

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

TEK STAINLESS PIPING PRODUCTS,)
INC., a Delaware corporation,)

Plaintiff,)

v.)

SHEILA MAHONY SMITH and)
MAHONY FITTINGS, INC., a)
Connecticut corporation,)

Defendants.)

C.A. No. N13C-03-175 MMJ CCLD

Submitted: July 24, 2013

Decided: October 14, 2013

On Plaintiff's Motion to Dismiss Counterclaims Three, Four and Five

DENIED

MEMORANDUM OPINION

John M. Seaman, Esquire (argued), Steven C. Hough, Esquire, Abrams & Bayliss LLP, Wilmington, Delaware; Mark E. Tully, Derek M. Adams, Esquire, Goodwin Proctor LLP, Boston, Massachusetts, Attorneys for Plaintiff

Richard A. Barkasy, Esquire (argued), Fred W. Hoensch, Schnader Harrison Segal & Lewis LLP, Wilmington, Delaware, Attorneys for Defendants/Counterclaimants

JOHNSTON, J.

FACTS

For purposes of this Motion, the relevant facts are straightforward. Mahony Fittings, Inc. (“Mahony Fittings”) was a family-run business, distributing industrial products, including valves, pipe, tube and fittings. Sheila Mahony Smith (“Smith”) owned and operated the business. On August 1, 2012, TEK Stainless Piping Products, Inc. (“TEK”) entered into an Asset Purchase Agreement (“APA”) with Mahony Fittings and Smith. Pursuant to the APA, TEK purchased substantially all of the assets of Mahony Fittings. As part of the APA, TEK agreed to pay Mahony Fittings a portion of certain net profits generated during an earn-out period between August 1, 2012 and December 31, 2014.

Also on August 1st, TEK and Smith executed an Employment Agreement. Smith agreed to serve as General Manager of TEK-Mahony Fittings Division (“Division”). On September 11, 2012, Smith resigned her employment effective September 25, 2012. Smith alleges that TEK’s representations regarding the post-sale operation of the Division were not accurate. Additionally, Smith contends that “intolerable working conditions” caused her to suffer emotional distress and exacerbated her existing health problems, and created concerns about her ability to care for her ill husband. Finally, Smith asserts that TEK operated the Division in a manner that denied Mahony Fittings any earn-out payments.

PROCEDURAL CONTEXT

On March 15, 2013, TEK filed a Complaint. TEK alleges fraudulent inducement and breach of contract, arising from the APA. TEK seeks relief in the form of rescission of the APA. Alternatively, TEK requests damages resulting from Defendants' alleged fraudulent inducement and Smith's alleged breach of the employment agreement.

On April 25, 2013, Mahony Fittings and Smith filed an Answer and Counterclaim. TEK has moved to dismiss Counts 3, 4, and 5 of the Counterclaim.

Counterclaim Count 3 seeks recovery of compensatory and punitive damages as a result of TEK's alleged misrepresentations concerning the Parker Instrumentation product line. Prior to entering into the APA, TEK acquired distribution rights for the Parker product line in New England and some portions of Long Island. Smith claims that TEK represented that if Mahony Fittings sold its assets to TEK, the Division would be the exclusive distributor of the Parker product line in Connecticut. After the closing of the APA, another TEK entity also distributed Parker products. Smith and Mahony Fittings assert that the net profits of the Division, by which the earn-out payments are determined, were substantially less than they would have been had the Division been the exclusive Parker distributor in Connecticut, as represented by TEK.

Counterclaim Count 4 alleges that TEK made the following fraudulent misrepresentations, in order to induce Mahony Fittings and Smith to enter into the APA: (1) Palisades Holdings, Inc, the parent company of TEK, would take over administrative functions of the daily operation of the Division, allowing Smith to focus on sales, staff transitioning and learning the new Parker line; (2) Smith would continue to manage the Division in the manner in which she had managed Mahony Fittings; (3) Smith would be assigned two outside sales persons from TEK; and (4) distribution in the warehouse would be automated to increase profitability.

Counterclaim Count 5 claims breach of implied covenants of good faith and fair dealing in the APA and Employment Agreement. The alleged bad faith is TEK's actions in operating the Division so as to deny Mahony Fittings any earn-out payment.

MOTION TO DISMISS STANDARD

When reviewing a motion to dismiss pursuant to Rule 12(b)(6), the Court must determine whether the claimant “may recover under any reasonably conceivable set of circumstances susceptible of proof.”¹ When applying this standard, the Court will

¹ *Spence v. Funk*, 396 A.2d 967, 968 (Del. 1978).

accept as true all non-conclusory, well-pleaded allegations.² In addition, every reasonable factual inference will be drawn in favor of the non-moving party.³ If the claimant may recover under that standard of review, the Court must deny the motion to dismiss.⁴

ANALYSIS

_____TEK's Motion to Dismiss raises three issues.

1. Whether Counterclaim Counts 3, 4, and 5 should be dismissed for failure to comply with the APA dispute resolution procedure.
2. Whether Counterclaim Counts 3, 4, and 5 should be dismissed pursuant to Rule 9(b) for failure to plead fraud with particularity.
3. Whether Counterclaims 3, 4, and 5 are barred by the APA's anti-reliance provision.

Dispute Resolution Procedure

Section 1.7 of the APA provides:

1.7 Dispute Procedure.

² *Id.*

³ *Wilmington Sav. Fund Soc'y, F.S.B. v. Anderson*, 2009 WL 597268, at *2 (Del. Super.) (citing *Doe v. Cahill*, 884 A.2d 451, 458 (Del. 2005)).

⁴ *Spence*, 396 A.2d at 968.

- (d) If within 30 days following the delivery of a statement of Net Profit or Net Loss pursuant to Section 1.6(f) Seller has not given Buyer written notice of its objection to the statement (which notice shall state the basis of the Seller's objection), then the Net Profit and Net Loss statement prepared by Buyer shall be conclusive and binding on the parties.
- (e) If Seller gives Buyer a written notice of objection pursuant to Section 1.7(a), and if Seller and Buyer fail to resolve the issues outstanding with respect to the calculation of Net profit or net Loss within 30 days after Buyer's receipt of the objection notice, Seller and Buyer shall submit the issues remaining in dispute to a nationally recognized independent public accounting firm that is independent of both Buyer and Seller and is chosen by mutual agreement of Buyer and Seller (the "independent Accountants") for resolution applying the principles, policies, and practices referred to in Section 1.6....

TEK argues that Mahony Fittings has failed to follow this dispute resolution procedure.

The APA closed on August 1, 2012. The first earn-out period ended December 31, 2012. The Section 1.6(f) statement was issued on March 1, 2013. It is undisputed that no objection was filed pursuant to Section 1.7(a).

However, during argument on the pending Motion, Defendants' counsel stated that the parties exchanged letters between March 1, 2013 and March 15th, the date this lawsuit was filed. This correspondence was not presented to the Court during argument.

The question arises whether this correspondence constitutes an objection under Section 1.7(a). It appears to the Court that discovery is appropriate on this issue. Therefore, dismissal at this stage of the proceedings is not warranted on the basis of failure to follow the dispute resolution procedure.

Further, even if Defendants had failed to object to the 2012 Section 1.6(f) statement, future claims would not be barred for the 2013 and 2014 statements. Obviously, any claims concerning the 2013 or 2014 statements are not ripe for determination. In the interest of judicial economy, if possible, all disputes among the parties to the APA and the Employment Agreement should be decided in this case.

Pleading Fraud with Particularity

Superior Court Civil Rule 9(b) provides that the circumstances constituting fraud must be stated with particularity. TEK argues that Defendants' allegations of fraud fall short of this heightened pleading standard. Specifically, the Counterclaim refers broadly to the months in which false misrepresentations were made, without reference to place, contents, or declarant.

Defendants counter that fraud is pled sufficiently if the allegations place the opposing party on notice of the precise misconduct, in order to safeguard against “spurious charges of immoral and fraudulent behavior.”⁵

Upon review of Counts 3 and 4 of the Counterclaim, the Court finds that the purported misrepresentations are set forth with sufficient particularity to withstand dismissal on the basis of Rule 9(b). The averments state a sequence of events that places the alleged misrepresentations in context. The alleged conversations among the parties contain adequate detail of affirmative representations to Smith – that the Division would be the exclusive distributor of the Parker product line in Connecticut. Additionally, Count 4 enumerates alleged misrepresentations made during negotiation of the contracts at issue. Although no specific dates are listed, the Counterclaim identifies the parties to the conversations and sets out the content of the discussions with sufficient particularity to place TEK on notice of the precise misconduct with which it is charged.

Count 5 seeks recovery on the basis of breach of the implied covenant of good faith and fair dealing. This is a breach of contract claim, which ordinarily is not subject to the Rule 9(b) particularity requirement. In any event, Count 5

⁵*Seville Indus. Machinery Corp. v. Southmost Machinery Corp.*, 742 F.2d 786, 791 (3d Cir. 1984), *cert. denied*, 469 U.S. 1211 (1985).

incorporates the remainder of the Counterclaim by reference, thereby stating the claim with particularity.

Anti-Reliance Provision

Section 10.6 of the APA provides:

10.6. Exclusive Agreement: Amendment. This Agreement supersedes all prior agreements among the parties with respect to its subject matter. This Agreement is intended (with documents referred to herein) to be a complete and exclusive statement of the terms of the agreement among the parties with respect thereto and cannot be changed or terminated except by a written instrument executed by Seller, Buyer and Owner. ***Except as explicitly set forth herein, no representations, warranties or promises of any kind have been made by Buyer or any third party to induce Seller or Owner to execute this [A]greement.*** (emphasis added)

TEK argues that Counterclaim Counts 3, 4, and 5 rely upon allegedly fraudulent statements made outside of the APA. Because the APA contains Section 10.6, which it asserts is an anti-reliance clause, TEK contends that these Counts are barred.

To be enforceable, an anti-reliance clause must be “a clear and unambiguous contractual provision in which the plaintiffs forthrightly affirm that they are not relying upon any representation or statement of fact not contained

within the [] Agreement.”⁶ Such clauses are intended to discourage fraud.⁷ A traditional integration clause will not be contorted into anti-reliance language, in the absence of evidence that the parties intended for the clause to bar fraud claims.⁸

Stated summarily, for a contract to bar a fraud in the inducement claim, the contract must contain language that, when read together, 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 so sign the contract. The presence of a standard integration clause alone, which does not contain explicit anti-reliance representations and which is not accompanied by other contractual provisions demonstrating with clarity that the plaintiff had agreed that it was not relying on facts outside the contract, will not suffice to bar fraud claims. Rather, in that circumstance, the defendant will remain at risk if the plaintiff can meet the difficult burden of demonstrating fraud.⁹

In *Anvil Holding Corp. v. Iron Acquisition Co., Inc.*,¹⁰ the Court of Chancery considered contract language stating that, except for the representations and warranties set forth in certain enumerated clauses in the contract, neither party “makes any other express or implied representation or warranty with respect to the

⁶*Kronenberg v. Katz*, 872 A.2d 568, 591 (Del. Ch. 2004), *aff’d*, 867 A.2d 902 (Del. 2005).

⁷*Id.* at 593.

⁸*Id.* at 592-93.

⁹*Id.* 593.

¹⁰2013 WL 2249655 (Del. Ch.).

Company...or any Seller or the transactions contemplated by this Agreement.”¹¹

Although Delaware courts will honor clauses in which sophisticated parties disclaim reliance on extra-contractual representations, such provisions must “clearly state that the parties *disclaim reliance* upon extra-contractual statements.”¹² The *Anvil* Court held that language, similar to the disputed clause in this case, did not reflect a clear promise by the buyer that it was not relying on statement made outside of the contract. Therefore, the buyer’s fraud claim was not precluded.¹³

In this case, the Court finds that APA Section 10.6 is not an anti-reliance clause, which would bar the fraud Counterclaims. Section 10.6 is not a clear and unambiguous agreement that the parties are not relying upon any representation or statement of fact not contained within the APA. This provision lacks the specific anti-reliance language required as evidence that the parties intended for the clause to bar fraud claims.

TEK also asserts that Section 1.6(g) of the APA expressly disclaims any representation or warranty as to the earn-out payments.

¹¹*Id.* at *8.

¹²
Id. (emphasis in original).

¹³*Id.*

Section 1.6(g) states:

- (g) Seller and Owner acknowledge and agree that although earn-out payments may become payable by Buyer to Seller under this **Section 1.6**, neither Buyer nor any of its affiliates makes any guarantee, covenant, representation or warranty to Seller or Owner that any particular amount of such payment(s) will in fact be realized.

Clearly, Section 1.6(g) is neither an integration nor anti-reliance clause.

The Court need not determine the applicability of Section 1.6(g) to this litigation at this juncture.

CONCLUSION

The Court finds that a factual question exists as to whether Defendants objected as required by APA Section 1.7(a). Therefore, dismissal at this stage of the proceedings is not warranted on the basis of failure to follow the dispute resolution procedure. Additionally, the Court finds that Counterclaim Counts 3, 4, and 5 shall not be dismissed on the grounds of failure to plead fraud with particularity pursuant to Superior Court Civil Rule 9(b). Finally, the Court finds that APA Section 10.6 is not an anti-reliance clause, which would bar the fraud Counterclaims.

THEREFORE, Plaintiff's Motion to Dismiss Counterclaims Three, Four and Five is hereby **DENIED**.

IT IS SO ORDERED.

/s/ *Mary M. Johnston*

The Honorable Mary M. Johnston