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UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware

Osram Sylvania Inc., Plaintiff,
v.
Townsend Ventures, LLC, TV Encelium Investment I, TV Encelium Investment II, Anthony Marano, Terry Mocherniak, and Marc Hoffknecht, Defendants.

C.A. No. 8123–VCP | Submitted: July 24, 2013 | Decided: November 19, 2013

Attorneys and Law Firms

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MEMORANDUM OPINION

PARSONS, Vice Chancellor.

***1** In this action, the buyer under an agreement to purchase the remaining capital stock of a company brings breach of contract and fraud claims against the sellers. The buyer alleges that the sellers manipulated the financial condition of the company in the periods leading up to the execution and the closing of the agreement to make the company appear to be more successful than it actually was. The buyer also claims that, before the closing, the sellers discovered that the company significantly had underperformed compared to its forecasts in the most recent financial quarter, but concealed this fact from the buyer. In its complaint, the buyer asserts, among other things, claims for breach of contract, breach of warranty, breach of the implied covenant of good faith and fair dealing, and fraud. As remedies for the alleged misconduct of the sellers, the buyer requests indemnification, damages, and a declaratory judgment in its favor.

The defendants have moved to dismiss the complaint under Court of Chancery Rule 12(b)(6) for failure to state a claim. This Memorandum Opinion reflects my ruling on the defendants' motion. For the reasons that follow, I grant the motion in part and deny it in part. Specifically, I grant the defendants' motion to dismiss the buyer's claims for breach of warranty, equitable fraud, and breach of the implied covenant. I deny the defendants' motion in all other respects.

I. BACKGROUND [1]

A. The Parties

The plaintiff in this action is Osram Sylvania Inc. (“OSI” or “Plaintiff”). The defendants are Townsend Ventures LLC, TV Encelium Investment I, Inc., TV Encelium Investment II, Inc., Anthony Marano, Terry Mocherniak, and Marc Hoffknecht (collectively, “Sellers” or “Defendants”). All of the business entities that are parties to this lawsuit were organized under the laws of Delaware.

B. Facts

1. Relevant background

OSI and Sellers are parties to a contested Stock Purchase Agreement (“SPA”), pursuant to which OSI purchased from Sellers all of the remaining issued and outstanding stock of Encelium Holdings, Inc., a Delaware corporation (“Encelium” or the “Company”). Encelium operates its business through a subsidiary, Encelium Technologies ULC, a British Columbia unlimited liability company (“Encelium Technologies”).

In 2011, OSI owned, indirectly through an affiliate, certain Purchaser Preferred Stock in Encelium. Sometime in 2011, OSI and Sellers began to discuss the possibility of OSI purchasing the remaining stock of the Company. On or about May 25, 2011, Sellers provided OSI with a presentation about Encelium (the “Management Presentation”) that included information about its technology, its sales and financials, the market in which it operates, the competitive landscape, and a review of Encelium's operations.

***2** In the Management Presentation, Sellers informed OSI that Encelium was planning to release products based on its newly developed GreenBus II technology (a successor to GreenBus I) in Fourth Quarter 2011. The Management Presentation revealed that Encelium had a negative EBITDA for calendar year 2010, but was projecting sales for calendar year 2011 of approximately $18 million. Sellers also informed OSI that two of Encelium's employees, Lisa Scholl and Neil Schroder, together were responsible for approximately 32% of the forecasted sales for 2011.

Following the Management Presentation, OSI and Sellers had numerous discussions about Sellers' sales forecasts, and Sellers knew that it was important to OSI that Encelium achieve its sales forecasts for Second and Third Quarter 2011. According to OSI, Sellers understood that the 2011 forecast numbers were integral to OSI's calculation of the purchase price for Encelium.

In early July 2011, Sellers reported to OSI that Encelium's sales for Second Quarter 2011 (which ended on June 30, 2011) were consistent with the forecasted sales numbers. For Third Quarter 2011, Sellers forecasted sales of approximately $4 million. Based on Sellers' representations concerning the financial condition, operating results, income, revenue, and expenses of Encelium, OSI agreed to pay approximately $47 million, subject to certain adjustments, for the Company's remaining capital stock. To that end, the parties executed the SPA (the “Execution”) on September 30, 2011 (the “Effective Date”), the last day of Third Quarter 2011. The transaction closed (the “Closing”) on October 14, 2011 (the “Closing Date”).

2. OSI's allegations

After the Closing, OSI learned that Encelium's sales in Third Quarter 2011 were significantly less than Sellers had forecasted. Encelium's Third Quarter sales were only $2 million, or approximately one half of the sales the Company had forecasted for that period. OSI alleges that Sellers knew Encelium's actual sales results for Third Quarter 2011 by the Closing Date, but they did not inform OSI of the Company's underperformance.

Upon further investigation, OSI alleges it discovered that Sellers had manipulated the Second Quarter 2011 numbers to hide the fact that the business of Encelium was not as Sellers had represented. OSI contends that, beginning in Second Quarter 2011 and continuing until the Closing, Sellers manipulated the financial condition and working capital of Encelium by, among other things: holding invoices for payment, billing and shipping excess product to create reportable revenue (without disclosing the credits to be applied), and failing to disclose discount policies. According to OSI, Sellers also attempted to manipulate the financial condition of the Company by altering the size and nature of the Company's business segments before the Closing. OSI asserts that, for all these reasons, the information in the Financial Statements, including those through June 30, 2011, did not fairly present the financial condition and results of operations of Encelium and, further, was not consistent with GAAP.

OSI also alleges that Sellers knew, by the Closing Date, that Encelium's salespeople Scholl and Schroder had resigned, but they did not notify OSI of this fact before the Closing. Together, Scholl and Schroder accounted for approximately 32% of Encelium's 2011 sales forecast. Scholl had been expected to make nearly $3.4 million in sales in the Third and Fourth Quarters of 2011. She resigned in mid-June 2011, however, before the end of the Second Quarter. Schroder had been expected to make $3.3 million in sales in 2011, but he resigned before August 2011.

***3** OSI further contends that, as of the Closing Date, Sellers were aware that Encelium had a significant liability that it had not accounted for in its financial statements or otherwise disclosed to OSI. Specifically, as of March 2011, Encelium had accepted a purchase order requiring it to provide and install lighting control systems in sixteen buildings at Patrick Air Force Base (“PAFB”) (the “PAFB Contract”). The PAFB Contract required that these systems be able to “utilize and interface with the LonTalk protocol in communication.” As of the Closing Date, however, the Encelium Lighting Control System had never interfaced with LonTalk. OSI asserts, therefore, that Encelium had a significant and costly obligation to make its Lighting Control System compatible with LonTalk, but that Sellers did not disclose properly or otherwise account for that obligation.

In addition, OSI claims that Sellers had represented to it that Encelium maintained about $400,000 worth of inventory of product based on the Company's GreenBus I technology. Yet, notwithstanding the anticipated launch of GreenBus II, Encelium's inventory of GreenBus I based technology had grown to nearly $1 million by the Closing.

As evidence of Sellers' bad faith in their alleged manipulation and concealment of Encelium's financial information, OSI refers to an August 2011 internal email by one of the Sellers. That email states that "[g]iven where sales are going the distraction with senior management is far too great to keep up any charade on the chance that a deal does happen." [2] OSI argues that this email supports an inference that Sellers were putting on a "charade" in order to entice OSI to enter into the SPA. OSI also avers that, in October, immediately before the Closing, Sellers stated in internal communications that if the Closing did not occur soon, the Company would have a "cash problem." [3] According to OSI, Sellers discussed addressing this issue by buying product from Encelium, which OSI avers provides further proof that Sellers attempted to prop up falsely the revenue and operations of Encelium before the Closing.

Based on the foregoing allegations, OSI contends that Sellers have breached numerous provisions of the SPA as well as the implied covenant of good faith and fair dealing. OSI also asserts several fraud-related claims arising from Sellers' alleged manipulation and concealment of Encelium's financial information in the periods before the Effective Date and the Closing. Due to Sellers' misconduct, OSI avers that it paid significantly more than it otherwise would have for the Company and requests, among other relief, damages and indemnification for its losses.

3. Relevant provisions of the SPA

The SPA contains numerous provisions that are relevant to this action. They generally fall into three categories: (1) representations and warranties; (2) covenants; and (3) indemnification. Article 3 of the SPA, entitled "Representations and Warranties Relating to the Acquired Companies," contains many of the provisions that OSI relies on in bringing its claims. For purposes of the contract, "Acquired Companies" is defined to include Encelium and its subsidiaries, such as Encelium Technologies. [4]

Section 3.5(b) of the SPA is a warranty of the accuracy of Encelium's financial statements from 2008 through June 30, 2011 (the end of Second Quarter 2011). It provides that: "[t]he Financial Statements are correct and complete in all material respects ... and fairly present the financial condition and the results of operations, changes in shareholders' equity, and cash flows of the Acquired Companies ... all in accordance with GAAP consistently applied."

Section 3.5(c) is a warranty that the Company has been operated in the ordinary course of business and that no material adverse changes have occurred. It provides that: "[s]ince the date of the Interim Balance Sheet [June 30, 2011], the Acquired Companies have operated the Business in the ordinary course of the Acquired Companies' Business consistent with past custom and practice." It further warrants that "there has not occurred any event or development that has resulted in, or would reasonably be expected to result in, a Material Adverse Change."

***4** Section 3.6 is a warranty as to liabilities. It provides that the Acquired Companies have not incurred any liabilities, except for liabilities: "(i) accrued or reserved against on the Interim Balance Sheet (which reserves are adequate, appropriate and reasonable); (ii) incurred in the Ordinary Course of Business of the Company since the date of the Interim Balance Sheet ... or (iii) set forth on Schedule 3.6 of the Disclosure Schedules." That section also warrants that any liabilities incurred in the ordinary course do not "individually or in the aggregate ... have a Material Adverse Effect on the Business."

Section 3.7 provides that for the period since December 31, 2010, similarly to Section 3.5(c), "no change or event ... has resulted in, or would reasonably be expected to result in, a Material Adverse Effect." Section 3.20 states that the inventory of the Acquired Companies is accurately disclosed and is "of a quantity, quality and mix as are historically consistent with past business practices." Finally, Section 3.35 provides that: "[n]o representation or warranty by any of the Seller Parties contained in this Agreement or any Transactional Document contains any untrue statements of material fact or intentionally omits to state any material fact necessary to make the statements ... not misleading."

In its breach of contract claims, OSI also invokes the covenants contained in Sections 6.1 and 6.4 of the SPA. Section 6.1 requires Sellers to operate the Company in the ordinary course of business between the Effective Date (September 30, 2011) and the Closing Date (October 14, 2011). Section 6.4 requires Sellers, in that same period, to notify OSI of any fact or circumstance that: "(i) has had, or would reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect; [or] (ii) has resulted in, or could reasonably be expected to result in, any

representation, warranty, covenant, condition, or agreement made by such Seller not being true or correct."

Based on Sellers' alleged breaches of the preceding provisions, OSI seeks indemnification. In Section 9.2(a)(i) and 9.2(a)(ii), Sellers agreed to "indemnify, defend, protect and hold harmless" OSI and its affiliates from "all losses and damages, including reasonable attorneys' fees, resulting from, imposed upon, or incurred or suffered by [OSI], directly or indirectly, as a result of breaches of the SPA by Sellers or the Acquired Companies. Specifically, the SPA provides for indemnification of OSI for losses or damages caused by "a breach or non-fulfillment [of] ... a covenant or obligation in this Agreement or in any Transaction Document" by a Seller, [5] or by an Acquired Company prior to the Closing." [6] In addition, Sellers agreed to indemnify OSI for any losses or damages resulting from: "a breach of or inaccuracy in a representation or warranty made by [Sellers] in Article 3 ... without giving effect to any qualifications as to 'materiality,' 'Material Adverse Effect,' or similar words." [7]

Section 9.3(a) establishes an indemnification threshold. It provides that Sellers will not have to indemnify OSI for inaccuracies in the representations and warranties contained in Article 3 unless the aggregate amount of indemnifiable damages attributable to those inaccuracies exceeds $200,000, in which case Sellers will be liable for the full amount. [8] For the stated purpose of avoiding disputes over the meaning of materiality qualifiers in calculating indemnifiable damages, Section 9.4, like Section 9.2(a)(i)(A), includes a "materiality scrape." Section 9.4 specifies that, "for purposes of this Article 9, any ... materiality qualifier contained in any representation or warranty shall be ignored in determining whether there has been a breach of or inaccuracy in a representation or warranty and in measuring the corresponding damages." The scope of the Section 9.4 "materiality scrape" explicitly includes terms such as " 'Material Adverse Effect,' 'material,' 'materially,' 'in all material respects' or similar materiality qualifiers."

C. Procedural History

***5** On December 19, 2012, OSI filed its Verified Complaint (the "Complaint") against Defendants, the Sellers under the SPA. The Complaint states eight counts against Defendants for breach of contract (Count I), breach of warranty (Count II), indemnification (Count III), equitable fraud (Count IV), fraud (Count V), negligent misrepresentation (Count VI), breach of the covenant of good faith and fair dealing (Count VII), and declaratory judgment (Count VIII). Sellers filed a motion to dismiss the entire Complaint (the "Motion to Dismiss" or "Motion") on March 1, 2013. After full briefing, I heard argument on that motion on July 12, 2013. Following argument, the parties each submitted supplemental briefing on the Delaware Supreme Court's opinion in *Gerber v. Enterprise Products Holdings, LLC,* [9] and its possible application to OSI's claim for breach of the implied covenant of good faith and fair dealing.

D. Parties' Contentions

Sellers assert that OSI's claims are duplicative and fit into two main categories: (1) claims arising out of the SPA; and (2) claims sounding in fraud. In seeking dismissal of the Complaint, Sellers argue that OSI has failed to state a valid claim for breach of the SPA or for fraud. Defendants contend that each of OSI's contract-based claims fails because OSI has not sufficiently tied any alleged misconduct by Sellers to specific provisions of the SPA. As to OSI's fraud-based claims, Defendants maintain that none of them is pled with particularity as required by Delaware law. For these reasons, Defendants assert that none of the counts of OSI's Complaint adequately states a claim on which relief can be granted.

OSI disputes Sellers' contentions and urges the Court to deny the Motion to Dismiss in its entirety. OSI argues that its breach of contract claims meet, and exceed, the applicable pleading standard set forth in Court of Chancery Rule 8 and provide Sellers ample notice of OSI's indemnification claims. OSI contends that its tort claims also meet the Rule 9(b) particularity standard, as well as the Rule 8 pleading standard, and similarly provide ample notice to Sellers of the claims against them. For these reasons, OSI asserts that Sellers' Motion to Dismiss should be denied.

II. ANALYSIS

This is a motion to dismiss under Court of Chancery Rule 12(b)(6). I therefore "assume the truthfulness of the well-pled allegations of the Complaint" [10] and afford Plaintiff "the benefit of all reasonable inferences." [11] If the well-pled allegations in the Complaint would entitle Plaintiff to relief under any "reasonably conceivable" set of

circumstances, the Court must deny the motion to dismiss. [12] The court, however, need not "accept conclusory allegations unsupported by specific facts." [13] Moreover, failure to plead an element of a claim precludes entitlement to relief and, therefore, is grounds to dismiss that claim. [14] Nonetheless, the Court must "accept even vague allegations as 'well pleaded' if they give the opposing party notice of the claim." [15]

A. Contract Claims

The Complaint contains four counts related to Sellers' alleged breaches of contract: Count I for breach of contract; Count II for breach of warranty; Count III for indemnification; and Count VIII for a declaratory judgment that Sellers breached the SPA and that OSI is entitled to indemnification. Because the facts giving rise to these four claims largely overlap, I consider them as a group.

***6** At the outset, I find that OSI's breach of warranty claim is duplicative of its breach of contract claim and, therefore, should be dismissed. OSI alleges breach of warranty as to exactly the same provisions of the SPA upon which it bases its breach of contract claim. Any breach of an express warranty also would qualify as a breach of contract, however, and the remedies available under either claim are equivalent. Furthermore, OSI requests the same relief under both claims, namely, damages for the amount that it overpaid under the SPA due to Sellers' breaches of the relevant provisions. A court may decline to consider a claim that is identical to or redundant with another. [16] The Court exercises that discretion here to dismiss the breach of warranty claim (Count II).

I also note that, in their briefs and at argument, Sellers did not specifically challenge OSI's claim for a declaratory judgment that Sellers had breached the SPA and that, as a result, OSI was entitled to indemnification. Instead, Sellers appear to argue that this claim (Count VIII) should be dismissed because OSI has failed to state claims for breach of contract and indemnification, the alleged wrongs underlying its request for a declaratory judgment. My determination as to whether OSI has stated a claim for a declaratory judgment, therefore, is dependent upon my determinations as to the viability of these other claims. To the extent that I deny the Motion to Dismiss as to OSI's claims for breach of contract and indemnification, I also deny the Motion as to OSI's request for a declaratory judgment. In that context, I consider next OSI's claims for breach of contract and indemnification.

1. Breach of Contract

To establish a breach of contract claim, a party must prove: (1) the existence of a contract; (2) the breach of an obligation imposed by the contract; and (3) damages that the plaintiff suffered as a result of the breach. [17] In this action, the existence of a valid contract between OSI and Sellers is uncontested. Thus, to determine whether OSI has stated claims for breach of contract, I focus on whether OSI adequately has pled the elements of breach and damages as to the various provisions of the SPA that it alleges have been violated.

OSI alleges that it is entitled, under the SPA, to be indemnified by Sellers for damages resulting from four main categories of contractual breaches. These are: (1) Sellers' manipulation and concealment of financial information before the Closing in the pre-effective and post-effective periods; (2) Encelium's loss of two salespeople; (3) Encelium's undisclosed liabilities under the PAFB Contract; and (4) Encelium's accumulation of excess inventory of GreenBus I based products. I examine the allegations in each category to determine whether those allegations support a claim for breach of any of the SPA's provisions.

a. Manipulation and concealment of financial information

1. In the pre-effective period

OSI alleges that Sellers inflated Encelium's sales results from Second Quarter 2011, and that they improperly manipulated and concealed the financial condition, results of operations, cash flows, and working capital of Encelium leading up to the Closing, in order to give the impression that the Company was doing better than it actually was. OSI contends that these actions breached numerous provisions of the SPA, including Sections 3.5(b) (warranting the accuracy of the financial statements), 3.5(c) (warranting that the Company had been run in the ordinary course of business and that there were no Material Adverse Changes), 3.7 (warranting that there were no Material Adverse Effects), and 3.35 (warranting the

accuracy and completeness of Sellers' other representations and warranties).

***7** Sellers argue that OSI's allegations that Sellers inflated the Company's performance in Second Quarter 2011 and manipulated and concealed the financial information of the Company are conclusory and unsupported by specific allegations and, therefore, should be dismissed.

I find that OSI, through its allegations of financial manipulation, adequately has pled breaches of Sections 3.5(b), 3.5(c), 3.7, and 3.35. Although Sellers criticize OSI's allegations as conclusory, OSI pled specific facts to support its claim that Sellers manipulated Encelium's financial information and sales results. OSI's allegations suggest, for example, that, in Second Quarter 2011 and in the period leading up to the Effective Date, Sellers inflated revenues by billing and shipping excess product, without applying proper credits or discounts. OSI alleges that Sellers then delayed issuing payment invoices to customers, presumably to delay any protests against the shipment of that excess merchandise. Sellers allegedly also manipulated the Company's financial information by altering the size and nature of the Company's business segments.

Taking OSI's well-pled factual allegations as true, it is reasonably conceivable that OSI could succeed in demonstrating that Sellers' inflation of sales, financial manipulation, and modification of the Company's business segments resulted in financial statements that were not "correct and complete" and did not "fairly present the financial condition" of the Company, thereby breaching Section 3.5(b). OSI also alleges that, in order to bring about the SPA, Sellers restructured the Company's business segments and manipulated its financial information in a way that was unsustainable. One reasonably could infer that these actions were not taken "in the ordinary course of the Acquired Companies' Business consistent with past custom and practice," and, therefore, caused a violation of Section 3.5(c).

There is also a reasonable possibility that OSI could demonstrate that the changes in Encelium's business practices in the period leading up to the Effective Date could be expected to produce a "Material Adverse Change" or to have a "Material Adverse Effect" on the long-term performance of the Company, breaching the representations of Sections 3.5(c) and 3.7 of the SPA. Under the contract, "Material Adverse Effect" and "Material Adverse Change" are defined to mean "any effect or change ... that would be materially adverse to the Business, assets, condition (financial or otherwise), results or operations of the Acquired Companies." [18]

It is reasonably conceivable that Sellers' alleged acts of financial manipulation could produce consequences that are materially adverse to the Company. For example, Sellers' alleged practice of billing and shipping excess product, without applying the proper credits or discount, could have a materially adverse effect on the financial condition of the Company when the excess product is returned and revenues are reduced. Furthermore, it is possible that OSI could demonstrate that Sellers' restructuring of the Company's business segments produced short-term financial gains at the cost of long-term viability, thereby resulting in a materially adverse effect on the business and operations of the Company. These theories are bolstered by the fact that Encelium's actual sales results dropped precipitously between Second Quarter 2011, when the financial manipulation allegedly began, and Third Quarter 2011.

***8** I conclude, therefore, that under a reasonably conceivable set of circumstances, OSI could prove that Sellers breached the representations and warranties contained in Sections 3.5(b), 3.5(c), and 3.7 of the SPA. These breaches would result, as well, in a breach of Section 3.35, which is a guarantee of the truthfulness and completeness of Sellers' representations and warranties in the SPA.

It also is reasonably conceivable that OSI could prove damages resulting from these breaches. The financial manipulation that is alleged to have resulted in breaches of Sections 3.5(b), 3.5(c), 3.7, and 3.35 made the Company appear to be more successful than it actually was in the period leading up to the Execution. Sellers' misconduct, therefore, may have caused OSI to agree to pay more for the Company than it otherwise would have. An increase in the purchase price would be a foreseeable consequence of the breaches that OSI alleges, and OSI therefore could claim the amount of any overpayment as damages under the SPA.

Thus, OSI has stated claims for breach of contract as to Sections 3.5(b), 3.5(c), 3.7, and 3.35 of the SPA.

2. In the post-effective period

OSI accuses Sellers of committing additional breaches of the SPA by manipulating and concealing financial information during the post-effective period before the Closing. Sellers had forecasted that Encelium would make approximately $4 million in sales in Third Quarter 2011. Instead, Encelium made approximately $2 million in sales in that period. The parties executed the SPA on September 30, 2011, the last day of the Third Quarter. OSI alleges that between the Execution and the Closing, Sellers learned of Encelium's actual sales numbers for Third Quarter 2011 and, therefore, knew that the Company had underperformed significantly compared to its forecasts. Nonetheless, Sellers did not disclose that information to OSI before the Closing. OSI also avers that the financial manipulation that it alleges began in Second Quarter 2011 continued until the Closing.

Based on these factual allegations, OSI argues that Sellers' actions breached the covenants in Sections 6.1 and 6.4 of the SPA. Those covenants required Sellers to operate Encelium in the ordinary course of business in the two weeks between the Execution and the Closing, and to inform OSI of anything occurring in that two-week period that might produce a Material Adverse Effect. Sellers deny that OSI has stated a claim under Sections 6.1 and 6.4, arguing that the actions that OSI challenges as outside of the ordinary course of business occurred before the Effective Date and the Company's mere failure to meet sales forecasts did not rise to the level of a Material Adverse Effect.

Having considered the allegations in the Complaint and the arguments of both sides, I find that OSI has pled sufficient facts that, if proven, could support a reasonable inference that Sellers' conduct during the post-effective period before the Closing breached their obligations under Sections 6.1 and 6.4 of the SPA. As determined in the preceding section, OSI adequately has pled that Sellers breached their obligations under Section 3.5(c) by causing Encelium, in the pre-effective period, to engage in conduct that was outside of the ordinary course of its business, such as shipping excess product and holding payment invoices. If this conduct continued until the Closing, as OSI alleges, then, for the same reasons as previously articulated, it is reasonably conceivable that such conduct also would constitute a breach of the ordinary course provision, Section 6.1, directly applicable to the period between the Execution and the Closing.

***9** Furthermore, OSI alleges that Sellers learned, during the post-effective period before the Closing, if not earlier, that Encelium had achieved only about half of the $4 million in sales that Sellers had forecasted for that period, yet Sellers did not disclose this information to OSI. Under Section 6.4, Sellers had an obligation to inform OSI of any fact occurring between the Execution and the Closing that would trigger a Material Adverse Effect. The fact that the Company had made only half of its forecasted sales in Third Quarter 2011, and therefore had achieved $2 million less in revenues, reasonably could be interpreted as reflecting a change in circumstances that was "materially adverse to the Business, ... results[, and] operations of the Acquired Companies." OSI thus has adequately pled breaches by Sellers of Sections 6.1 and 6.4 of the SPA.

Moreover, for similar reasons to those stated in the preceding section, I find that it is reasonably conceivable that OSI could prove damages resulting from these breaches. The financial manipulation and concealment that are alleged to have resulted in breaches of Sections 6.1 and 6.4 made the Company appear to be more successful than it was in the period leading up to the Closing. Therefore, it is reasonably conceivable that, due to Sellers' misconduct, OSI suffered damages by overpaying for the Company.

I find, therefore, that OSI has stated claims for breach of contract as to Sections 6.1 and 6.4 of the SPA.

b. Loss of two salespeople

OSI alleges that Lisa Scholl and Neil Schroder, together, were responsible for approximately 32% of Encelium's 2011 sales forecast. Scholl and Schroder, however, left the Company before the Effective Date. OSI claims that the departure of these two employees constituted a Material Adverse Change or Effect, and that Sellers' failure to disclose those departures to OSI therefore breached Sections 3.5(c) and 3.7 of the SPA.

Sellers argue that OSI fails to state a claim on this issue, because turnover is a normal part of every business and the departure of two employees—even employees whose departure will affect forecasted sales—is not an event that requires disclosure. Rather, Sellers contend that turnover is a change relating to "general business or economic conditions," [19] and therefore does not qualify as a Material Adverse Effect or Change. Furthermore, Sellers note that Scholl and Schroder were not listed as "Key Personnel" under the SPA. [20] Lastly, Sellers assert that the departures of Scholl and Schroder, in fact, were disclosed to OSI, because Scholl

and Schroder were not included on the list of Encelium's current employees in Schedule 3.16(a) of the SPA. [21]

As an initial matter, at this early stage of the proceedings, I am not persuaded by Sellers' argument that the loss of Scholl and Schroder as employees falls under the carve-out for "general business or economic conditions" in the definitions of Material Adverse Change and Material Adverse Effect. Such carve-outs typically are intended to insulate sellers from liability for losses that result from general economic or industry-wide downturns, rather than occurrences specific to a company. It is reasonably conceivable, therefore, that the carve-out would not apply to Encelium's loss of specific employees such as Scholl and Schroder, absent evidence that those departures were related to some larger economic trend.

The fact that Scholl and Schroder were not on the list of Encelium's current employees in Schedule 3.16(a) undercuts any argument by OSI that Sellers actively tried to conceal the fact that Scholl and Schroder had left the Company. If, however, the loss of Scholl and Schroder reasonably would be expected to result in a Material Adverse Change, Section 3.7 of the SPA required Sellers affirmatively to disclose their departure. Without the benefit of a more complete record, I am unwilling to say definitively that Scholl and Schroder's absence from Schedule 3.16(a), without more, was enough to satisfy Sellers' obligations under Section 3.7 or to provide OSI with sufficient notice to preclude, as a matter of law, its claims regarding the loss of those two employees. This determination is without prejudice, however, to Sellers' ability to make and supplement this argument in future stages of this litigation.

***10** Notwithstanding the foregoing, I consider it unlikely that OSI will be able to demonstrate that Encelium's loss of Scholl and Schroder as employees constituted a Material Adverse Change or Effect for purposes of Sections 3.5(c) and 3.7. As Sellers suggest, employee turnover is a regular occurrence in business and the departure of employees, therefore, typically does not rise to the level of a Material Adverse Change. Here, the significance of Scholl and Schroder to Encelium was based upon their *projected* sales performances. Projected sales, however, are by their nature speculative and uncertain to be achieved. Furthermore, OSI's assertions as to the material importance of Scholl and Schroder are undermined by the fact that OSI did not negotiate to have them included in the list of Key Employees in Section 1.1 of the SPA.

Based on the foregoing, I consider it questionable whether OSI could state a claim for breach of Sections 3.5(c) and 3.7 based solely on the departure of Scholl and Schroder. Nonetheless, I decline to dismiss this aspect of OSI's claim for several reasons. First, I note that I already have held that OSI has independently stated a claim for breach of Sections 3.5(c) and 3.7 arising from Sellers' alleged manipulation of Encelium's financial information in the pre-effective period. The allegations regarding Scholl and Schroder simply buttress that claim. I also am cognizant of the minimal threshold that a claim must meet to survive a motion to dismiss. Although it is unlikely that OSI would be able to show that the loss of Scholl and Schroder alone rose to the level of a Material Adverse Change, I am reluctant to say that OSI could not prevail in making this showing under any "reasonably conceivable set of circumstances susceptible of proof." [22]

Another factor in my determination is the fact that dismissing this claim now would be unlikely to substantially benefit the parties or to serve the interests of judicial economy. OSI has advanced a claim for indemnification based on the same allegations that support its breach of contract claims. [23] For purposes of indemnification, the "materiality scrape" in Section 9.4 serves to neutralize the effect of any "materiality qualifiers" in determining whether there have been indemnifiable breaches of the representations and warranties in the SPA. Thus, even if the Court were to dismiss this breach of contract claim on the grounds that the loss of Scholl and Schroder was not a Material Adverse Change, the Court would have to ignore the adjective "material" in evaluating the sufficiency of OSI's corresponding indemnification claim. That is, the Court would be required to uphold OSI's claim for indemnification based on the departure of Scholl and Schroder, if that departure conceivably could be shown to constitute even an immaterial adverse change. The fact that the parties likely would have to litigate the merits of OSI's indemnification claim arising from the loss of Scholl and Schroder as employees, even if this breach of contract claim were dismissed, substantially diminishes any benefit that might be achieved by granting dismissal at this early stage of the proceedings.

Thus, I deny Sellers' Motion to Dismiss OSI's claim that the loss of Scholl and Schroder resulted in a breach of Sections 3.5(c) and 3.7.

c. Obligations under the PAFB Contract

***11** OSI brings an additional breach of contract claim based on Encelium's obligation under the PAFB Contract to integrate its Lighting Control System with LonTalk. OSI claims that this obligation amounts to a liability under the SPA, and that Sellers violated Section 3.6 of the SPA because this liability was not: (a) accrued or reserved against on the Interim Balance Sheet; (b) incurred in the ordinary course of business after June 30, 2011; or (c) set forth on the schedules attached to the SPA.

I determine first that Encelium's obligation to integrate its Lighting Control System with LonTalk qualifies as a liability under the SPA. The SPA broadly defines liability to include "any Debt, obligation, duty or liability of any nature, including ... costs and expenses." As of the Closing, Encelium's Lighting Control System had never interfaced with LonTalk and developing this capability would require a significant investment of time and resources. The requirement that Encelium integrate its Lighting Control System with LonTalk, therefore, constituted both a cost and an obligation under the PAFB Contract. Thus, that requirement qualifies as a liability under the SPA.

Sellers nonetheless argue that OSI has failed to state a claim. Sellers contend first that Encelium's obligation to integrate with LonTalk was incurred in the ordinary course of business and, therefore, did not constitute a breach of Section 3.6, even if it was not disclosed. In addition, Sellers assert that OSI was fully aware of Encelium's rights and obligations under the PAFB Contract before the Execution. Specifically, Sellers allege that all documents relevant to the PAFB Contract were disclosed or made available to OSI before the Effective Date, thereby satisfying any disclosure obligation that might exist under Section 3.6.

For purposes of their motion to dismiss, Sellers' arguments are unpersuasive. As to Sellers' contention that Encelium incurred the liability resulting from the PAFB Contract in the ordinary course of business, only liabilities incurred in the ordinary course after June 30, 2011 are exempt from the accounting and disclosure requirements of Section 3.6. OSI alleges that Encelium's liability under the PAFB Contract was incurred in March 2011, when Encelium accepted a purchase order from PAFB that included the relevant obligation. Taking OSI's well-pled allegations as true, Encelium incurred the obligation under the PAFB Contract before June 30, 2011 and, therefore, that obligation had to be accounted for and disclosed under Section 3.6.

Sellers also assert that they previously disclosed all information relevant to the Company's obligations to PAFB. The extent of Sellers' disclosures and OSI's knowledge before the Effective Date, however, are factual questions that cannot be resolved on a motion to dismiss. Furthermore, the SPA requires all liabilities that have been incurred before June 30, 2011 to be either: (1) accounted for on the Interim Balance Sheet, or (2) set forth on the schedules attached to the SPA. Thus, even if Sellers did disclose documents related to the Company's obligations to PAFB before the Effective Date, those disclosures conceivably might not satisfy Sellers' obligations under the SPA.

As to damages, I consider it reasonably conceivable that Sellers' alleged failure to comply with the applicable disclosure requirements could support a claim for damages, as it may have caused OSI to underestimate the extent of Encelium's liabilities before the Execution and the Closing and, therefore, to pay more for Encelium than it otherwise would have. For these reasons, I conclude that OSI has stated a claim for breach of Section 3.6 by Sellers.

d. Excess inventory of GreenBus I based products

***12** Section 3.20 of the SPA states that the inventory of the Acquired Companies is disclosed accurately and is "of a quantity, quality and mix as are historically consistent with past business practices." OSI alleges that Sellers breached this warranty by "ramping up inventory of its [GreenBus I] based product from the $400,000 level to [the] almost $1,000,000 level" as of the Closing. [24] According to OSI, due to the anticipated launch of GreenBus II, this accumulation of product inventory was detrimental to Encelium, because the Company might be unable to sell $1 million worth of inventory based on outdated technology.

Sellers assert that OSI has failed to assert a breach of Section 3.20, because OSI did not make any specific allegations as to Encelium's "past business practices." According to Sellers, the fact that inventory levels of GreenBus I based technology were higher at the Closing than they were at some point before the Closing is insufficient to support a reasonable inference that the higher inventory level represented a deviation from historical patterns.

I disagree. Based on the minimal threshold needed to survive a motion to dismiss, OSI adequately has pled a breach of Section 3.20. OSI's factual allegations support a weak, but plausible, inference that Encelium's past business practice was to maintain a lower level of GreenBus I based technology than it possessed at Closing. It is, therefore, reasonably conceivable that OSI could show that Encelium's inventory at the time of Closing was not of "a quantity, quality and mix as [were] historically consistent with past business practices." It is also reasonably conceivable that, because of the release of GreenBus II, OSI will be affected adversely by having to write off some portion of the excess GreenBus I based inventory. For these reasons, I find that OSI has stated a claim for breach of Section 3.20 of the SPA.

2. Indemnification

OSI's right to indemnification for damages caused by breaches of the SPA is made explicit in Section 9.2. In that provision, Sellers agreed to indemnify OSI for any losses or damages it might suffer due to inaccuracies in the representations and warranties contained in Article 3 of the SPA, or due to breaches by Sellers or the Acquired Companies of their covenants under the agreement. Section 9.4 includes a "materiality scrape," which provides that, for indemnification purposes, materiality qualifiers will be ignored in determining whether a representation or warranty has been breached, as well as the corresponding amount of any damages. Section 9.3(a) establishes an indemnification threshold. That section provides that Sellers will not have to indemnify OSI for inaccuracies in the representations and warranties contained in Article 3 unless the aggregate amount of indemnifiable damages attributable to those inaccuracies exceeds $200,000, in which case Sellers will be liable for the full amount, subject to various other limitations set forth in Section 9.3.

Above, I concluded that OSI has stated claims for breach of contract based on alleged breaches by Sellers of the representations and warranties contained in Sections 3.5(b), 3.5(c), 3.6, 3.7, 3.20, and 3.35 of the SPA. I also have determined that OSI has stated claims for breach of contract due to Sellers' alleged breach of the covenants contained in Sections 6.1 and 6.4. Under Section 9.2, Sellers have an obligation to indemnify OSI for losses or damages resulting from each of these alleged breaches. Because I have found that OSI has stated a claim for breach of these sections even accounting for their materiality qualifiers, my determination as to whether a claim for indemnification has been stated is not dependent upon the application of the "materiality scrape" in Section 9.4.

***13** OSI alleges that it has suffered in excess of $8 million in damages due to Sellers' breaches of the $47 million SPA. Based on OSI's allegations of significant financial manipulation and concealment of matters relevant to the substantial purchase price agreed to in the SPA, I find it reasonably conceivable that OSI could demonstrate at least $200,000 in damages. For the foregoing reasons, I conclude that OSI has stated a claim for indemnification under Article 9, arising from the alleged breaches by Sellers of Sections 3.5(b), 3.5(c), 3.6, 3.7, 3.20, 3.35, 6.1, and 6.4 of the SPA. I therefore deny Sellers' Motion to Dismiss as to Count I for breach of contract and Count III for indemnification.

B. Tort Claims

The Complaint contains three counts related to fraud: Count IV for equitable fraud; Count V for fraud (also known as common law or legal fraud); and Count VI for negligent misrepresentation. I decide, in turn, whether OSI has stated claims for fraud, equitable fraud, and negligent misrepresentation. I then address Sellers' arguments that OSI's fraud-related claims should be dismissed because OSI improperly is attempting to "bootstrap" a breach of contract claim into a fraud claim and, further, is seeking to establish "fraud by hindsight."

1. Fraud

The elements of fraud under Delaware law are: (1) a false representation, usually one of fact, made by the defendant; (2) the defendant's knowledge or belief that the representation was false, or was made with reckless indifference to the truth; (3) an intent to induce the plaintiff to act or to refrain from acting; (4) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and (5) damage to the plaintiff as a result of such reliance. [25]

Additionally, Court of Chancery Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." That is, "[t]o satisfy Rule 9(b), a complaint must allege: (1) the time, place, and contents of the false representation; (2) the identity of the person making

the representation; and (3) what the person intended to gain by making the representations." [26] Conditions of mind, however, such as malice, intent, and knowledge, may be averred generally. [27] Essentially, the particularity requirement obligates plaintiffs to allege the circumstances of the fraud "with detail sufficient to apprise the defendant of the basis for the claim." [28]

Sellers contend that OSI's fraud claim fails to meet the particularity requirements of Rule 9(b) and does not satisfy the first two elements of common law fraud. Specifically, Sellers argue that OSI's fraud claim is "devoid of detail regarding the 'time, place, and contents' of the alleged misrepresentations on which the fraud claims are based." [29] Sellers also assert that OSI's allegation in the Complaint that Sellers "knew or should have known" that their financial statements and sales forecasts were false when made [30] do not plead the state of mind required for fraud.

Notwithstanding Sellers' arguments, I find that OSI has alleged with particularity facts supporting a claim of fraud. OSI claims that Sellers committed fraud by making "[false] representations ... to OSI regarding the business, financial condition, operating results, income and expenses of Encelium's business," [31] and by "intentionally ma[king] false statements to OSI during the due diligence relating to the transaction." [32] In this vein, OSI pled that Sellers intentionally inflated the sales figures, and otherwise manipulated the financial statements, for Second Quarter 2011 to make it appear as though the Company had met its forecasts and was more successful than it actually was. [33] The Complaint specifies several of the techniques used to achieve this financial manipulation, including: billing and shipping excess product to create reportable revenue (without disclosing the credits or discounts to be applied), holding invoices for payment, and altering the Company's business segments. I therefore find that OSI has alleged the "time, place, and contents" of misrepresentations by Sellers that support a claim for fraud, at least with respect to the reported sales results and financial statements for Second Quarter 2011.

***14** At argument, OSI also suggested that Sellers committed fraud by not disclosing, in the post-effective period before the Closing, that the actual sales results for Third Quarter 2011 were 50% below what had been forecasted. [34] OSI does not allege that Sellers made any false statements with respect to the actual sales in Third Quarter 2011; instead, it argues that Sellers remained silent when they had a duty to speak. OSI appears to contend that Sellers had a duty to disclose the underperformance in Third Quarter 2011 because otherwise their previous sales forecast for that period would have been misleading. A sales forecast, however, is a prediction or statement of opinion about what will occur in the future, and "[o]pinions and statements as to probable future results are not generally fraudulent even though they relate to material matters." [35] It follows that later failing to disclose information to correct an earlier forecast also is not actionable in fraud. [36] Therefore, I find that OSI has failed to state a claim for fraud predicated on Sellers' failure to disclose the actual sales results from Third Quarter 2011.

As to the state of mind required for fraud, Sellers correctly note that a mere allegation that a defendant "knew or should have known" about a false statement is not sufficient to plead the requisite state of mind. [37] As previously discussed, however, OSI also alleges that Sellers actively participated in manipulating the Company's Second Quarter 2011 sales results and financial statements to make the Company appear stronger. These allegations suggest that, at least as to those representations and the corresponding warranty in the SPA, Sellers had actual knowledge that they were materially false and misleading. The Complaint also avers that Sellers internally discussed, before the Closing, the possibility of buying product from Encelium to address its "cash problem," which supports an inference that Sellers falsely were trying to bolster the financial condition of the Company. Although state of mind can be alleged generally, these allegations provide further support for the proposition that Sellers conceivably were knowing participants in an effort to defraud OSI. [38] I hold, therefore, that OSI adequately has pled the state of mind required for fraud.

***15** OSI's particularized allegations also satisfy the last three elements of fraud. OSI alleges that Sellers misrepresented the sales results and financial condition of the Company in Second Quarter 2011 in anticipation of the SPA, to induce OSI to buy the remaining stock of Encelium at an inflated price. OSI credibly avers that it reasonably relied on the false financial information in purchasing the stock of Encelium. Furthermore, Sellers specifically had warranted the accuracy of the Company's financial statements. Lastly, OSI asserts that Sellers' misrepresentations as to the financial condition of the Company informed the purchase price that was agreed to under the SPA, and that, as a result, OSI paid substantially

more for the remaining capital stock of Encelium than it otherwise would have.

For the foregoing reasons, I find that OSI has pled the elements of fraud with sufficient particularity "to apprise the defendant of the basis for the claim." OSI thus has stated a claim for fraud.

2. Equitable Fraud

Equitable fraud is broader than common law fraud and "includes all willful or intentional acts, omissions, and concealments which involve a breach in either legal or equitable duty, trust, or confidence, and are injurious to another, or by which an undue or unconscientious advantage over another is obtained." [39] Where the facts of the case suggest an equitable reason to do so, this Court traditionally has loosened the pleading and proof requirements for fraud by, among other things, removing the element of scienter, "reflecting its willingness to provide a remedy for negligent or innocent misrepresentation." [40] While certain requirements are relaxed, a plaintiff claiming equitable fraud must sufficiently plead the existence of special equities, such as some form of fiduciary relationship between the parties or other similar circumstances, which common law fraud does not require. [41]

In *Airborne Health, Inc. v. Squid Soap, LP*, [42] this Court held that the doctrine of equitable fraud was inapplicable under circumstances analogous to those present in this case. The parties in *Airborne* were counterparties to an asset purchase agreement that was negotiated at arm's length. The plaintiff, however, had not alleged the existence of a fiduciary relationship or of any other special relationship of trust or confidence between itself and the defendant. Moreover, both the plaintiff and defendant in *Airborne* were sophisticated parties who were advised by competent counsel. Under those circumstances, this Court found that there was no "special circumstance that would merit exercising this Court's equitable power to go beyond the traditional framework of common law fraud." [43] This Court, therefore, granted judgment on the pleadings in favor of the defendant on the plaintiff's equitable fraud claim.

As in *Airborne*, this case involves counterparties to a purchase agreement that was negotiated at arm's length. OSI has failed to allege any special relationship of trust or confidence between itself and Sellers, and both OSI and Sellers are sophisticated parties who had access to competent counsel during the transaction. Thus, for reasons analogous to those articulated in *Airborne*, I find that OSI has failed to plead the existence of any special equities in this case that would merit application of the doctrine of equitable fraud. Accordingly, I grant the Motion to Dismiss as to this claim (Count IV).

3. Negligent Misrepresentation

***16** A claim for negligent misrepresentation requires: (1) a particular duty to provide accurate information, based on the plaintiff's pecuniary interest in that information; (2) the supplying of false information; (3) failure to exercise reasonable care in obtaining or communicating information; and (4) a pecuniary loss caused by justifiable reliance on the false information. [44] "Negligent misrepresentation differs from fraud only in the level of scienter involved; fraud requires knowledge or reckless indifference rather than negligence." [45]

I determined *supra* in Part II.B.1 that OSI has stated a claim for fraud arising from Sellers' alleged manipulation and concealment of financial information in the period leading up to the Effective Date. In effect, therefore, I already have found that OSI has pled all of the elements of negligent misrepresentation, except for the lesser scienter requirement. It is reasonably conceivable, however, that OSI ultimately may be unable to prove that Sellers intentionally or with reckless indifference provided false information, but will be able to prove that they were negligent in providing that information by, for example, failing to ensure that the financial information provided to OSI was compliant with applicable accounting principles. Therefore, I find that OSI has stated a claim for negligent misrepresentation.

4. "Bootstrapping" and "fraud by hindsight"

Sellers advance two additional arguments for dismissing OSI's fraud-related claims. Specifically, Sellers accuse OSI of improperly attempting to "bootstrap" a breach of contract claim into a fraud claim and, further, of seeking to establish "fraud by hindsight." [46]

Delaware law holds that a plaintiff "cannot 'bootstrap' a claim of breach of contract into a claim of fraud merely by

alleging that a contracting party never intended to perform its obligations." [47] Stated differently, a plaintiff cannot state a claim for fraud simply by adding the term "fraudulently induced" to a complaint that states a claim for breach of contract, or by alleging that the defendant never intended to abide by the agreement at issue when the parties entered into it. [48] Such bootstrapping is not present in the aspects of OSI's fraud claims that I have found viable, however, as OSI does not argue in those instances that fraud should be inferred based solely on an alleged pre-existing intent by Sellers to breach the contract. Instead, OSI has pointed to specific misrepresentations by Sellers, including misrepresentations about the sales results and financial condition of the Company made *before* the Execution of the SPA. For this reason, I find that OSI's fraud claim is not a mere bootstrap of its breach of contract claim.

Sellers' argument that OSI's fraud claim is premised upon "fraud by hindsight" is similarly unpersuasive. A claim improperly based on hindsight attempts to infer fraudulent intent based solely on subsequent activity. [49] OSI has not asked the Court to infer pre-closing fraud from Defendants' post-closing activities. Instead, OSI alleges that Sellers' intentional manipulation of the financial condition of the Company in Second Quarter 2011 resulted in fraudulent misrepresentations. In that regard, OSI relies on the Company's *contemporaneous* activities of allegedly selling excess product without applying appropriate credits or discounts, holding invoices for payment, and manipulating the Company's business segments, among other things.

***17** Therefore, I deny Sellers' Motion to Dismiss as to Counts V and VI for fraud and negligent misrepresentation.

C. Breach of Covenant of Good Faith and Fair Dealing

Count VII of the Complaint is for breach of the implied covenant of good faith and fair dealing (the "implied covenant"). The implied covenant "inheres in every contract" governed by Delaware law and mandates that parties to a contract refrain from arbitrary or unreasonable conduct that prevents the other party from receiving the "fruits of the bargain." [50] When considering an implied covenant claim, a court must ask whether it is "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 that matter." [51] A valid implied covenant claim, however, requires more than general allegations of bad faith conduct. The plaintiff must allege a specific implied contractual obligation and a breach of that obligation that precluded the plaintiff from enjoying their reasonable expectations of the bargain. [52]

As noted by the Delaware Supreme Court, "[a]pplying the implied covenant is a 'cautious enterprise' and we will only infer 'contractual terms to handle developments or contractual gaps that the asserting party pleads neither party anticipated.' " [53] When an issue is addressed by the express terms of a contract, those express terms "always supersede," and cannot be overridden by, the implied covenant. [54] "The doctrine thus operates only in that narrow band of cases where the contract as a whole speaks sufficiently to suggest an obligation and point to a result, but does not speak directly enough to provide an explicit answer." [55]

Having considered the allegations in the Complaint, I conclude that OSI has failed to state a claim for breach of the implied covenant. To state such a claim, a plaintiff must, at a minimum, "allege a specific implied contractual obligation, a breach of that obligation by the defendant, and resulting damage to the plaintiff." [56] Nowhere in the Complaint, however, does OSI specifically identify an implied contractual obligation that it was owed by Sellers, or allege what conduct by Sellers it considers to have breached that implied obligation. To the contrary, Count VII (the implied covenant claim) merely incorporates by reference all of the previous allegations in the Complaint and asserts that "[t]hrough its faithless and fraudulent conduct, as alleged above, Sellers breached the covenant of good faith and fair dealing implied in the SPA." [57] Even under Delaware's permissive pleading standard, vague allegations will be accepted as well-pled only if they provide the defendant with notice of the claim. [58] OSI's conclusory allegations fail to meet that minimal threshold.

***18** Despite drawing all reasonable inferences in OSI's favor, I conclude, after conducting a thorough review of the Complaint, that OSI has failed to plead facts sufficient to support its claim for breach of the implied covenant. Nearly all of the alleged misconduct by Sellers is governed by express provisions of the SPA. For example, Sellers' alleged efforts to inflate revenues by shipping excess product, holding

payment invoices, and altering business segments already were proscribed by its obligations to operate the Company in the ordinary course of business.[59] Relatedly, Sellers' alleged manipulation of the sales results and financial statements for Second Quarter 2011 was prohibited by Sellers' warranty of the accuracy of Encelium's financial statements.[60] As a final example, Sellers' failure to disclose that the actual sales results for Third Quarter 2011 fell far short of the forecasts was governed by, if anything, Sellers' obligation to disclose any Material Adverse Effect or Change that occurred before the Closing.[61] Because express contractual provisions "always supersede" the implied covenant,[62] to the extent that OSI's implied covenant claim merely duplicates breach of contract claims brought under the SPA, it is fatally flawed.

At argument, OSI presented one theory for breach of the implied covenant that was not merely duplicative of its breach of contract claims.[63] OSI asserted that both parties understood that the 2011 sales forecasts provided by Sellers were extremely significant to OSI, particularly because Encelium's EBITDA in 2010 had been negative. Indeed, the Complaint alleges that Sellers knew that the 2011 sales forecasts were integral to OSI's calculation of the purchase price for Encelium and that it was, therefore, of paramount importance to OSI that the Company's forecasts were accurate.[64] Based on the mutually understood significance of the 2011 forecasts, OSI asserted at argument that Sellers had an implied obligation to ensure that the Company's actual sales in 2011 met those forecasts.

This argument misses the mark, however, because it was foreseeable to the parties at the time of contracting that Encelium's actual sales might fall short of the forecasts. Despite this, and despite the alleged importance of the 2011 sales forecasts to OSI's calculation of the purchase price, no representations or warranties regarding the forecasts were included in the SPA. The implied covenant "only applies to developments that could not be anticipated"[65] and "cannot properly be applied to give ... plaintiffs contractual protections that 'they failed to secure for themselves at the bargaining table.' "[66] Thus, if OSI wanted a guarantee or other assurance as to the reliability of Encelium's 2011 sales forecasts, it was incumbent upon OSI to negotiate for one when the contract was formed.

The fact that it was foreseeable to OSI that Encelium might fail to achieve its sales forecasts distinguishes OSI's implied covenant claim from the implied covenant claim that was upheld by the Supreme Court in *Gerber v. Enterprise Products Holdings, LLC.*[67] In *Gerber*, the defendant general partner, to avoid liability for approving certain potentially conflicted transactions, relied on a safe harbor provision and a "conclusive presumption of good faith" provision in a Limited Partnership Agreement. The Court determined that the general partner utilized these provisions in a manner that undermined their purpose and could not reasonably have been anticipated by the plaintiff at the time the contract was formed.[68] Finding that the parties would have prohibited the defendant's "arbitrary" and "unreasonable" conduct had they negotiated with respect to it when they formed their contract, the Court concluded that the plaintiff had stated a claim for breach of the implied covenant. An important predicate to the Court's holding in *Gerber*, however, was its finding that the challenged conduct was unforeseeable. As that case reaffirmed, the Court "will only infer 'contractual terms to handle developments or contractual gaps that the asserting party pleads neither party anticipated.' "[69] Here, the parties could have anticipated Encelium's failure to achieve its sales forecasts and the Complaint does not plead that neither party anticipated that possibility.

***19** At argument, OSI asserted that, at the time of contracting, it was not actually foreseeable to OSI that the Company would not achieve its forecasted sales for Third Quarter 2011, because Encelium had manipulated the sales results for Second Quarter 2011 to make it appear as though the Company was meeting its forecasts.[70] Past performance is never a guarantee of future success, however, and, here, the Closing occurred less than one year after Encelium's EBITDA was negative. Thus, even with sales results that appeared to be in line with the forecasts for Second Quarter 2011, it was foreseeable that Encelium's earnings might fail to meet forecasts in future periods. The courts will not imply terms to "rebalanc[e] economic interests after events that could have been anticipated, but were not, that later adversely affected one party to a contract."[71] I therefore find that OSI has failed to state a claim for breach of the implied covenant and dismiss Count VII.

III. CONCLUSION

For the reasons stated in this Memorandum Opinion, I grant Sellers' Motion to Dismiss in part, and deny it in part. I dismiss with prejudice OSI's claims for breach of warranty (Count

II), equitable fraud (Count IV), and breach of the implied covenant (Count VII), and I deny the Motion to Dismiss in all other respects.

IT IS SO ORDERED.

All Citations

Not Reported in A.3d, 2013 WL 6199554

Footnotes

1 Unless otherwise noted, the facts recited herein are drawn from the well-pled allegations of the plaintiff's Verified Complaint, and the Stock Purchase Agreement attached to it as Exhibit A, and are presumed true for the purposes of the defendants' motion to dismiss.

2 Compl. ¶ 48(i).

3 *Id.* ¶ 48(j).

4 SPA § 1.1.

5 SPA § 9.2(a)(ii)(B).

6 SPA § 9.2(a)(i)(B).

7 SPA § 9.2(a)(i)(A).

8 Thresholds such as this are often incorporated into stock purchase agreements out of recognition that "representations concerning an ongoing business are unlikely to be perfectly accurate and to avoid disputes over smaller amounts." American Bar Ass'n, Model Stock Purchase Agreement with Commentary 329 (2d ed.2010). *See also I/M [X] Info. Mgmt. Solutions, Inc. v. MultiPlan, Inc.,* 2013 WL 3322293, at *6 (Del. Ch. June 28, 2013).

9 67 A.3d 400 (2013).

10 *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)).

11 *Id.* (quoting *In re USACafes, L.P. Litigation,* 600 A.2d 43, 47 (Del. Ch.1991)) (internal quotation mark omitted).

12 *Central Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC,* 27 A.3d 531, 536 (Del.2011); *see also Winshall v. Viacom Int'l, Inc.,* 2013 WL 5526290, at *4 n.12 (Del. Oct. 7, 2013).

13 *Price v. E.I. duPont de Nemours & Co., Inc.,* 26 A.3d 162, 166 (Del.2011) (citing *Clinton v. Enter. Rent–A–Car Co.,* 977 A.2d 892, 895 (Del.2009)).

14 *See Crescent/Mach I P'rs, L.P. v. Turner,* 846 A.2d 963, 972 (Del. Ch.2000) (Steele, V.C., by designation).

150 *Central Mortg.,* 27 A.3d at 535.

16 *See Metro. Life Ins. Co. v. Tremont Gp. Hldgs., Inc.,* 2012 WL 6632681, at *18 (Del. Ch. Dec. 20, 2012) (dismissing a negligent misrepresentation claim as duplicative of a fraud claim) (citing *Triton Const. Co. v. E. Shore Elec. Servs., Inc.,* 2009 WL 1387115, at *17 (Del. Ch. May 18, 2009) (declining to consider a civil conspiracy claim because it would be redundant of the relief for aiding and abetting), *aff'd,* 988 A.2d 938 (Del.2010) (TABLE)).

17 *See Bakerman v. Sidney Frank Importing Co.,* 2006 WL 3927242, at *19 (Del. Ch. Oct. 10, 2006).

18 SPA § 1.1. "Material Adverse Change" and "Material Adverse Effect" are defined equivalently under the SPA and, therefore, are used interchangeably at various points in this Memorandum Opinion.

19 SPA § 1.1 (definition of "Material Adverse Effect" and "Material Adverse Change").

20 *Id.* (definition of "Key Personnel").

21 Defs.' Reply Br. Ex. 1. This schedule listed the Acquired Companies' employees as of the Effective Date, September 30, 2011. SPA § 3.16(a).

22 *Central Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC,* 27 A.3d 531, 536 (Del.2011). For example, if OSI were to establish that Scholl and Schroder were essential members of the Encelium sales force who, due to their skills and qualifications, effectively were irreplaceable, it is conceivable that their departure could be deemed "materially adverse to the Business, ... results[, and] operations" of the Company, thus arguably meeting the requirements for a Material Adverse Change. SPA § 1.1.

23 Compl. ¶¶ 85–90. I discuss OSI's claims for indemnification in greater detail *infra* in Part II.A.2.

24 Compl. ¶ 71.

25 *Metro. Life Ins. Co. v. Tremont Gp. Hldgs., Inc.,* 2012 WL 6632681, at *16 (Del. Ch. Dec. 20, 2012) (citing *Gaffin v. Teledyne, Inc.,* 611 A.2d 467, 472 (Del.1992)).

26 *Id.* (quoting *Narrowstep, Inc. v. Onstream Media Corp.,* 2010 WL 5422405, at *12 (Del. Ch. Dec. 22, 2010)) (internal quotation marks omitted).

27 Ct. Ch. R. 9(b).

28 *Metro. Life Ins.,* 2012 WL 6632681, at *16 (quoting *Narrowstep,* 2010 WL 5422405, at *12) (internal quotation marks omitted).

29 Defs.' Opening Br. 8.

30 Compl. ¶ 99.

31 *Id.* ¶ 98.

32 *Id.* ¶ 101.

33 At argument, OSI also attempted to support its fraud claim by arguing that Sellers "intentionally withheld information about the resignations of [Scholl and Schroder.]" Tr. 55. The fact that Scholl and Schroder were not included in the list of Encelium's current employees in Schedule 3.16(a) of the SPA, however, effectively negates OSI's allegations that Sellers intentionally were trying to conceal their departure. Therefore, I have assigned no weight to this argument in determining whether OSI has stated a claim for fraud.

34 *See* Tr. 54–55.

35 *Esso Standard Oil Co. v. Cunningham,* 114 A.2d 380, 383 (Del. Ch.1955). *See also Grunstein v. Silva,* 2009 WL 4698541, at *13 (Del. Ch. Dec. 8, 2009) ("[S]tatements which are merely promissory in nature and expressions as to what will happen in the future are not [generally] actionable as fraud.") (quoting *Outdoor Techs., Inc. v. Allfirst Fin., Inc.,* 2001 WL 541472, at *4 (Del.Super.Apr. 12, 2001)); 9 Stuart M. Speiser et al., *The American Law of Torts* § 32:27, at 266–67 (2009) ("[r]epresentations as to what will be performed or will take place in the future are regarded as predictions and hence are not fraudulent.").

36 *See BAE Sys. N. Am. Inc. v. Lockheed Martin Corp.,* 2004 WL 1739522, at *8 (Del. Ch. Aug. 3, 2004) (finding no duty to disclose to correct past predictive statements regarding the likelihood of success in litigation.)

37 *Stuchen v. Duty Free Int'l, Inc.,* 1996 WL 33167249, at *5 (Del.Super.Apr. 22, 1996).

38 By contrast, I am not convinced that the internal "charade" email referenced in the Complaint supports an inference of scienter. Although that email was not attached to the Complaint, it was incorporated by reference and is therefore before me on this Motion to Dismiss. *See e4e, Inc. v. Sircar,* 2003 WL 22455847, at *3 (Del. Ch. Oct. 9, 2003). Having considered the full text of the email, I conclude that the one sentence quoted in the Complaint is taken out of context and does not support the proposition that OSI cites it for, namely, that Sellers had created a charade in order to defraud OSI. Defs.' Reply Br. Ex. 2. Indeed, the author of the email appears to be indicating that, based on OSI's behavior in negotiations, the notion that the SPA deal actually would go through was a "charade" that was not worth maintaining, because it was too distracting to the Company's management. Within that context, the email does not support a reasonable inference that Sellers acted with scienter.

39 *Airborne Health, Inc. v. Squid Soap, LP,* 984 A.2d 126, 144 (Del. Ch.2009) (quoting John Norton Pomeroy, *A Treatise on Equity Jurisprudence* § 873, at 422 (5th ed.2002)) (internal quotation mark omitted).

40 *Id.* (quoting Donald J. Wolfe, Jr. & Michael A. Pittinger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 2.03[b][1], at 2–33 (2009)) (internal quotation marks omitted).

41 *See, e.g., Narrowstep, Inc. v. Onstream Media Corp.,* 2010 WL 5422405, at *13–14 (Del. Ch. Dec. 22, 2010); *Envo, Inc. v. Walters,* 2009 WL 5173807, at *6 (Del. Ch. Dec. 30, 2009); *Airborne Health, Inc.,* 984 A.2d at 144.

42 984 A.2d at 144.

43 *Id.*

44 *Metro. Life Ins. Co. v. Tremont Gp. Hldgs., Inc.,* 2012 WL 6632681, at *17 (Del. Ch. Dec. 20, 2012) (citing *H–M Wexford LLC v. Encorp, Inc.,* 832 A.2d 129, 147 n.44 (Del. Ch.2003)).

45 *Id.* at *18 (quoting *Glosser v. Cellcor, Inc.,* 1994 WL 593929, at *21 n.46 (Del. Ch. Oct. 17, 1994)) (internal quotation marks omitted).

46 *See* Defs.' Opening Br. 8–10.

47 *Narrowstep, Inc. v. Onstream Media Corp.,* 2010 WL 5422405, at *15 (Del. Ch. Dec. 22, 2010) (quoting *Iotex Commc'ns, Inc. v. Defries,* 1998 WL 914265, at *4 (Del. Ch. Dec. 21, 1998)) (internal quotation marks omitted).

48 *Id.* (citing *Iotex,* 1998 WL 914265, at *5).

49 *See, e.g., In re Encore Computer Corp. S'holders Litig.,* 2000 WL 823373, at *8–9 (Del. Ch. June 16, 2000) (declining to infer pre-closing intent based solely on post-closing actions); *Sanders v. Devine,* 1997 WL 599539, at *9 (Del. Ch. Sept. 24, 1997) (declining to infer fraudulent intent as of the date shares were issued solely because those shares later were

cashed out by the issuer); *Noerr v. Greenwood,* 1997 WL 419633, at *5 (Del. Ch. July 16, 1997) (declining to infer share price was misrepresented simply because of a later stock price increase).

50 *Winshall v. Viacom Int'l, Inc.,* 55 A.3d 629, 636 (Del. Ch.2011).

51 *Gerber v. Enter. Prods. Hldgs., LLC,* 67 A.3d 400, 418 (Del.2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC,* 50 A.3d 434, 441 (Del. Ch.2012), *aff'd in part, rev'd in part on other grounds,* 68 A.3d 665 (Del.2013)).

52 *See Kuroda v. SPJS Hldgs., L.L.C.,* 971 A.2d 872, 888 (Del. Ch.2009).

53 *Gerber,* 67 A.3d at 421 (quoting *Nemec v. Shrader,* 991 A.2d 1120, 1125 (Del.2010)).

54 *Id.* at 419 (quoting *ASB Allegiance Real Estate Fund,* 50 A.3d at 441).

55 *Airborne Health, Inc. v. Squid Soap, LP,* 984 A.2d 126, 146 (Del. Ch.2009).

56 *Kuroda,* 971 A.2d at 888 (citing *Fitzgerald v. Cantor,* 1998 WL 842316, at *1 (Del. Ch. Nov. 10, 1998)).

57 Compl. ¶ 115.

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

59 SPA §§ 3.5(c), 6.1.

60 SPA § 3.5(b).

61 SPA §§ 3.5(c), 6.4.

62 *Gerber v. Enter. Prods. Hldgs., LLC,* 67 A.3d 400, 419 (Del.2013) (quoting *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, LLC,* 50 A.3d 434, 441 (Del. Ch.2012), *aff'd in part, rev'd in part on other grounds,* 68 A.3d 665 (Del.2013)).

63 *See* Tr. 51–53.

64 Compl. ¶¶ 37–38.

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

66 *Winshall v. Viacom Int'l, Inc.,* 2013 WL 5526290, at *4 (Del. Oct. 7, 2013) (quoting *Aspen Advisors LLC v. United Artists Theatre Co.,* 861 A.2d 1251, 1260 (Del.2004)).

67 67 A.3d 400 (Del.2013).

68 *Id.* at 422–25.

69 *Id.* at 421 (citing *Nemec v. Shrader,* 991 A.2d 1120, 1125 (Del.2010)).

70 *See* Tr. 53.

71 *Nemec,* 991 A.2d at 1128.