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

DENNIS MEHIEL as Stockholders' Representative of SF HOLDINGS GROUP, INC.,	)	
Plaintiff,	)	
v.	)	C.A. No. 06C-01-169-JEB
SOLO CUP COMPANY, an Illinois Corporation,	)	
Defendant.	)	

Submitted: January 29, 2007
Decided: March 26, 2007

OPINION

Defendant's Motion to Dismiss.
Granted in Part. Denied in Part.

Appearances:

David J. Teklits, Esquire, and Thomas W. Briggs, Esquire.
Morris Nichols Arsht & Tunnell LLP.
Attorneys for Plaintiffs.

Edward B. Micheletti, Esquire and Jenness E. Parker, Esquire.
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP.
Attorneys for Solo Cup Company.

JOHN E. BABIARZ, JR., JUDGE.

Defendant Solo has moved to dismiss the Complaint in this case for lack of subject matter jurisdiction. The Complaint alleges common law actions which Defendant argues constitute appeals of an arbitration decision over which the Superior Court has no jurisdiction. Plaintiff argues that the Complaint raises issues that are separate and distinct from the questions decided in the earlier proceedings. For the reasons explained below, the motion is granted in part and denied in part.

This case stems from Defendant Solo's acquisition of SF Holdings ("the Company") and pertains to disagreements about the amount of the Company's working capital, which in turn affected the purchase price. Plaintiff Dennis Mehiel, who was the Company's chairman and chief executive officer, brings this action in his capacity as the designated shareholders' representative.

In December 2003, the parties entered into a Merger Agreement ("the Agreement") and closed the deal in February 2004. The Agreement established the base purchase price as $670,900,000 and estimated the working capital[1] as $242,897,000, calculated as of March 2003. At closing, Solo deposited with an escrow agent $15 million of the total purchase price as Deferred Payment Retention to cover potential working capital adjustments or indemnification costs.

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[1]The phrase "working capital" is defined in the Agreement as "current assets determined in accordance with GAAP [Generally Accepted Accounting Practices] consistently applied (including cash and assets held for sale) less current liabilities determined in accordance with GAAP consistently applied (excluding current maturities of long term debt)." Agreement § 3.11(b).

The Agreement also established a multi-step process to adjust the amount of working capital based on changes that may have occurred in the interval between March 2003 and February 2004. Two days prior to Closing, the Company was required to provide Solo with proposed adjustments, and Solo had the chance after Closing to put forth its own adjustments. The parties sought numerous changes, and they were not able to negotiate their differences. As provided in the Agreement, a Neutral Auditor from a nationally known accounting firm was engaged to arbitrate the dispute. The Agreement provided that the Neutral Auditor's decision was to be "final, binding and conclusive"[2] and made no provision for appeal or reconsideration. Following numerous submissions by the parties, the Neutral Auditor issued his decision, in May 2006, resolving most issues in the Company's favor.

One issue decided in Solo's favor pertained to a facility located in St. Thomas, Maryland ("St. Thomas"), which was valued at approximately $5.6 million. St. Thomas had been the subject of great contention between the parties, who disagreed as to whether St. Thomas should be treated as a long-term asset, as claimed by Solo, or an Asset Held for Sale, included in Current Assets, thereby increasing the amount of working capital). The Neutral Auditor accepted Solo's position and did not include St. Thomas in working capital. This conclusion resulted in a $5.6 million decrease in the purchase price. Under the Agreement, Solo was entitled to withdraw this amount from the Deferred Payment Fund created by Solo prior to Closing.

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[2]Agreement at § 3.9 (c).

Plaintiff filed this lawsuit prior to the issuance of the arbitrator's decision in May 2006, and amended it afterward.[3] The Second Amended Complaint alleges two counts of fraudulent inducement, two counts of breach of contract and one count of unjust enrichment. Counts I, II, III and V pertain to the St. Thomas facility. Count IV refers to what is known as the Earthshell Reserve, an escrow account set up by the Company for possible rent and/or utility shortages for St. Thomas. Plaintiff seeks damages of $5.6 million plus interest, punitive damages, attorneys fees and costs related to St. Thomas. Plaintiff also seeks $281,195 plus interest related to the Earthshell Reserve, as well as punitive damages, attorney fees and costs.

Defendant moves to dismiss on the following grounds. First, the Superior Court does not have jurisdiction over this action, which in substance is an appeal of the outcome of the working capital arbitration. Second, the claims are barred by the doctrine of *res judicata*. Third, the Complaint does not adequately allege the elements of the fraudulent inducement, breach of contract, or unjust enrichment. Fourth, there is no basis for Plaintiff's claims for the fees, costs and expenses incurred in the working-capital arbitration.

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[3]This is not the first action regarding this merger filed in Delaware courts. In November 2004, Plaintiff filed an action in Chancery Court seeking production of Solo's accounting working-capital records. The court ruled that Solo had no obligation to provide Plaintiff with access to the accountant's books, records, or employees or to books, records or employees of any entity other that SF Holdings. *Mehiel v. Solo Cup Co.*, 2005 WL 1252348, at *5 (Del. Ch.). In 2005, Plaintiff filed an action to determine whether certain claims could be resolved in the working-capital arbitration or in the indemnification arbitration provided for in §10.2 of the Agreement. The court held that the claims could be decided in either arbitration but not in both. *Mehiel v. Solo Cup Co.*, 2006 WL 3074723 at *4 (Del. Ch.), *aff'd* 2006 WL 987988, at *1 (Del.).

On a motion to dismiss, the Court is to determine the existence of subject matter jurisdiction from the face of the complaint.[4] Material factual allegations are to be regarded as true.[5] On a jurisdictional issue, the Court must also look beyond the language of the complaint to determine the true nature of the claim and the desired relief.[6] A complaint will be dismissed only if the Court is reasonably certain that the plaintiff is not entitled to relief under any set of facts.[7]

Defendant argues that all claims raised in the Complaint were resolved at the working capital arbitration and that the only avenue of appeal of an arbitration decision is by way of the Federal Arbitration Act ("FAA").[8] Plaintiff argues that the complaint alleges common law causes of action that were not raised to the Neutral Auditor and were beyond the scope of his authority.

The first question is whether the proceedings before the Neutral Auditor, which were established in § 3.9(c) of the Agreement, constituted an arbitration, as argued by Defendant. Plaintiff contends that the Complaint raises different issues from the accounting questions

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[4] *Prestancia Mgmt. Group, Inc. v. Virginia Heritage Foundation, II LLC*, 2005 WL 1364616, at *3 (Del. Ch.).

[5] *Diebold v. Commercial Credit Corp.*, 267 A.2d 586, 588 (Del. 1970).

[6] *Nelson v. Russo*, 844 A.2d 301, 302-03 (Del. 2004).

[7] *Gordon v. Nat'l Railroad Passenger Corp.,* 1997 WL 298320, at *7 (Del. Ch.).

[8] 9 U.S.C. §1 – §16.

presented to the Neutral Auditor.[9]

Arbitration is a matter of contract, and a party cannot be required to arbitrate any dispute which he has not agreed to arbitrate.[10] Both state and federal policy favors arbitration.[11] In this case, § 3.9(c) of the Agreement provides a mechanism for resolving working capital questions if the parties reached a stalemate:

> If at the conclusion of the Resolution Period there are amounts still remaining in dispute, then all amounts remaining in dispute shall be submitted to PricewaterhouseCoopers, LLP or another firm of nationally recognized independent public accountants reasonably acceptable to Parent and the Stockholders' Representative (the 'Neutral Auditor"). . . . The Neutral Auditor shall act as an arbitrator to determine, based solely on presentations by Parent and the Stockholders' Representative, and not by independent review, only those items still in dispute. . . . The term "Final Closing Working Capital Statement," as used in this Agreement, shall mean. . . the definitive Closing Working Capital Statement resulting from the determinations made by the Neutral Auditor in accordance with this Section 3.9(c). . . prepared in conformity with GAAP applied on a basis consistent with the Target Working Capital. (Emphasis in the original.)

This section is clear. It authorizes the parties to find a good accountant to arbitrate working capital questions based on submissions presented by the parties. The Neutral Auditor's

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[9]Plaintiff's arguments verge on being issues of arbitrability, which are the "gateway questions about the scope of an arbitration provision and its applicability to a given dispute." *James & Jackson, LLC v. Willie Gary, LLC,* 906 A.2d 76, 79 (Del. 2006). Instead of contesting arbitrability in a proceeding to enjoin an arbitration pursuant to DEL. CODE ANN. tit. 10, § 5703 or making an application to vacate the arbitration award under § 5714, Plaintiff chose to file an action at law on the theory that § 3.9(c) of the Merger Agreement did not establish an arbitration to settle working capital disputes.

[10]*James & Jackson, LLC v. Willie Gary, LLC*, 906 A.2d 76, 78 (Del. 2006)(quoting *Howsam v. Dean Witter Reynolds, Inc.*, 537 U.S. 79 (2002)).

[11]*DMS Properties-First, Inc. v. P.W. Scott Assoc.*, 748 A.2d 389, 391 (Del. 2000).

decision is to be "final, binding and conclusive." Mehiel's conduct during the proceedings demonstrates his understanding that he was engaged in an arbitration. A letter regarding discovery (dated July 22, 2005), from Mehiel's counsel to David Hoffman, the Neutral Auditor refers to the working capital proceedings as the "arbitration." It also asks Hoffman to enforce "standard arbitration law and rules."[12] It cites to the Revised Uniform Arbitration Act, the FAA and case law pertaining to arbitration. This letter and every letter from Plaintiff's attorney to the Neutral Auditor references the proceedings as an arbitration. Thus the contractual language showing an intent to arbitrate disagreements about working capital is mirrored in the parties' conduct. The Court finds that the proceeding before the Neutral Auditor was a binding arbitration.

The next question is whether the issues raised in the Complaint were settled at arbitration. In its Memorandum, Defendant Solo has compared excerpts from the Second Amended Complaint with arguments made during arbitration in order to show that the issues now before the Court were addressed at arbitration. As acknowledged in Memorandum in Opposition, Plaintiff also refers to these documents.[13] The Court may consider evidence outside the pleadings if necessary to the determination of a motion to dismiss without converting the motion to a summary judgment motion, which is a consideration of the merits

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[12]Micheletti Aff., Exh. 2, at 1.

[13]*See* Plaintiff's Memorandum of Law in Opposition to Defendant's Motion to Dismiss, at 7, n. 1.

of the claim.[14]

Count I alleges that Solo fraudulently induced Mehiel into executing the Agreement by stating that it accepted the accounting methodologies used to determine the working capital statement in the Agreement, when in fact Solo subsequently challenged the Company's accounting treatment of the St. Thomas facility. During arbitration Mehiel argued that "Solo did not make any objections to [the Company's] accounting for working capital (and indeed, on several occasions affirmatively stated it had no such objections), and in so doing, deceived the sellers of [the Company] into believing that there was an understanding on price." The Court finds that Count I of the Complaint raises the issue of Solo's fraud regarding to GAAP that was presented to and resolved by the Neutral Auditor.

Count II alleges that Solo fraudulently induced Mehiel to refrain from selling St. Thomas by stating that Mehiel would not suffer financial harm if he did not sell the facility. Mehiel made the same argument at arbitration: "Shortly before closing, Ronald Whaley from Solo asked Mehiel to refrain from signing the Contract of Sale on the St. Thomas facility [for which] Mehiel had recently entered into a non-binding letter of intent. . . . Whaley specifically pointed out to Mehiel that there was no financial impact to the shareholders." Mehiel repeated this assertion in a letter dated January 13, 2005.[15] The Court finds that Count II

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[14]*Simon v. The Navellier Series Fund*, 2000 WL 1597890, at *4 (Del. Ch.) (citing 5A Charles A. Wright & Arthur R. Miller, Federal Practice and Procedure § 1364, at 468-69 (2d ed. 1990)("[t]he validity of [Rule 12(b)(1)-(5)] defenses rarely is apparent on the face of the pleading and motions raising them generally require reference to matters outside the pleadings.").

[15]Micheletti Aff., Ex. 7, App. L n.1.

raises the issue of Solo's fraud in relation to sale of St. Thomas that was raised to and resolved by the Neutral Auditor.

Count III alleges that Solo failed to prepare its working capital statement in good faith in that it did not apply GAAP to St. Thomas in violation of the Agreement. During arbitration, Mehiel stated to the arbitrator that his goal in "this arbitration is to expose the extent to which the Closing Working Capital Statement was not performed 'in good faith in conformity with GAAP applied on a basis consistent with the Target Working Capital."[16] Mehiel reiterated this argument when it stated to the arbitrator that Solo actions constituted a "gross breach" of the duty to act in good faith when it attempted to renegotiate the price of the merger by challenging the Company's inventory accounting.[17] Mehiel also argued that Solo acted in bad faith when it challenged the Company's classification of St. Thomas after having asked Mehiel not to sell the facility, which Mehiel agreed to as a favor to Mr. Whaley.[18] The Court finds that Mehiel made the same good faith breach of contract argument during arbitration that he now makes in Count III of the Complaint.

Count IV alleges that Solo failed to prepare its working capital statement in good faith in its treatment of the Earthshell Reserve. Mehiel's letter, dated October 14, 2005, shows that he made this argument during arbitration. In the arbitrator's letter to the parties dated

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[16]Solo App. Ex. 2 at 7.

[17]Solo App. Ex. 7 at 1–2.

[18]Solo App. L at 2.

November 4, 2005, the arbitrator stated "I will not address Mehiel's proposed adjustments related to the Earthshell Reserve. . . ."[19] (Emphasis in the original.) Thus, while this argument was made, the arbitrator did not entertain it, and it was not part of the final arbitration decision.

Count V alleges that Solo was unjustly enriched by persuading the Neutral Auditor to treat St. Thomas as a long-term asset and remove it from working capital. In reference to St. Thomas, Mehiel stated in a letter to the Neutral Auditor that "Solo's proposed adjustment is inequitable, and if accepted, would result in Solo receiving monetary benefit (to Mehiel's detriment) for its post-closing decision to not complete the sale of the St. Thomas facility.[20] Further, "[i]f this asset held for sale is removed from Final Working Capital, Solo will enjoy the following windfall: it will have reduced the purchase price of the merger (through this adjustment) and *at the same time* retained the benefit of keeping the St. Thomas facility – at no cost to itself – which it could then sell for cash."[21] (Emphasis in the original.) The Court finds that Mehiel made the same argument as to St. Thomas to the arbitrator that it now makes to the Court, the only difference being that the argument is now phrased as a common law action.

The Court concludes that Counts I, II, III and V of the Second Amended Complaint

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[19]Affidavit of Thomas W. Briggs, Jr., Ex. A.

[20]Micheletti Aff., Ex. 7, App. L at 4.

[21]*Id.*. at 5.

allege arguments that were presented to and resolved by the Neutral Auditor, whose decision the parties agreed would be "final, binding and conclusive."[22] Count IV, pertaining to the Earthshell Reserve, was raised to the arbitrator, who stated in writing to the parties that he would not address it.

The next question is whether the Court has jurisdiction to consider issues that were settled at arbitration. Defendant argues that Plaintiff's only remedy is an action under the Federal Arbitration Act.[23] Plaintiff concedes that Defendant's argument regarding the Federal Arbitration Act is "technically correct,"[24] but contends that the Second Amended Complaint alleges common law claims that are beyond the scope of the Neutral Auditor's authority.

A party who wants to confirm or vacate an arbitration award can file an action pursuant to the Federal Arbitration Act.[25] State and federal courts have concurrent jurisdiction to enforce the Arbitration Act.[26] In this case, neither party has made any petition

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[22]Agreement §3.9(c).

[23]9 U.S.C. §1 – §16.

[24]Plaintiff's Memorandum at 16.

[25]9 U.S.C. §1, §2, §9, §10, §11, §12, §16.

[26]*Moses H. Cone Hospital v. Mercury Constr.*, 460 U.S. 1, 25 (1983) (observing that "[t]he Arbitration Act. . . creates a body of federal-court substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction. . . . Section 4 provides for an order compelling arbitration only when the federal district would have jurisdiction over a suit on the underlying dispute; hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue. . . . Section 3 likewise limits the federal courts to the extent that a

under the FAA. Delaware has its own Uniform Arbitration Act ("DUAA"), and the Agreement is to be governed and construed by Delaware law.[27] Under the DUAA, the Court of Chancery has jurisdiction to enforce the provisions of the Act and to enter judgment on or vacate an arbitration award.[28] This Court has no jurisdiction over arbitration decisions. Furthermore, valid and final arbitration awards are given the same effect as a court's judgment under the doctrine of *res judicata*.[29] Thus, as to Counts I, II, III and V of the Complaint, which raise issues resolved in arbitration, Defendant's motion to dismiss is granted.

The general rule is that *res judicata* gives preclusive effect not only to claims that were actually raised, but also to those that might have been raised.[30] The Complaint alleges that during the contractual review period, Solo personnel told Mehiel's representative, Tom

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federal court cannot stay a suit pending before it unless there is such a suit in existence. Nevertheless, although enforcement of the Act is left in large part to the state courts, it nevertheless represents federal policy to be vindicated by federal courts where otherwise appropriate.").

[27]Agreement at §11.12.

[28]DEL. CODE ANN. tit. 10, § 5701, §5702.

[29]*Cooper v. Celente*, 1992 WL 240419, at *6 (Del. Super.) (also summarizing the elements of *res judicata* as follows: (1) the prior decision-maker must have jurisdiction over the subject matter and the parties; (2) the same parties or their privies are involved in the latter proceeding; (3) the same cause of action has been brought, or the issues are the same as those raised before; (4) the issues were decided adversely to the contentions of the party (the party against whom *res judicata* is asserted); and, (5) the prior decision was a final decree, *citing Playtex Family Products v. St. Paul Surplus,* 564 A.2d 681, 683 (Del. Super. Ct. 1989)).

[30]*Foltz v. Pullman, Inc.*, 319 A.2d 38, 40 (Del. 1974); *Maldonado v. Flynn*, 417 A.2d 378, 381 (Del. Ch. 1980); *Bailey v. City of Wilmington*, 766 A.2d 477, 481 (Del. 2001).

Uleau, that the Earthshell Reserve had not been written off because of an oversight and that it should not have been included in Solo's closing working capital statement. The Complaint further alleges that Solo never corrected this error and therefore did not prepare its closing working capital statement in conformity with GAAP. Mehiel raised this issue with the Neutral Auditor, who stated in his letter, dated November 4, 2005, that he would not address the Earthshell issue:

> [A]fter due and careful consideration of the language in the agreement, and the submissions made by both sides, I have decided that in my capacity as the Neutral Auditor, I will address on the merits the *Inventory* adjustments proposed by Solo and Mehiel's proposed adjustment related to *Cash*. This ruling in no way suggests how I might ultimately decide these items on their merits, but rather only that I have decided that these items should be considered as components of the Disputed Items. I will not address Mehiel's proposed adjustments related to the *Earthshell Reserve, Linerboard Anti-Trust* or *Unrecorded Miscellaneous Cash Receipts*. (Emphases in the original.)

The Neutral Auditor did not offer an explanation for his decision not to address Earthshell, although Defendant stated at oral argument that the issue was not raised within the time frame established by the Neutral Auditor. Whatever the reason, the Neutral Auditor did not consider the Earthshell question, nor did he rule that the question is not arbitrable.

Defendant argues that the Complaint fails to allege the elements of breach of contract in regard to the Earthshell Reserve. These elements are a contractual obligation, a breach of that obligation and damages.[31]

The Complaint alleges that Mehiel was obligated under the Agreement to prepare its

[31] *VLIW Tech., LLC v. Hewlett-Packard Co.,* 840 A.2d 606, 612 (Del. 2003).

closing working capital statement in good faith and in conformity with GAAP applied in a basis consistent with the Agreement's statement of the target working capital. The Complaint also alleges that Solo included the Earthshell Reserve in its Closing working capital despite its previous concession that the Reserve had been inadvertently and inaccurately included. Thus, Solo failed to meet either obligation, resulting in damages of $281,195, the amount of money in the Reserve. These are straightforward allegations, and the Court finds that the Complaint sufficiently pleads the elements of breach of contract. Defendant's motion to dismiss for failure to state a claim for relief under Super. Ct. Civ. R. 12(b)(6) is denied.

In conclusion, Defendant's motion to dismiss is granted as to Counts I, II, III, and V is granted. Defendant's motion to dismiss Count IV is denied.

It Is So ORDERED.

Judge John E. Babiarz, Jr.

JEB,Jr./ram/bjw
Original to Prothonotary