. in Opp'n to Superior Ct. Defs.' Mot. to Dismiss the Superior Ct. Compl. 37.

agreement, arbitration, or litigation; and (6) the Indemnifying Party must pay any amount held to be due to the Indemnified Party within five business days.

The parties have not identified any provision prescribing the consequences of failing to follow one or all of these procedures, *e.g.*, the Agreement does not state that the Indemnified Party would forfeit its claim by failing to follow these procedures. Defendants assert, however, that they would be liable to indemnify the Buyer only if the Buyer complied with all of the procedural requirements listed in Section 9.3.

a. Notice with reasonable detail

The first requirement of Section 9.3 is met: the Indemnified Party, the Buyer, sent written notice of a right to indemnification to the appropriate Indemnifying Party, the Sellers' Representatives on behalf of the Sellers. The second requirement is that the notice specify in "reasonable detail" the basis for the Buyer's claim. The Agreement does not define "reasonable detail." The Buyer sent the Sellers' Representatives a two to three page letter.[40] In its letter, the Buyer asserted that two situations formed the basis for its claim for indemnification: (1) that the Company had reached an understanding with Lockheed before closing and without notifying the Buyer to modify pricing terms from firm fixed pricing to materially lower time and materials rates; and (2) that the Company knew before closing that the SSA intended to reduce funding under the Company's most profitable contract. The Sellers timely responded with a seven-page letter.[41]

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[40] Ct. Ch. Compl. Ex. C.

[41] Buyer's Opp'n Br. 32.

The Buyer's letter specifically mentioned two contracts that required unanticipated post-closing alterations and alleged that the Company knew that these changes were inevitable before closing but failed to notify the Buyer of them. At this stage, I am unable to conclude that the Buyer's letter did not set forth its claims in "reasonable detail" as required by the Agreement. At a minimum, this question involves factual issues that cannot be resolved on Defendants' motion to dismiss.

On Defendants' motion to dismiss, I must draw all reasonable inferences in favor of Plaintiff. Paragraph 45 of the Complaint states: "On August 7, 2012, Buyer sent a Notice of Claim *pursuant to the terms of the Purchase Agreement* and the Escrow Agreement notifying the Sellers' Representative of its claim for breach of Section 3.25 and potentially for fraud."[42] These allegations by Plaintiff are not contradicted by the Complaint or the documents incorporated therein.[43] Rather, Defendants contend that the notice provided did not include "reasonable detail," and the Buyer disagrees. In these circumstances, I conclude, for purposes of the motion to dismiss, that the meaning of reasonable detail is subject to legitimate debate and that the Buyer's notice conceivably has met the requirements of Article IX in that regard.[44]

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42 Compl. ¶ 45 (emphasis added).

43 *See H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 139 (Del. Ch. 2003) ("[A] complaint may, despite allegations to the contrary, be dismissed where the unambiguous language of documents upon which the claims are based contradict the complaint's allegations.").

44 Compl. ¶ 45.

b. Negotiation period

There is no dispute that the Sellers' Representatives responded to the Buyer's notice of claim with reasonable detail within the twenty-five days specified in Article IX. A dispute exists, however, as to whether the Buyer complied with the requirement that the parties negotiate the claims for at least twenty-five days after the Buyer received the Sellers' response. Notably, the Agreement does not state that one party or the other must initiate negotiations. The relevant provision states: "If the Indemnifying Party [*i.e.*, Seller] provides its response within such time period, the Indemnified Party [*i.e.*, Buyer] and the Indemnifying Party [*i.e.*, Seller] *shall negotiate* the resolution of the claim(s) for a period of not less than twenty-five (25) Business Days . . . ."[45]

The Buyer concedes that there were no negotiations after the notice of claim and response letters. The Complaint neither alleges that the parties entered negotiations nor states any reason why the parties did not negotiate to resolve the claim during the period after the Buyer received the Sellers' response. The Complaint states only that: "On September 6, 201[2], the Sellers' Representative responded with a letter refusing the Notice of Claim."[46]

The Buyer argues that the parties did not engage in negotiations because the Sellers did not make an "overture inviting productive negotiations."[47] According to the

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45 Purchase Agreement § 9.3(c) (emphasis added).

46 Compl. ¶ 45.

47 Buyer's Opp'n Br. 34.

Buyer, negotiations obviously would have been futile because the Sellers' response attacked each aspect of the Buyer's claim, including its motive for sending the notice of claim. The Buyer also asserts that Delaware law does not require parties to engage in a futile act.[48]

I do not take lightly the parties' obligation under Section 9.3(c) of the Purchase Agreement to attempt to negotiate the resolution of the claim at issue. Section 9.3(c) provides, in relevant part, that after a Notice of Claim has been received, if the Indemnifying Party fails to respond in reasonable detail within twenty-five business days:

> [T]he Indemnifying Party will be deemed to have conceded the claim(s) set forth in the Notice of Claim. If the Indemnifying Party provides its response within such time period, the Indemnified Party and the Indemnifying Party shall negotiate the resolution of the claim(s) for a period of not less than twenty-five (25) Business Days after such response is provided.

It is not surprising, therefore, that the Sellers sent a timely and detailed response. The Agreement, however, does not set forth with any specificity what activities would constitute negotiations and does not require one party or the other to initiate negotiations. Moreover, the Agreement does not state that a failure to negotiate would be grounds to dismiss an Indemnified Party's later complaint. Based on the circumstances alleged here, it is reasonably conceivable that the Buyer will succeed in showing that they reasonably concluded from the Sellers' response letter that any negotiations would have been futile.

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[48] *See Reserves Dev. LLC v. R.T. Props., LLC*, 2011 WL 4639817, at *7 (Del. Super. Sept. 22, 2011) ("[T]he law does not require a futile act.").

The Sellers' response stated, for example, that there is a "complete lack of factual basis for the claims asserted."[49] In the same vein, the response further asserted: "We respectfully suggest that the Company would be better served by pursuing activities to grow its business rather than to litigate baseless claims against current members of its Board of Directors, management, employees, and shareholders."[50] Conversely, nothing in the record at this preliminary stage indicates that negotiations would have had a reasonable prospect of success.[51]

Moreover, Anvil and Thompson Street filed a complaint in this Court on October 23, 2012, two weeks before the Buyer filed its Complaint in Superior Court. Thus, one reasonably could question the Sellers' own belief that negotiations would have been

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49 Ct. Ch. Compl. Ex. D at 7.

50 *Id.*

51 In their reply brief, Defendants suggest that an October 10, 2012 letter that the Sellers' Representatives sent to the Buyer invited the Buyer to comply with the Purchase Agreement's requirement to negotiate. *See* Reply Br. in Supp. of Superior Ct. Defs.' Mot. to Dismiss the Superior Ct. Compl. Ex. A. Plaintiff objects to the use of this letter as evidence on Defendants' motion to dismiss. The Superior Court Complaint made no reference to the letter and, although it was mentioned generally in the Court of Chancery Complaint, it was not attached as an exhibit to that Complaint. In any event, I need not decide whether it would be appropriate to consider the October 10, 2012 letter on Defendants' motion to dismiss. Based on the tone of that letter, and on the fact that it was sent five days before the expiration of the minimum twenty-five business day negotiations period, it is difficult to dispute the Buyer's apparent conclusion that any such negotiations would have been futile. One reasonable inference from the letter is that Defendants simply were making a record of their willingness to negotiate and their ability to file a lawsuit after the negotiations period expired. The letter contains no meaningful invitation to negotiate, simply an invitation for the Buyer to capitulate and to authorize the release of the escrow fund.

anything other than an exercise in futility. For all of these reasons, I conclude that the apparent lack of negotiations between the parties does not provide a basis to dismiss the Buyer's breach of contract claim.

c. Plaintiff suing the Sellers' Representatives only

Defendants also seek dismissal of the Complaint based on the Buyer's failure to name each of the twenty-three Sellers as a defendant in this action. Instead of suing each Seller, Plaintiff sued Anvil and Thompson Street in their capacity as "Sellers' Representatives" under Section 10.17 of the Purchase Agreement.

Section 10.17 provides, in relevant part, that each Seller designates Anvil and Thompson Street as the Sellers' Representatives to

> do any and all [] acts or things on behalf of each Seller . . . which may be required pursuant to this Agreement, the Escrow Agreement or otherwise, in connection with the consummation of the transaction contemplated hereby or thereby and the performance of all obligations hereunder or thereunder at or following the Closing . . . .[52]

The Section also provides that such acts include but are not limited to the authority to

> agree to, object to, negotiate, *resolve*, enter into settlements and compromises of, demand arbitration or litigation of, and comply with orders of arbitrators or courts with respect to, (A) *indemnification claims by Buyer or any other Buyer Indemnified Party pursuant to Article IX* or (B) any dispute between any Buyer Indemnified Party and any such Seller, in each case relating to this Agreement or the Escrow Agreement, except, in the case of clauses (A) and (B), to the extent that any such claim or dispute relates to a breach by or

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[52] Purchase Agreement § 10.17(a).

> indemnification obligation of a specific Seller and not all Sellers . . . .[53]

In addition, Section 9.5(s) provides that:

> Notwithstanding anything to the contrary set forth in this Agreement: . . . any claim for indemnification under this Article IX for which each Seller (rather than a single Seller or a single group of related Sellers) may be liable or responsible *shall be asserted* by the applicable Buyer Indemnified Party *against all Sellers*.[54]

These two provisions reasonably could be read to require Plaintiff to name all Sellers as defendants in this action. In these circumstances, however, another arguably reasonable construction of the relevant sections is that the Buyer could sue all Sellers indirectly through the Sellers' Representatives. Here, the Complaint unambiguously states that Plaintiff is suing Anvil and Thompson Street in their capacity as Sellers' Representatives and appears to state claims against all Sellers. Moreover, Section 10.17(a)(v) expressly gives the Sellers' Representatives the authority to "resolve . . . indemnification claims by Buyer or any other Buyer Indemnified Party pursuant to Article IX." I question whether this second interpretation of Sections 9.5(s) and 10.17(a)(v), in fact, is reasonable and, therefore, would render the Agreement ambiguous in this regard. Ultimately, however, it appears unnecessary to decide that issue here.

Defendants' counsel agreed at oral argument that the Buyer's alleged failure to name all the Sellers as defendants should not be grounds for precluding the Buyer from

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53 *Id.* § 10.17(a)(v) (emphasis added).

54 *Id.* § 9.5(s) (emphasis added).

amending the Complaint, if necessary, to name all the Sellers as defendants. In that regard, opposing counsel undertook to confer about resolving this issue if Defendants persisted in their position that the Buyer must name each Seller as a defendant. Having received no notice of any agreement as to this issue, I will grant Defendants' motion to dismiss for failure to name all Sellers as defendants, but without prejudice to Plaintiff's ability to amend its Complaint within twenty days of the date of this Memorandum Opinion and Order to include additional defendants. Whether or not the parties reach some agreement to simplify the procedural and logistical complications that may be caused by this aspect of the Court's ruling, I expect counsel to cooperate closely to minimize the costs of including so many additional parties in this action.

III. CONCLUSION

For the foregoing reasons, I grant the motion to dismiss Count II with prejudice to the extent it claims a bad faith breach of contract. I also grant the motion to dismiss Count II for breach of contract against Anvil and Thompson Street in their capacity as Sellers' Representatives without prejudice to Plaintiff's ability to amend its Complaint to name all Sellers as defendants within twenty days of the date of this Memorandum Opinion and Order. In all other respects, the motion to dismiss is denied.

IT IS SO ORDERED.