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Re: Matria Healthcare, Inc. v. Coral SR LLC
C.A. No. 2513-VCN
Date Submitted: July 31, 2007
Supplemental Briefing: September 10, 2007
Second Supplemental: February 13, 2008

Dear Counsel:

This letter opinion addresses the continuing difficulties encountered in implementing the Court's Memorandum Opinion of March 1, 2007 (the "Memorandum Opinion"),[1] which, after substantial dispute between the parties as to the form of order, was implemented by the final judgment, dated May 25, 2007

[1] *Matria Healthcare, Inc. v. Coral SR LLC*, 2007 WL 763303 (Del. Ch. Mar. 1, 2007). Familiarity with the Memorandum Opinion is presumed. For convenience, terms defined in the Memorandum Opinion are used here.

(the "Final Judgment").[2] Before the Court is Coral's Motion to Enforce Final Judgment which seeks to preclude Matria from submitting to arbitration before the AAA certain claims arising out of Matria's acquisition of CorSolutions.

* * *

Matria acquired CorSolutions in accordance with the Merger Agreement. Coral serves as the representative of CorSolutions' Stakeholders with respect to certain post-merger disputes. A complex system involving four separate arbitration fora was imposed by the Merger Agreement for dispute resolution. By Section 2.9 of the Merger Agreement, post-closing disputes regarding balance sheet adjustments and the related computation of working capital, cash on hand, and indebtedness were to be submitted to the Settlement Accountant. On the other hand, claims against the Escrow Fund for damages resulting, *inter alia*, from misrepresentation may be resolved through arbitration before the AAA in accordance with Section 7.4 of the Merger Agreement. Recognizing that some claims might fall within both of these arbitration provisions, the parties agreed, by Section 7.3(c)(iii) of the Merger Agreement, that if the claim fell within the scope

[2] The Court's letter opinion accompanying the Final Judgment appears at 2007 WL 1584638 (Del. Ch. May 25, 2007) (the "Letter Opinion").

of arbitration before the Settlement Accountant and the scope of arbitration before the AAA, then the claim would be resolved by the Settlement Accountant.

* * *

CorSolutions provided a Pain Management Program (the "Program") to the Customer.[3] The Program, because of design shortcomings, identified too many participants who might benefit from it. That resulted in over-billing of the Customer and also supported inflated revenue and earnings projections. Before the merger, CorSolutions' management was aware of problems with the Program. Internal audits had revealed a substantial failure to meet contractual objectives. Moreover, the Customer had made known to CorSolutions its concerns about the Program.

CorSolutions, however, did not disclose any of these matters to Matria before the merger. Its affirmative representations in the Merger Agreement were inconsistent with these facts, then known to CorSolutions but not to Matria. Matria claims to have been the victim of CorSolutions' fraud and misrepresentation. Shortly after the merger, Matria learned of the challenges confronting the business it had just acquired.

[3] The Court, in providing a factual context for its analysis, does not make factual findings; it simply summarizes Matria's contentions and states them in an unqualified fashion.

CorSolutions' problems with the Program would have two broad consequences. First, the Customer, recognizing that it had overpaid CorSolutions, would assert a claim to recover those overpayments. Those claims may be viewed as historical and, in accordance with the Merger Agreement, were properly subject to arbitration before the Settlement Accountant as an adjustment to working capital because the claim could be quantified as of the time of the merger. Second, revenues and earnings projected from CorSolutions' work for the Customer would be reduced because the Customer would require a redesign of the Program and would cease paying for services for those individuals who would not benefit from (or who should not have been included within) the Program. These consequences would be prospective and would deny Matria some of the financial rewards anticipated from the merger. Matria had relied upon the projections in establishing the price that it was willing to pay for CorSolutions.

* * *

The Final Judgment provided in pertinent part:

> (i) . . . Section 2.9 of the Merger Agreement . . . governs the arbitration of all post-closing adjustment disputes related to the customer audit of CorSolutions which resulted in Matria's entry into a settlement of the claims with its customer, (ii) . . . Section 7.4 of the Merger Agreement does not apply to any post-closing adjustment dispute related to that customer and (iii) . . . Coral [is enjoined] from

> further proceeding pursuant to Section 7.4 of the Merger Agreement with the arbitration of this customer dispute before the American Arbitration Association[.]

* * *

The Memorandum Opinion focused upon the Customer's claim and concluded that it was subject to a working capital adjustment and, thus, arbitration before the Settlement Accountant. Matria has pursued arbitration before the Settlement Accountant of the working capital adjustment. Matria, however, has also sought arbitration before the AAA of other claims based on CorSolutions' misrepresentation (or failure to disclose) the problems with the Program. It alleges that the misrepresentation (or concealment in the face of a duty to disclose) was "made to induce Matria to pay a higher purchase price for CorSolutions than was warranted due to the problems with the . . . Program . . . and to induce Matria to proceed with the merger without providing Matria with an opportunity to negotiate reduction in the purchase price."[4] In short, Matria asserts that it was deceived by

[4] Resp't Matria Healthcare, Inc.'s First Amended Response to Claimant's Demand for Arbitration and Counterclaim (before the AAA in File No. 51 193 0159 06) (the "Arbitration Demand") at ¶ 79. Matria also alleges that had it known of the problems with the Program, it might have refused to go forward with the merger transaction. *Id.* at ¶ 80.

CorSolutions (and the Stakeholders) into paying too much for CorSolutions. It seeks damages resulting from the alleged fraudulent conduct.[5]

* * *

Coral has moved to enforce the Final Judgment. It argues that the claims which Matria has presented to the AAA fall within the scope of the Final Judgment and must be arbitrated before the Settlement Accountant. It accurately notes that the claims which Matria has presented to the AAA arise out of the same fundamental set of facts addressed by the Settlement Accountant. Matria, on the other hand, contends that the claims it has presented to the AAA must be arbitrated before the AAA because there is no accounting adjustment to CorSolutions' balance sheet that would compensate for the excessive consideration which it paid for CorSolutions, consideration it would not have paid if CorSolutions had met its disclosure obligations.

* * *

The claim which Matria brought before the AAA depends upon the same facts as the Customer's claim that was submitted to the Settlement Accountant to

[5] Matria employs the same misrepresentations (coupled with its reliance on them) to support three related theories for recovery: fraud, equitable fraud, and breach of contract (breach of representations and warranties).

determine its effect on working capital. Both relate to problems with the Program's design, its over-inclusiveness, and its adverse effects on the relationship with the Customer.[6]

The Court has expressed reservations about the risks of splitting claims based on the same underlying conduct between different arbitrators,[7] but its function here is to determine whether Matria has complied with the Final Judgment. The Final Judgment, based upon the terms of the Merger Agreement, provides that the Settlement Accountant is the arbitrator of contractual choice for "all post-closing adjustment disputes" related to the Customer or the customer audit. The question, thus, is whether the claim which Matria has brought before the AAA for resolution can fairly be classified as a "post-closing adjustment dispute." The parties agreed that certain accounting adjustments would be accomplished through the Settlement Accountant. The purpose, in general, was to reach a balance sheet that would reflect accurately the financial status of CorSolutions as of the merger if the facts had been known by all at the time. The

[6] Although the working capital adjustment sought from the Settlement Accountant is flavored by Matria's allegation of fraud, an adjustment might be appropriate even in the absence of fraud. Conversely, Matria's claims before the AAA are dependent on misrepresentation (or a related theory for recovery).

[7] *See* Letter Opinion, 2007 WL 1584638, at *1.

Customer's claim could be quantified, perhaps somewhat imprecisely. That claim, as determined, however, could be incorporated into the balance sheet with its corresponding impact on working capital. Coral, however, has not demonstrated that any similar accounting adjustment could be made to accommodate the reduction in future earnings which CorSolutions' business would suffer because of the known, but undisclosed, problems with the Program. Simply, there is no adjustment to CorSolutions' balance sheet that would address the overpayment of merger consideration by Matria because of the misrepresentation of future revenues and earnings from the Program (or concealment and the failure to disclose the reduction in same because of problems with the Program). In short, the prospective effect on earnings—material to Matria in its decision as to how much to pay for CorSolutions—is beyond the scope of any adjustment that could be made to CorSolutions' books.[8] Accordingly, the consequence of CorSolutions'

[8] Matria, in the Arbitration Demand (at footnote 1), carefully recites that it "does not seek to recover any portion of the working capital adjustment that is currently before the Settlement Accountant as a portion of such damages." The matter may not be as simple as it seems because resolution of the Customer's claim may have involved future consideration or additional efforts to satisfy the Customer's concerns. *See* Memorandum Opinion, 2007 WL 763303, at *3. That future affirmative component of satisfying the Customer's third-party claim (in addition to any repayment) should have been submitted to the Settlement Accountant because it could fairly be characterized as an obligation of CorSolutions as of the merger. On the other hand, the loss of revenue (or earnings) as the result of a reduction in the level of effort to be provided to the Customer or a reconfiguration of how the work should be performed for the Customer, for example, would not be the result of a third-party claim as such and could not be addressed fairly

misrepresentation (or concealment) as to the Program cannot be remedied by the Settlement Accountant. Such claims, however, clearly fall within the scope of the AAA arbitration process, but, unlike the dispute over the Customer's claim and its impact on working capital, the Settlement Accountant cannot fairly address them as a "post-closing adjustment." Thus, the preference of Section 7.3(c)(iii) of the Merger Agreement for resolution by the Settlement Accountant of claims that could be resolved by either the Settlement Accountant or the AAA has no application.[9]

* * *

It follows that Matria is not required to arbitrate its misrepresentation-based claims of overpayment of merger consideration before the Settlement Accountant and that Coral's Motion to Enforce Final Judgment must be denied.

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by the Settlement Accountant. This all may be complicated by the agreement between the Customer and Matria to extend the Customer's contract. The line may be a fine one and it may demonstrate the difficulty of having different arbitrators address claims that arise from the same core set of facts. It does, however, implement what the parties agreed to in the Merger Agreement and, more importantly for present purposes, is not inconsistent with the Final Judgment. The claims are distinct and under the Merger Agreement are to be addressed by separate arbitrators. Some risk of overlap—which may present something of a challenge to last arbitrators—is unavoidable.

[9] By letter of August 2, 2007, additional briefing was requested. In that letter, the Court framed part of the inquiry as whether the claims presented to the AAA would be "amenable to remedy by adjustment to CorSolutions' books." In short, the conclusion is that the claims could not be resolved by accounting adjustments.

IT IS SO ORDERED.

Very truly yours,

/s/ John W. Noble

JWN/cap
cc: Register in Chancery-K