IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

INTERIM HEALTHCARE, INC, CATAMARAN ACQUISITION CORP. and CORNERSTONE EQUITY INVESTORS, IV, L.P.,	)	C.A. No. 00C-09-180 (JRS) (consolidated)
Plaintiffs,	)	
v.	)	
SPHERION CORPORATION,	)	
Defendant.	)	

Date Submitted: September 29, 2003
Date Decided: November 21, 2003

Upon Consideration of Plaintiff's Motion for Partial Summary Judgment. ***DENIED.***

Sean J. Bellew, Esquire, COZEN O'CONNOR, Wilmington, Delaware; Robert W. Hayes, Esquire, Sarah E. Davies, Esquire and Mary Craine Lombardo, Esquire, COZEN O'CONNOR, Philadelphia, Pennsylvania. Attorneys for Plaintiffs.

Allen M. Terrell, Jr., Esquire and Alyssa M. Schwartz, Esquire, RICHARDS, LAYTON & FINGER, Wilmington, Delaware. Attorneys for Defendant.

SLIGHTS, J.

I. Introduction

On September 26, 1997, defendant, Spherion Corporation ("Spherion") sold its stock in Interim Healthcare, Inc. ("Interim") to plaintiffs, Catamaran Acquisition Corp. ("Catamaran"), and Cornerstone Equity Investors IV, L.P. ("Cornerstone") (collectively "plaintiffs"). This transaction has spawned litigation in this Court and in the Court of Chancery. The cases have been consolidated for discovery and the parties have stipulated to a consolidated bench trial of both the legal and equitable claims. In this opinion, the Court addresses plaintiffs' motion for partial summary judgment with respect to the breach of warranty and related claims pending in this Court.[1] Material issues of fact remain unresolved in the record. Consequently, the motion for summary judgment must be **DENIED**.

II. Facts

A. The Parties

Spherion is a Delaware corporation engaged in the business of providing temporary staff to various industries. Spherion was the parent company of Interim, one of the nation's largest providers of home healthcare services. Cornerstone is a

[1]The Court addressed Spherion's motion for partial summary judgment in the Chancery action by an opinion and order dated November 19, 2003. In that decision, the Court granted Spherion partial summary judgment on plaintiffs' equitable reformation claim and transferred the legal claims pending in the Court of Chancery back to this Court for disposition. *See Interim Healthcare, Inc. v. Spherion Corp.*, C.A. No 18977 NC, Slights, J. (Del. Ch. Nov. 19, 2003)(Mem. Op.).

Delaware limited partnership that manages funds on behalf of a relatively small group of sophisticated investors. When Interim was offered for sale by Spherion, Cornerstone formed Catamaran, a Delaware corporation, as the vehicle through which it would acquire Interim.

B. The Agreement

Spherion's decision to sell Interim was followed by an active auction involving several bidders. After plaintiffs submitted the prevailing $134 million bid for Interim, the parties entered into a lengthy period of due diligence and negotiations regarding the terms by which the sale would be consummated. These negotiations led to the execution of a Restated Stock Purchase Agreement on September 26, 1997 (the "Agreement"). Because a substantial portion of Interim's revenues came from the highly regulated, government-run Medicare program, the parties expended much energy during due diligence and while negotiating the Agreement on this aspect of Interim's business.

As part of its pre-sale audit of Interim's pro forma income statements, Interim's auditors, Deloitte & Touche, LLP, engaged healthcare experts to review the propriety of Interim's claims for reimbursement from Medicare. During due diligence, plaintiffs also engaged healthcare experts to evaluate Interim's Medicare reimbursements and to assess whether Interim may be exposed to future liability for

submitting improper claims for reimbursement to Medicare. At the time the Agreement was consummated, all experts agreed that Interim had properly sought reimbursements from Medicare and also that it had set aside sufficient reserves to address any overpayments it may have received from Medicare.

The Agreement reflects the parties' focus on Medicare-related issues. Five of the Sellers' Representations and Warranties address Medicare issues and Medicare-related liabilities.[2] And each of these Representations and Warranties is tied to a general indemnification obligation which, subject to certain limitations, provides the plaintiffs with indemnity protection in the event they are later required to pay "any [d]amages that are caused by or arise out of ... any breach by Seller of any of its covenants or agreements under [the] Agreement...."[3]

Not surprisingly, plaintiffs' concerns with respect to current or future liabilities did not end with Medicare. Plaintiffs sought disclosures of all pending and threatened litigation against Interim along with Representations and Warranties that such disclosures were accurate. In response, Spherion identified certain pending litigation, all of which, according to Spherion, was routine and none of which, according to Spherion, "could have a material adverse effect on [Interim's] business,

[2]D.I 84, Ex. 1, at §§3.14-3.18.

[3]*Id.* at §10.1(a).

financial condition, cash flow or results of operation."[4] Like the Medicare Representations and Warranties, the Agreement's pending/threatened litigation Representation and Warranty was subject to the "Seller's Indemnification" provision.

C. The Representations and Warranties

The Court must admit to some difficulty in discerning from the parties' submissions precisely which of the Agreement's Representations and Warranties are at issue here. The Court has done its best to isolate the potentially applicable provisions and will discuss them briefly below.

1. Financial Statements

At Section 3.7, Spherion warrants that the financial statements it provided to plaintiffs during due diligence were "prepared in accordance with GAAP ... and presented fairly in all material respects the consolidated financial position and results of operations of [Interim] ... for the period indicated...."[5] Because Interim had been operated by Spherion as an affiliated company without separate financial records, the Agreement makes clear that the pro forma income statements prepared by Interim reflect Interim's best efforts to depict its performance as a stand alone enterprise.

---

[4] *Id.*, Ex. 12, at SPH012171; Ex.1, at §3.20. According to the Agreement, "Material Adverse Effect means any ... effect that, individually or in the aggregate, is materially adverse to the financial condition, business or results of operations of [Interim] taken as a whole." *Id.,* at §1.67.

[5] *Id.*, at §3.7.

Nevertheless, Section 3.7 is not qualified by a so-called "best knowledge" provision -- a provision that limits the representation to matters known to the party giving the warranty.[6] Spherion warrants without qualification that its audited consolidated financial statements "present fairly" Interim's financial condition "as of and for the periods indicated."[7]

2. Medicare Notices

In Section 3.16(a), Spherion warrants and represents that it has not received any "notices of program reimbursement," official notices from Medicare that a provider owes money to Medicare, nor has it received any indication that it was the subject of any "threatened proceeding or investigation...."[8] With respect to threatened proceedings, Spherion qualifies its representation by inserting a "best knowledge" provision.

In Section 3.16(b), Spherion states that it has not submitted a "false claim or ... a claim without a reasonable basis therefor with HCFA or its fiscal

---

[6] "Knowledge of the Seller Executives," as used in the representations and warranties, is defined in Section 1.61 as "actual knowledge of such individuals on the date of this Agreement or on the Closing Date." *Id.*, at §1.61.

[7] *Id.*

[8] *Id.*, at §3.16.

intermediaries...."[9] This representation is not qualified by "best knowledge."

3. Government Filings

At Section 3.17, Spherion states, without qualification, that its "cost reports and other filings are complete and in compliance in all material respects with applicable Laws."[10] The Agreement defines "Laws," at Section 1.62, as "any federal, state, local or foreign law, statute, ordinance, rule, regulation, permit, order, judgment or decree."[11] Section 3.17 also provides that, to the best of Spherion's knowledge, "there are no existing overpayments due and owing to HCFA...."

4. Litigation

Section 3.20 addresses the issue of pending or threatened litigation. Spherion states that it has disclosed all pending litigation and has, to the best of its knowledge, disclosed all threatened litigation relating to Interim. By its terms, this provision addresses both pending or threatened lawsuits and pending or threatened "litigation" relating to allegations of Medicare fraud and abuse.[12] In Section 3.28, Spherion specifically denies the existence of any "material disputes [with], or claims by

---

[9] *Id.*

[10] *Id.*, at §3.17.

[11] *Id.*, at §1.62.

[12] *Id.*, at §3.20.

Franchisees...."[13] "Material dispute or claim" is not defined in the Agreement. Finally, at Section 3.29, Spherion represents that there are no liabilities, other than those already disclosed, that would have a "Material Adverse Effect" on Interim.[14]

5. Indemnification

The parties address the Seller's indemnification obligations by including a general indemnification commitment at Section 10.1 and more specific indemnification commitments at Section 10.4. As stated, the general indemnification provision requires Spherion to indemnify plaintiffs for "any [d]amages that are caused by or arise out of ... any breach by Seller of any of its covenants or agreements under [the] Agreement...."[15] Section 10.1 is subject to a limitations provision at Section 10.3 which set forth a deductible of $2 million and a cap on Spherion's exposure of $25 million. Section 10.4 defines Spherion's indemnity obligations with respect to specifically identified liabilities, including limitations specific to these claims. Finally, Section 10.5 sets forth the notice procedures when either party seeks indemnification from the other.

---

[13] *Id.*, at §3.28.

[14] *Id.*, at §3.29.

[15] *Id.*, at §10.1.

D. The Alleged Breaches of Warranties

Within months of the closing, plaintiffs began to communicate with Spherion regarding matters they believed were covered by the Seller's Representations and Warranties and the corresponding indemnity obligations. Some of the liabilities were unanticipated; some plaintiffs argued should have been anticipated and disclosed in the Agreement; and others were anticipated and specifically addressed in the Agreement. The alleged breaches will be discussed below.

1. The Medicare Overpayment

Less than a year after the sale, the Health Care Financing Administration ("HCFA"), through its fiscal intermediary, Palmetto Government Benefit Administrators ("PGBA"), initiated an audit of Interim's requests for reimbursement of costs associated with the treatment of Medicare beneficiaries ("cost reports") for fiscal year 1996.[16] Audits of Interim's cost reports for fiscal years 1997, 1998 and 1999 soon followed. PGBA concluded that Interim had utilized an improper cost allocation methodology and that, consequently, it had been overpaid by Medicare nearly $40 million.

[16] A more detailed discussion of the Medicare overpayment issue appears in the court's opinion addressing Spherion's motion for partial summary judgment. *See Interim Healthcare, Inc. v. Spherion Corp.*, C.A. No 18977 NC, Slights, J. (Del. Ch. Nov. 19, 2003)(Mem. Op.).

When PGBA announced its intent to audit Interim, plaintiffs tendered the defense of the audit to Spherion. Spherion declined the tender and plaintiffs took the lead in the negotiations with PGBA and HCFA on behalf of Interim. After lengthy negotiations, plaintiffs, with Spherion's assistance, knowledge and approval, settled with HCFA by agreeing to pay $5.2 million. This amount reflected a global settlement of all liabilities for fiscal year 1994 and fiscal years 1996 through 1999.[17]

During the negotiations with HCFA, plaintiffs learned that Aetna, Interim's previous fiscal intermediary, had expressed concern to Interim regarding its cost allocation methodology. Cost allocation is a critical component of the cost reports Interim submitted to Medicare. According to plaintiffs, the concerns were of a nature that Interim was or should have been on notice that an audit of its cost reports would reveal that Interim had been overpaid in 1996 and would be liable to repay the overage. Plaintiffs also contend that Spherion knew or should have known that the managers plaintiffs inherited from Interim would continue to submit improper cost reports to Medicare and would thereby subject plaintiffs to future liability for overpayments.

[17]The 1994 audit was underway at the time of the sale and was disclosed by Interim during the negotiations preceding the Agreement. Because plaintiffs entered into a global settlement with HCFA, it is difficult to determine what amount of the settlement should be attributed to any given year in which Interim is alleged to have been overpaid by Medicare.

Plaintiffs seek indemnification from Spherion for the full amount of the global settlement reached with HCFA. In addition, plaintiffs contend that the Medicare overpayments were not properly reflected in Interim's financial statements. Because plaintiffs relied upon these income statements when valuing Interim during the auction process, they now contend that they paid too much for Interim and should be indemnified for the difference between Interim's true value and the price they paid for it.

2. The Therapy Student Litigation

Prior to the sale of Interim, Spherion instituted a program whereby American physical therapy students ("Therapy Students") received loans from Interim to study abroad. Upon their return to the United States, the Therapy Students were obligated to work for Interim for two years. After completing their study abroad, many of the Therapy Students learned that they were not qualified for professional licensure in the United States because the foreign schools at which they studied were not accredited. They sued Interim seeking to avoid repayment of their loans and damages. Interim was in the process of settling these claims when the sale occurred. Accordingly, the claims were specifically identified in the Agreement and were the subject of a separate indemnification provision.[18] Therapy Students continued to make claims

[18]See D.I.84, Ex.1, at §10.1(b).

after the sale and plaintiffs continued to make payments in settlement of the claims.

As stated, plaintiffs' entitlement to indemnification with respect to amounts it has paid or will pay to Therapy Students in settlement of their claims is subject to a specific indemnification provision in the Agreement.[19] This provision requires Spherion to indemnify the plaintiffs for the amount of the loan write-offs and the damages sustained by the Therapy Students as a consequence of the breach of the study abroad contracts, subject to certain limitations, e.g., "Seller and Buyer shall each pay 50% of all Specified Damages...; Buyer shall pay the first $100,000 of Specified Damages...; Seller's liability for Specified Damages shall not exceed $2,000,000."[20] Plaintiffs allege that they have properly demanded indemnification from Spherion for the Therapy Student claims but to no avail.

3. The Huff Litigation

In June of 1996, the parents of Joseph Huff initiated an action against Interim and other defendants in an Ohio state court. The complaint alleged that Joseph Huff sustained severe injuries as a result of the negligent administration of medication by an Interim nurse ("Huff 1"). Interim's insurance company assumed the defense of Huff 1 and, in June 2000, the matter was settled and the case dismissed. Thereafter,

---

[19] *Id.* at §10.4.

[20] *Id.*

the Huffs filed a new action in federal court arising from the same incident against additional defendants, including Interim Home Solutions ("IHS"), a partnership in which Interim was a general partner ("Huff 2"). Interim's insurance carrier initially denied coverage of this claim and plaintiffs were required to defend it on behalf of Interim. Ultimately, Interim's carrier settled Huff 2 on its behalf, but only after plaintiffs brought a separate action for coverage against the carrier. Plaintiffs allege that they expended in excess of $40,000 in prosecution of the coverage action.

Spherion does not dispute that it did not disclose either Huff 1 or the not-yet-filed Huff 2 litigation to the plaintiffs during negotiations. Spherion argues that Interim's liability in Huff 1, if any, was covered by insurance thereby making it an "Excluded Liability" under the Agreement and not subject to disclosure. With respect to Huff 2, Spherion contends that the action was unforeseeable at the time of the sale and that Spherion could not disclose what it did not know or suspect was an issue.

4. The Williams Litigation

In 1998, plaintiffs terminated the Interim franchise of Nancy Williams for non payment of franchise royalties. Ms. Williams, in turn, sued Interim claiming that Interim had allowed company-owned franchises to operate within her franchise territory. The matter was eventually settled for $100,000. Although Ms. Williams had threatened to sue Interim before the sale on a variety of issues, Spherion alleges

that it did not take her threats seriously and did not, therefore, disclose the threats of litigation to plaintiffs before the sale. Plaintiffs seek indemnification for the amount of the settlement it paid to Ms. Williams with interest and counsel fees.

E. Plaintiffs' Demands for Indemnification

The Seller's Indemnification provision is subject to a notice requirement which provides that the "indemnified party ... must provide written notice to the indemnifying party setting forth reasonable detail as to [the third-party claim for which indemnification is sought]."[21] The Agreement further provides that such written notice shall be delivered "promptly" and, in any event, by such time as to allow the indemnifying party to contest the third-party claim before it is paid.[22] Finally, as to notice, the Agreement states that claims for indemnification against the Seller (Spherion) shall expire unless Buyer asserts such claims within 18 months of the closing "in writing, setting forth with reasonable specificity the nature of such claims."[23]

With respect to the Medicare overpayment, plaintiffs allege that they orally notified Spherion of the results of the audit as soon as the results were communicated

[21] D.I. 84, Ex. 1, at §10.5.

[22] *Id.*

[23] *Id.* at §10.1(b).

to Interim. Plaintiffs formally noticed Spherion of their intent to pursue indemnification by letter dated October 9, 1998. This notice was supplemented by letters dated November 30, 1998, January 8, 1999, and March 22, 1999. The 18 month post-closing deadline expired on March 27, 1999. Thus, all four of plaintiffs' written notices were transmitted within the time prescribed by the Agreement.

The first three notices identified only "Medicare paybacks [sic] involving 1996 ... cost report audits."[24] In the March 22, 1999 notice, plaintiffs clarified that they were seeking indemnification with respect to "any pre-closing periods...."[25] Nevertheless, Spherion alleges that all of the notices, individually or combined, failed to identify with "reasonable specificity" the claims for which plaintiffs were seeking indemnification. According to Spherion, plaintiffs were obliged to identify each individual provider audit which formed the basis of their demand. Plaintiffs acknowledge that only some of the individual provider audits were identified in their notices to Spherion. They maintain, however, that given the circumstances of the audits, and the nature of the deficiencies identified by the fiscal intermediary, both parties knew that all of Interim's cost reports would give rise to overpayment liability. Accordingly, the reference first to "1996 cost report audits" and later to "any pre-

[24]D.I. 78, Umansky Aff., Ex. A.

[25]*Id.*, Ex. G.

closing periods" provided Spherion with more than ample "detail" to allow it to assess its exposure and to intervene in the negotiations with HCFA and its fiscal intermediary as it saw fit.

Plaintiffs' October 9, 1998 letter to Spherion also identified the Therapy Student claims and the Williams litigation as claims for which plaintiffs would seek indemnification from Spherion under the Agreement. With respect to the Therapy Student claims, Spherion alleges that plaintiffs were required to identify each student and to specify whether the student was seeking forgiveness of his/her loan, damages or both.[26] Moreover, Spherion alleges that, according to the plain terms of the Agreement, it is liable only for those claims of which it received proper notice within 18 months of the closing. Plaintiffs respond by noting that the universe of Therapy Students was relatively small and well known to Spherion at the time it received plaintiffs' October 9, 1998 notice. Spherion knew that any one of the Therapy Students could, and likely would, assert a claim against Interim. In any event, plaintiffs contend that the loan write-offs were not "Third Party Claims" as defined by the Agreement and were not, therefore, subject to the notice requirements set forth

[26]Spherion admits that plaintiffs identified some Therapy Students by name in the written notices. As to the claims involving these students, there does not appear to be a dispute regarding plaintiffs' entitlement to indemnification. The parties shall meet and confer regarding either a settlement of these claim or a form of order to reflect judgment for plaintiffs with respect to these claims. This order should be submitted to the Court for execution at the time of the Pretrial Conference.

in the Agreement.

The parties do not appear to dispute that the notice of plaintiffs' intent to seek indemnification for the amounts paid to defend and settle the Williams Litigation was proper. The claim was mentioned first in the October 9, 1998 letter and then explained in more detail in the January 8, 1999 letter. The notice was timely and, as indicated by Spherion's silence with respect to this issue, apparently effective.

Plaintiffs first demanded indemnification for the Huff litigation by letter dated July 21, 2000. Spherion denied the claim five days later by letter dated July 26, 2000. The denial was not, however, based on improper notice but rather based on Spherion's contention that the Huff litigation was not subject to disclosure under the Agreement because the liability in Huff 1 was covered by insurance and Huff 2 did not involve Interim.

III. The Parties' Contentions

On a dense factual record, plaintiffs have moved the Court for partial summary judgment with respect to each of their breach of warranty claims. They acknowledge that as to some of the claims, the Court will need to hear testimony and receive evidence before it can determine the precise amount of plaintiffs' damages. But with respect to Spherion's obligation to indemnify plaintiffs in some amount for each of the breaches of warranty, plaintiffs contend that the material facts are not in dispute

and that they are entitled to judgment as a matter of law. Specifically, plaintiffs seek summary judgment for: (1) the amounts refunded to the government arising from the Medicare overpayments; (2) the damages resulting from misstatements in Interim's financial statements which did not account for the undisclosed liability to Medicare for overpayments; (3) the amounts paid as damages in connection with the Therapy Student program; and (4) the damages and costs paid in connection with the undisclosed Huff and Williams litigations.

Spherion points to several factual controversies in the record that cannot be resolved on summary judgment. First, Spherion notes that proper notice is a predicate to indemnification under the Agreement and that, at the very least, the record is replete with controversy regarding whether plaintiffs provided proper notice of their claims for indemnification.[27] Second, Spherion contends that plaintiffs cannot demonstrate conclusively that any breach of warranty has occurred here. For instance, according to Spherion, factual disputes remain with respect to whether: (1) Interim's cost reports were proper; (2) Interim was, in fact, overpaid by Medicare; (3) if Interim was overpaid, how much of the settlement ultimately reached with HCFA can be attributed to cost reports for which the Agreement provides that Spherion can

[27]Indeed, Spherion suggests that the record clearly demonstrates that plaintiffs' notices were not in compliance with the notice provisions of the Agreement. They have not, however, cross moved for summary judgment on this issue.

be held liable; (4) Spherion is obligated to indemnify plaintiffs for all of the Therapy Student claims; (5) Spherion was required to disclose either the Huff Litigation or the Williams Litigation since neither controversy amounted to "threatened litigation" as contemplated by the Agreement.

IV. Discussion

A. Standard of Review

Summary judgment may only be granted where there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law.[28] The moving party bears the initial burden of demonstrating the absence of an issue of material fact and entitlement to judgment as a matter of law.[29] Once the moving party carries this burden, the burden shifts to the non-moving party to identify the material issues of fact that remain in the record.[30] The Court must view the evidence in the light most favorable to the non-moving party.[31] If there is any reasonable hypothesis that would allow recovery by the non-moving party, then summary judgment is inappropriate.[32] Likewise, summary judgment will not be granted if it "seems

---

[28] *Wilson v. Joma, Inc.*, 537 A.2d 187, 188 (Del. 1988).

[29] *Arco Extrusion Corp. v. Cunningham*, 810 A.2d 345, 346 (Del. 2002).

[30] *Kysor Indus. Corp. v. Margaux, Inc.*, 674 A.2d 889, 894 (Del. Super. 1996).

[31] *Matas v. Green*, 171 A.2d 916, 918 (Del. 1961).

[32] *Nationwide Mutual Ins. Co. v. Flagg*, 789 A.2d 586, 591-92 (Del. Super.).

desirable to inquire more thoroughly into the facts in order to clarify the application of law to the circumstances."[33]

In instances where the Court will act as fact-finder at trial, and in the face of a complete record, the Court inevitably will confront the temptation to resolve factual controversies on summary judgment rather than reserve the fact-finding for trial. This is especially true when the evidence, while controverted, appears to preponderate in favor of a particular factual conclusion. The Court must resist this temptation, however, for while there is no "right" to summary judgment,[34] "[i]n civil causes where matters of fact are at issue," Delaware's Constitution mandates that "such matters *shall be tried* by the court [or] ... by a jury."[35]

B. The Agreement is Unambiguous

Neither party has argued that the Agreement is ambiguous. The Court, likewise, can discern no ambiguity in the parties' choice of contractual language.[36]

---

[33] *Guy v. Judicial Nominating Commission*, 659 A.2d 777, 780 (Del. Super. 1995).

[34] *Cross v. Hair*, 258 A.2d 277, 278 (Del. 1969).

[35] DEL. CONST. of 1897, art. IV, §20 (emphasis supplied).

[36] *See In re Explorer Pipeline, Co.*, 781 A.2d 705, 713 (Del. Ch. 2001)(When interpreting a contract, "[t]he court first reviews the language of the contract to determine if the intent of the parties can be ascertained from the express words chosen by the parties or whether the terms of the contract are ambiguous.")(citation omitted).

The Court's analysis, therefore, is confined to the "four corners" of the contract.[37] The Court need not consider extrinsic evidence to ascertain the parties' intent when the contract is clear and, indeed, under the parol evidence rule, it is prohibited from doing so.[38] The fact that the governing contract is clear and unambiguous does not mean that the Court can, in all instances, interpret the contract and determine whether it has been breached as a matter of law. When the facts relating to the parties' conduct is in dispute, or when the unambiguous terms of the contract leave room for interpretation, the Court must put the parties to their proofs at trial. Such is the case here.

C. The Medicare Overpayments

1. Spherion's Consent to Settle

Plaintiffs' showcase argument is that the Court need not consider the bona fides of the government's claim against Interim for overpayments because Spherion, by consenting to plaintiffs' settlement with HCFA, has conceded its obligation to indemnify plaintiffs for the amount of the settlement. In other words, plaintiffs contend that when they have provided Spherion with the opportunity to assume the defense of the PGBA audit, and then the opportunity to approve of the settlement,

---

[37] *See O'Brien v. Progressive Northern Ins. Co.*, 785 A.2d 281, 288-89 (Del. 2001).

[38] *Id.*

they need only establish a potential liability to Medicare to recover indemnification for the settlement.

Under common law, a right to indemnity arises upon a showing that the settlement was induced by a real or potential liability, that it was reasonable, and that another is responsible for indemnity.[39] The "majority rule" is that an indemnitee must show actual liability in the underlying lawsuit.[40] Plaintiffs, however, have cited a number of cases in support of their contention that they need only establish a potential liability which was extinguished by settlement as a predicate to their claim for indemnification.[41] The cases that have recognized a right to indemnification on a showing of potential liability articulate an exception to the general rule, and do so only when the indemnitee offers adequate measures to protect the interests of the

---

[39] *Gentry v. Wilmington Trust Co*., 321 F. Supp. 1379, 1383 (D. Del. 1970)(citations omitted)

[40] *Tankrederiet Gefion A/S v. Hyman-Michaels Co.*, 406 F.2d 1039, 1042 (6th Cir. 1969)(recognizing that the majority view is "that an indemnitee must show actual liability to recover against an indemnitor.")(citations omitted).

[41] D.I. 75, at 27-29 (citing *Hess Oil, V.I. Corp. v. Firemen's Fund Ins. Co.*, 626 F. Supp. 882 (D.V.I. 1986); *Dominic v. Hess Oil, V.I. Corp.*, 624 F. Supp. 117 (D.V.I. 1985); *Burlington Northern, Inc. v. Hughes Bros., Inc*., 671 F.2d 279 (8th Cir. 1982); *Burke v. Ripp*, 619 F.2d 354 (5th Cir. 1980); *Missouri Pac. Railroad Co. v. International Paper Co.*, 618 F.2d 492 (8th Cir. 1980); *Central Nat'l Ins. Co. v. Devonshire Coverage Corp*., 565 F.2d 490 (8th Cir. 1977); *Parfait v. Jahncke Service Inc.*, 484 F.2d 296 (5th Cir. 1973), cert. denied, 415 U.S. 957 (1974)). *But see Bourg v. Chevron*, 91 F.3d 141 (5th Cir. 1996)(distinguishing the equitable indemnification principles in *Burke* and *Parfait* because they "did not apply to indemnity claims based on written agreements"); *Silverman v. Worsham Bros. Co.*, 625 F. Supp. 820 (S.D.N.Y. 1986)(distinguishing *Parfait* because it involved principles of implied indemnity law rather than an agreement between the parties).

indemnitor before any settlement is reached.[42] This line of authority is less persuasive in contract indemnity cases. Where the parties are free to allocate financial responsibility, courts should look to the language of the indemnity clause, rather than the actual-potential liability test, to determine the parties' intent and set the boundaries of the indemnity obligation.[43]

In this case, the Court cannot conclude that a departure from the "majority rule" is justified, particularly when the parties' indemnification obligations have been negotiated thoroughly, and have been articulated clearly and unambiguously in their contract. "It is an elementary canon of contract construction that the intent of the parties must be ascertained from the language of the contract."[44] Upon a review of the "four corners" of the Agreement, the Court can find no commitment or undertaking by either party to indemnify the other based only upon the settlement of a potential liability to a third party. The parties here are sophisticated and

---

[42] *M & O Marine, Inc. v. Marquette* Co., 730 F.2d 133, 135 (3d Cir. 1984)(citing *Parfait*, supra).

[43] *Bainville v. Hess Oil V.I. Corp*, 837 F.2d 128, 130-31 (3d Cir. 1988)("The capacity to shift financial responsibility by contract naturally includes the capacity to contractually allocate financial responsibility for stipulated judgments where cases are settled without the benefit of an adjudication of actual liability... in *contract* indemnity cases...the question of whether actual liability is a prerequisite to the duty to indemnify is answered by reference to what the parties, by virtue of their contractual capacity intended, as reflected in the language of the indemnity clause.")(emphasis in original)(citing *United States v. Seckinger*, 397 U.S. 203 (1970)).

[44] *Citadel Holding Corp. v. Roven*, 603 A.2d 818, 822 (Del. 1992)(citations omitted).

experienced in the healthcare industry; they bargained at arms-length for the terms of the Agreement. They are bound by the language of the contract they signed.[45]

Under the plain terms of Section 10.1, a right to indemnification arises out of "any breach" or "any inaccuracy" in the representations and warranties.[46] Thus, a right of indemnification arises *only* upon a showing of breach of warranty or inaccuracy of representation. The parties could have agreed to an indemnity obligation triggered when one party settles a potential liability of the other but they did not do so.

To prevail on summary judgment, then, plaintiffs must demonstrate with undisputed evidence that Spherion breached at least one of its warranties with respect to its relationship with Medicare and that such breach caused damages as defined in the Agreement. As discussed below, plaintiffs have not carried their burden.

2. Notice

Spherion contends that the Court need not address the merits of plaintiffs' breach of warranty claim regarding the Medicare overpayment liability because plaintiffs failed to provide proper notice of the claim. Plaintiffs acknowledge their

---

[45] *See Progressive Int'l Corp. v. E.I. duPont deNemours & Co.*, 2002 Del. Ch. LEXIS 91, at *22 ("[The] presumption that parties will be bound by the language of the contracts they negotiate holds even greater force when, as here, the parties are sophisticated entities that bargained at arm's length.")(citations omitted).

[46] D.I. 84, Ex. 1, at §10.1.

obligation to provide proper notice but argue that Spherion is reading the notice provision too literally and that the Court should consider their notice to Spherion in the context of a complex audit, fluid negotiations with PGBA and HCFA, and an indemnitor (Spherion) that was fully in the loop throughout the entire process.

Plaintiffs ignore the procedural posture of the case and the fact that the terms they chose to define their notice responsibilities necessarily implicate a fact-intensive inquiry that is not appropriately conducted at this stage of the litigation. The Agreement sets forth the criteria for notice with the precision of a shotgun: the notice should provide "reasonable detail" of the claim, should describe the claim with "reasonable specificity," and should be delivered to the seller "promptly" after the claim arises so Spherion can contest the claim. The parties chose not to define these terms, apparently preferring that the question of notice be determined on a case-by-case basis. And while the Court might be able to resolve the notice issue based on the detailed information contained in this record, particularly given Spherion's active participation in the discussions with PGBA and HCFA throughout the audit process, summary judgment is not the time to do so. The notice issue must be reserved for trial.

3. The Merits of the Claim

Plaintiffs have properly conceded that, to the extent they are claiming a breach of a representation and warranty that is qualified by Spherion's "best knowledge," the state of Spherion's knowledge at the time of the sale is disputed and must be resolved at trial. Thus, with respect to the Medicare overpayment issue, plaintiffs concede that they are not entitled to summary judgment on Section 3.16 (a) to the extent it addresses threatened proceedings or investigations by Medicare, Section 3.16(c) to the extent it addresses pending government investigations of Interim franchisees, Section 3.17 to the extent it addresses existing overpayments due to HCFA, or Section 3.20 to the extent it addresses threatened litigation. Each of these warranty provisions is qualified by the Seller's "knowledge" at the time of the Agreement. To prove breach, plaintiffs must prove that Spherion actually knew of the fact or circumstance that it was representing it did not know.

Spherion's representation and warranty regarding the propriety of its cost reports is not qualified. According to Spherion, Interim's cost reports were "complete and in compliance in all material respects with applicable Laws."[47] Plaintiffs counter that both PGBA and HCFA stated in their Notices of Program Reimbursement that Interim's cost reports were not in compliance with HCFA regulations, including

[47]D.I. 84, Ex. 1, at §3.17.

HCFA Medicare program transmittals directly on point.[48] It *appears* that plaintiffs are arguing that HCFA and PGBA have removed any factual controversy with respect to whether Interim's cost reports complied with applicable laws.[49]

For its part, Spherion points to several unresolved issues regarding the propriety of Interim's cost reports. First, repeating a centerpiece theme of their arguments in the Court of Chancery, Spherion emphasizes that experts engaged by both Spherion and the plaintiffs reviewed Interim's cost reports in detail prior to the sale and both concluded that the requests for reimbursement of costs were conservative and legal.[50] Second, Spherion argues that it prepared its cost reports exactly how it was told to prepare them by its fiscal intermediary, Aetna, before Aetna was replaced by PGBA. The problems identified by PGBA in its audit were addressed by a later HCFA transmittal which stated that providers could rely on cost allocation methodologies previously approved by a fiscal intermediary even if these

---

[48]See D.I. 82 , Ex. 2, at IHC0102377-82, IHC0102355-57, IHC0005464-68, IHC0102967-68.

[49]The Court's hesitancy in this regard reflects an apparent inconsistency in plaintiffs' argument. Plaintiffs argue that the determination of whether Interim submitted claims for reimbursement "without a reasonable basis therefor" under Section 3.16 must await trial. (O.B. 3, n.1) Yet they appear to argue that the Court can determine whether Interim's cost reports "complied with the Law" on an undisputed record as a matter of law. These apparently inconsistent positions beg the question: if the cost reports were not in compliance with applicable Laws, how could they have been filed with a "reasonable basis therefor?"

[50]D.I. 84, Ex. 22, at IHC0029559 (Ernst & Young report evaluating Interim's Medicare cost reports, stating that "[o]verall, thre were very few significant audit adjustments made by the fiscal intermediaries...[i]n general, the cost reports appear conservative.").

methodologies might be inconsistent with HCFA's current view of the issue. Spherion also points to the different opinions held by the parties' experts: Spherion's Medicare expert says the reports were proper; plaintiffs' expert says they were not.[51]

Viewing the evidence in the light most favorable to Spherion,[52] the Court is satisfied that there are multiple factual issues which must be resolved before the Court can determine if plaintiffs are entitled to indemnification for the Medicare overpayments. First, it is not at all clear at this point whether Interim submitted improper cost reports. And while plaintiffs could have bargained for an indemnity obligation which would be triggered when plaintiffs were assessed with any overpayment liability by HCFA, regardless of fault or circumstances, the Agreement provides no such protection. Rather, the Seller's indemnification provision is triggered only by a "breach by Seller of any of its covenants or agreements...."[53] Whether Spherion breached the Agreement by submitting improper cost reports is

[51]D.I. 82, Ex.16; D.I. 91, Ex.A.

[52]*Matas*, 171 A.2d at 918.

[53]D.I. 84, Ex. 1, at §10.1.

hotly contested and the resolution of this issue must await trial.[54]

The Court also cannot determine what amount, if any, of the HCFA settlement would be subject to indemnification under the Agreement. Even assuming *arguendo* that plaintiffs demonstrated a right to indemnification for the 1996 overpayments as a matter of law, the settlement with HCFA represented payments for fiscal years 1994 and 1996 through 1999. The Agreement itself does not clearly reflect an intent to warrant the accuracy of post-sale cost reports,[55] nor does the Agreement reflect a clear intent that Spherion would indemnify plaintiffs for liabilities created by post-sale cost reports. It may be that plaintiffs can prevail on their claim that the indemnification obligation should extend to liabilities created by post-sale cost reports prepared in accordance with pre-sale methodologies. The success of this argument, however, will depend upon an interpretation of the Agreement, not upon the terms of the Agreement itself. This exercise, if it is to be performed at all, must be animated by trial

---

[54]The Court agrees with plaintiffs that they were entitled to rely upon the truthfulness of Spherion's representations during due diligence. D.I. 89, at 27-31. *See also Tam v. Spitzer*, 1995 WL 510043 (Del. Ch.); *Craft v. Bariglio*, 1994 WL 8207 (Del. Ch.). But plaintiffs also indicated in the Agreement at Section 5.1 that they had conducted their own investigation into Interim's business and that they determined the scope of the investigation they would perform. Moreover, their own healthcare experts reviewed the cost reports before the closing and concluded they were proper. It may be that at trial plaintiffs will be able to point to facts which were not known to their experts at the time of the pre-closing review which now demonstrate that the cost reports were not proper. They have not, however, demonstrated that such facts are undisputed.

[55]*See* D.I. 84, Ex.1, at §3.17. *See also id.,* at §8.1 ("The representations and warranties of Seller contained in Section 3 shall be true and correct in all material respects *on the date hereof and at and as of the Closing Date....*")(emphasis supplied).

testimony; it cannot be performed in the face of a contested summary judgment record.[56]

There are other fact issues in dispute. The parties disagree with respect to whether the $2 million "threshold", i.e., the deductible to be paid by plaintiffs, applies to the Medicare overpayment liability. The "threshold" would not apply, for instance, if plaintiffs proved that Interim submitted cost reports "without a reasonable basis therefor" contrary to the representation and warranty at §3.16(b). The parties also dispute the extent to which Interim's reserves for Medicare liability would offset the amounts paid in settlement. This dispute involves the interpretation of complex financial and accounting records best understood when accompanied by the explanation of the person(s) who prepared them.

Finally, the Court notes that the success of plaintiffs' claim that Spherion overstated Interim's income depends upon the success of their claim that Interim submitted improper cost reports and received more than it was entitled to receive from Medicare. The manner in which plaintiffs valued Interim is not material unless

---

[56]It is a well settled principle of contract law that where the facts are disputed or where different reasonable inferences may be drawn from undisputed facts, it is the duty of the trier of fact to determine issues of performance or breach. 17A AM. JUR. 2D *Contracts* § 608(2003)(citations omitted). *See, e.g., Kelly v. McKesson HBOC, Inc.*, 2002 Del. Super. LEXIS 39, at *13-14 (finding that material issues of fact existed with respect to what was reasonably known by one party in a breach of contract action); *Heather Construction, Inc. v. Gangi*, 1987 Del. Super. LEXIS 1047, at *6 ("Whether a contract has been breached is ordinarily a question of fact for the trier of fact if evidence on that issue is conflicting or if different reasonable inferences may be drawn therefrom.").

plaintiffs can establish that the information they received from Spherion about Interim's past financial performance was somehow inaccurate. Since plaintiffs' claim in this regard is linked directly to their contention that Interim received reimbursements from Medicare to which it was not entitled, the Court cannot resolve this issue until it resolves the factual disputes related to the Medicare overpayment issue.[57]

While the Court appreciates that the parties have submitted a complete record on summary judgment - - one that has allowed the Court to understand fully the boundaries of the factual controversies involved - - the resolution of disputed issues of fact cannot occur on summary judgment. The issues will be resolved at or after trial.

D. The Therapy Student Claims

Spherion acknowledges that it specifically agreed to indemnify plaintiffs for the Therapy Student claims, subject to certain limitations as specified in the

[57]In response to plaintiffs' argument that Spherion breached Section 3.7, Spherion refers to its auditors who attested to the accuracy of Interim's financial statements. *See e.g.* D.I. 84, Ex. 4, at DT000002 (Deloitte & Touche letter describing the upcoming audit of Interim's financial statements to be conducted in "conformity with generally accepted accounting principles."); D.I. 84, Ex. 5, at DT 000072 (Deloitte & Touche results of the audit of Interim's financial statements, stating that, to the best of their knowledge, there were no violations of Medicare regulations.); D.I. 84, Ex. 11 (Deloitte & Touche Independent Auditors Report of Interim's financial statements, declaring that their audits were conducted in accordance with GAAP, and that, in their opinion, "such financial statements present fairly, in all material aspects, the financial position of the Company.").

Agreement. The issue in dispute is notice.[58] And, again, the open-ended notice provisions in the Agreement set the stage for a fact-intensive inquiry regarding the adequacy of plaintiffs' notice to Spherion of these claims. Having said this, the Court encourages the parties to explore a resolution of these claims short of trial. The Therapy Student claims were anticipated liabilities at the time of closing. The potential universe of these claims was well known to both parties and the terms that define the parties' respective responsibilities to account for these claims are meticulously defined in the Agreement. Under these circumstances, the parties should be able to resolve these claims without court intervention. If not, the Court will resolve them at trial.[59]

E. The Huff Litigation

The Huff litigation, as the parties point out, is actually two actions arising out of the same facts. In Huff 1, Interim was a named defendant. But Spherion claims it was not obliged to disclose Huff 1 because Interim's liability was covered by insurance. Spherion cites to Schedule 1.44 to the Agreement in support of this

[58]Plaintiffs argue that the notice requirements set forth in Section 10.5 of the Agreement do not apply to the Therapy Student claims. This is premised on the assumption that the Therapy Student claims are not "Third Party Claims" as that term is defined in the Agreement. The plain language of the Agreement, however, states that "Third Party Claims" are claims by "any person or entity...that could give rise to a right of indemnification under Section 10." There is no indication that the Therapy Students would not fall within this definition.

[59]To reiterate, the Therapy Student claims for which Spherion has acknowledged it received proper notice should be paid without further delay.

argument but, as best as the Court can tell, this schedule has not been included in the record. Plaintiffs disagree with Spherion's interpretation of Schedule 1.44 and claim that Section 3.20 required Spherion to disclose Huff 1 even if it was an "Excluded Liability." The Court needs to see Schedule 1.44 before it analyzes this issue further.

In Huff 2, Interim was not a named defendant, but a partnership in which it is a general partner (IHS) was sued. Interim may have been accountable for IHS' liabilities depending upon the terms of the partnership agreement. On the other hand, it is clear that IHS was not a "Transferred Entity" as that term is used in the "Litigation" representation and warranty.[60] Nevertheless, it is still not clear whether Huff 2 is really an Interim liability given Interim's status as general partner. More inquiry is necessary to determine whether the parties intended for the actions of entities affiliated with Interim to be covered by the indemnification provision. Summary judgment on this issue at the present time is inappropriate.

F. The Williams Litigation

Plaintiffs' argument that Spherion breached Section 3.20 by failing to disclose the Williams litigation is supported by an undisputed record. An Executive Vice President of Interim, Robert Livonius, testified at deposition that Ms. Williams had

[60]D.I. 84, Ex. 1, at §3.20.

threatened to sue Interim "many times" prior to the sale.[61] Spherion (then Interim) did not take the threats seriously and now argues that Ms. Williams' grumbling did not amount to a "*material* dispute, or claim by [a] Franchisee," as that phrase is used in Section 3.28 of the Agreement.[62] While this may be true, Spherion ignores Section 3.20 which requires Spherion to identify all threatened claims or litigation, regardless of whether the claim is "material" or not. Spherion, through Interim, knew of Ms. Williams' threats of litigation prior to the sale but did not disclose them to plaintiffs. The breach is not the underlying liability to Ms. Williams, but rather the failure to disclose her threats of litigation to plaintiffs. Under the clear and unambiguous terms of the Agreement, this omission was a breach of Section 3.20.

The question remains: to what extent, if at all, are plaintiffs entitled to indemnification for the breach. According to Section 10.1, plaintiffs can recover "any Damages ... caused by ... any breach [of warranty]." "Damages" is defined in Section 1.19 as "claims, losses, ... damages, liabilities and expenses, ... including settlement costs and [l]itigation expenses." In this instance, plaintiffs contend that Spherion should indemnify them for the amount of the settlement ($100,000) plus counsel fees incurred in defending the suit ($290,717.25). Although it is clear that the settlement

---

[61]D.I. 82, Ex. 12, at IHC0009580. *See also* D.I. 82, Ex. 13, at 115; D.I. 82, Ex. 15.

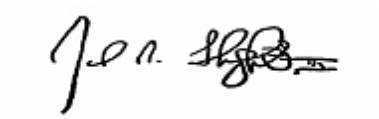
[62]D.I. 84, Ex. 1, at §3.28 (emphasis supplied).

payment, fees and costs all are recoverable "Damages" under Section 10.1, it is less clear whether these "Damages" were "caused" by Spherion's breach of Section 3.20. There is, at least, anecdotal evidence to suggest that plaintiffs would have insisted on some indemnity protection for the Williams litigation had they known of the potential liability, just as they did for the Therapy Student claims and other Interim liabilities of which the parties were aware at the time of closing. The record is not such, however, that this determination can be made as a matter of undisputed fact. The "causation" issue, therefore, must be resolved at trial.

V. Conclusion

As is often the case when parties dispute the quality of each other's performance under a contract, the factual issues are many and the disputes hotly contested. The Court is obliged at this stage of the litigation to view the facts in a manner favorable to the non moving party. Through this lens the Court has detected numerous disputes of fact in the record with respect to each of plaintiffs' breach of warranty claims. These disputes must be resolved by the fact-finding process at trial. Accordingly, plaintiffs' motion for partial summary judgment is **DENIED.**

IT IS SO ORDERED.



Judge Joseph R. Slights, III

Original to Prothonotary