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Court of Chancery Grants Motion for Judgment on the Pleadings Finding no Implied Condition as to the Accuracy of Information in Financial Reports

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In *Greenstar IH Rep, LLC and Gary Segal v. Tutor Perini Corporation*, the Court of Chancery granted the plaintiff's motion for judgment on the pleadings and motion to dismiss counterclaims in a breach of contract suit arising out of the sale of GreenStar Services Corporation to Tutor Perini Corporation ("Tutor Perini") in 2011 (the "Acquisition"). The merger agreement that memorialized the Acquisition (the "Merger Agreement") provided Greenstar IH Rep, LLC ("Plaintiff") a right to receive post-closing earn out consideration from Tutor Perini ("Earn-Out Payments") over a five year period in the event that certain pre-tax profit milestones were reached on an annual basis. Tutor Perini made Earn-Out Payments in the first and second years following the Acquisition, but declined Plaintiff's demand for Earn-Out Payments in the third, fourth, and fifth years. As such, Plaintiff filed a complaint seeking damages relating to Tutor Perini's failure to make Earn-Out Payments; Tutor Perini counterclaimed alleging fraud and a right to offset any harm caused by fraud.

Upon consummation of the Acquisition, Five Star Electric Corporation ("Five Star") became a subsidiary of Tutor Perini. At the time of the Acquisition, Gary Segal, was the President and CEO of Five Star, and he remained in those positions until 2016. Under the merger agreement, Tutor Perini committed to pay Earn-Out Payments over a five-year period following the closing in "an amount equal to 25% of the Pre-Tax Profit that exceeds Seventeen Million Five Hundred Thousand Dollars ($17,500,000.00); provided that any [y]early Earn-Out Payment shall not exceed Eight Million Dollars ($8,000,000.00) in the aggregate (the "Yearly Earn-Out Cap")." As stated in the definition, the calculation of the Earn-Out Payments depended on Tutor Perini's Pre-Tax Profit; Pre-Tax Profit is defined under the Merger Agreement as "the profit of the Company and its Subsidiaries . . . prior to reduction for income taxes of the Company and its Subsidiaries for such Earn-Out Term, calculated in accordance with past practices and based upon financial statements (prepared in accordance with GAAP consistently applies) of the Company."

As required by the Merger Agreement, Tutor Perini prepared Pre-Tax Profit Reports in the first four years following the Acquisition to disclose the profits which would serve as the basis for calculating the Earn-Out Payments. The Merger Agreement provided that "the Pre-Tax Profit Report and Pre-Tax Profit . . . shall be binding upon [Plaintiff] and [Tutor Perini] upon approval of such Pre-Tax Profit Report by [Plaintiff] or the failure of [Plaintiff] to object in writing within thirty (30) days after receipt [of the Pre-Tax Profit Report]." Based upon the reports, Plaintiff was entitled to Earn-Out Payments in the first four years following the Acquisition, but only received Earn-Out Payments in the first two years, thus leading to the breach of contract claims. Tutor Perini argued that while the amounts it disclosed in the Pre-Tax Reports presented its calculations at the time the disclosures were made, the calculations were based on inaccurate financial information provided by Segal, as Five Star's CEO, and therefore, could not bind Tutor Perini. To Tutor Perini, since the profits disclosed in the Pre-Tax Reports did not reflect actual Pre-Tax Profits, those amounts could not be the basis for the Earn-Out Payments.

The Court of Chancery found that the Merger Agreement unambiguously spelled out how the Earn-Out Payments were to be calculated and disputed. To the Court, the calculation was expressly dependent upon Tutor Perini's calculation of Pre-Tax Profit as disclosed in the reports, and the Merger Agreement provided a streamlined process for earn-out related disputes. The Court held that if the parties did not invoke the dispute process, then the Pre-Tax Profits and reports would be binding upon the parties and the required Earn-Out Payments would need to be calculated and paid from these amounts.

Thus, the Court rejected Tutor Perini's two primary arguments. First, Tutor Perini argued that it did not owe the Earn-Out Payments whenever it could demonstrate that it calculated Pre-Tax Profits based on financial statements that were not GAAP compliant. The Court found that nothing in the Merger Agreement could be read to negate or qualify the obligation to make payments, but rather defined how to calculate the Pre-Tax Profit. Second, Tutor Perini alleged that there was a gap in the Merger Agreement with respect to accuracy of the Pre-Tax Profits and that the Court should fill in the gap pursuant to the implied covenant of good faith and fair dealing. However, the Court found that there were no gaps and refused to "imply a term that is inconsistent with the intent of the parties as evidenced by the express terms of the agreement."

Finally, the Court granted Plaintiff's motion to dismiss the fraud counterclaim for failure to meet the particularity requirement with respect to pleading fraud. Under an applicable Court of Chancery rule, , a plaintiff must plead the circumstances constituting the fraud with particularity, specifically with reference to (i) the time, place and contents of the false representations; (ii) the facts misrepresented; (iii) the identity of the person(s) making the misrepresentation; and (iv) what the person(s) gained from making the misrepresentation. The Court found that Tutor Perini failed to allege, among other things, how the amounts provided by Five Star were overstated, how the information was inaccurate or erroneous, what role Segal played in preparing the disclosures, and how Segal caused Five Star to provide the fraudulent information. As such, this lack of particularity was fatal to the fraud counterclaim as a matter of law. As such, the Court of Chancery granted Plaintiff's motion to dismiss the counterclaim.

Greenstar IH Rep and Segal v. Tutoro Perini Corp. memorandum opinion 171031

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