

**Publications Intl., Ltd. v Phoenic Intl. Publs., Inc.**

2017 NY Slip Op 30225(U)

February 1, 2017

Supreme Court, New York County

Docket Number: 651334/2016

Judge: Anil C. Singh

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SUPREME COURT OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK: PART 45

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PUBLICATIONS INTERNATIONAL, LTD.,

Plaintiff,

-against-

PHOENIX INTERNATIONAL PUBLICATIONS, INC.,  
and JIANGSU PHOENIX EDUCATION  
PUBLISHING CO. LTD.,

Defendants.

DECISION AND  
ORDER

Index No.  
651334/2016

-----X  
PHOENIX INTERNATIONAL PUBLICATIONS, INC.,

Defendant/Counterclaim-  
Plaintiff,

-against-

PUBLICATIONS INTERNATIONAL, LTD.,

Plaintiff/Counterclaim-  
Defendant,

and

JRS DISTRIBUTION CO., and LOUIS WEBER,

Additional  
Counterclaim-Defendants.

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HON. ANIL C. SINGH, J.:

Plaintiff/counterclaim defendant Publications International, Ltd. (“PIL”) and additional counterclaim defendants JRS Distribution Co. (“JRS”) and Louis Weber (collectively, the “PIL parties”) move pursuant to CPLR 3211(a)(1), 3211(a)(7) and 3019 to dismiss three counterclaims. Defendants/counterclaim plaintiffs oppose the motion.

This is a dispute over funds in an escrow account.

Plaintiff PIL is an Illinois corporation in the business of publishing books. It had two subsidiaries in Mexico: Publications International Ltd. S de R.L. de C.V., and PIL Services Mexico S de R.L. de C.V. (collectively, "PIL Mexico").

Defendant Phoenix International Publications, Inc. ("PIP" or "claimant") is an Illinois corporation that is a publisher of children's books. Defendant Jiangsu Phoenix Education Publishing Co., Ltd. is an entity organized under the laws of China. It is an educational publishing house.

In Spring 2014, the PIL parties agreed to sell PIL's children's books publishing business to PIP for \$80 million. As part of the transaction, PIP acquired all of the shares in PIL Mexico. The parties agreed that \$2.2 million of the purchase price was allocated to the sale of the shares in PIL Mexico.

The parties executed an asset purchase agreement dated May 12, 2014 (the "APA"). As part of the transaction, the PIL parties agreed to indemnify PIP for certain potential post-closing liabilities. Specifically, under section 8.3(a) of the APA, the PIL parties agreed to indemnify PIP "from and against all Damages imposed upon or incurred by Purchaser ... arising out of, in connection with or resulting from: (i) any breach of any representation or warranty ... ; (iii) any Excluded Liabilities...." The parties set aside \$5 million of the purchase price in escrow as security for post-closing claims that fell within the scope of the PIL parties' post-closing indemnification obligations.

Under the APA, PIP agreed to pay PIL the purchase price in installments with a

remainder of \$5 million of the purchase price deposited in an escrow account.

Under the escrow agreement, the parties agreed that escrow funds would be released in three tranches:

1. On the first anniversary of the closing date, i.e., July 16, 2015, \$2.5 million was to be disbursed to PIL (less any claims made by PIP against the escrow account as of July 16, 2015);
2. On the eighteen month anniversary of the closing date, i.e., January 16, 2016, \$1.5 million was to be disbursed to PIL (less any claims made by PIP against the escrow account as of that date); and
3. On the second anniversary of the closing date, i.e., July 16, 2016, the balance in the escrow account was to be released to PIL (less any claims made by PIP against the escrow account as of July 16, 2016).

A claim could be made against the escrow agreement “[i]f PIP determines that certain facts exist that, if proven, would entitle PIP to a payment under Section 4.9 of the [APA] or would entitle PIP or any Purchaser Affiliate to a payment under Section 8.3(a) of the [APA]” (Escrow Agreement section 1.3(a)(i)).

Plaintiff PIL contends that, despite all three of the escrow release dates having now passed, PIP has refused to sign the required joint instructions to release the escrow funds. According to PIL, PIP attempts to justify its action by making certain claims against the escrow funds.

The second amended answer and counterclaims of PIP assert that none of the escrow funds should be released to PIL. Rather, some or all of the funds should be released to PIP to compensate it for damages it has sustained already, and any remaining funds should stay in escrow to secure PIP’s claims for which damages are not yet fully ascertainable because

of the PIL parties' alleged misconduct.

The first counterclaim is for breach of contract, and the second counterclaim is for a declaratory judgment.

PIP has identified seven categories of indemnification claims against PIL (and the escrow funds): 1) the excess returns claim; 2) a claim that the PIL parties willfully and in bad faith manipulated returns of merchandise in order to lower the amount of PIP's excess returns claim (the "manipulated returns" claim); 3) the Mexican taxes claim; 4) the Mexican corporate documents claim; 5) the warehousing services loss claim; 6) a claim that PIL and JRS have failed to transfer certain assets to PIP; and 7) a claim that JRS has imposed improper additional charges for services that it was required to perform under a transition services agreement dated July 16, 2014.

PIL asserts that three of PIP's claims – the "Mexican taxes claim," the "Mexican corporate documents claim," and the "manipulated returns claim" – should be dismissed because they fall outside the PIL parties' indemnification obligations under the APA and, thus, fall outside the definition of the term "Claim" in the escrow agreement.

#### Discussion

On a motion to dismiss pursuant to CPLR 3211(a)(7), the court accepts the claim's factual allegations as true, according to the claimant the benefit of every possible favorable inference, and determining only whether the facts as alleged fit within any cognizable legal theory (Mill Financial, LLC v. Gillett, 122 A.D.3d 98, 103 [1<sup>st</sup> Dept., 2014]). However, bare legal conclusions, as well as factual claims either inherently or flatly contradicted by

documentary evidence, are not presumed to be true and accorded every favorable inference (Biondi v. Beekman Hill House Apt. Corp., 257 A.D.2d 76, 81 [1<sup>st</sup> Dept., 1999], affd 94 N.Y.2d 659 [2000]). Where extrinsic evidence is submitted in connection with the motion, the appropriate standard of review is whether the proponent of the pleading has a cause of action, not whether they have stated one (IIG Capital LLC v. Archipelago, L.L.C., 36 A.D.3d 401, 402 [1<sup>st</sup> Dept., 2007]).

If the documentary proof disproves an essential allegation of the claim, dismissal pursuant to CPLR 3211(a)(1) is warranted even if the allegations, standing alone, could withstand a motion to dismiss for failure to state a cause of action (McGuire v. Sterling Doubleday Enters., L.P., 19 A.D.3d 660, 661 [1<sup>st</sup> Dept., 2005]). In other words, dismissal is warranted pursuant to CPLR 3211(a)(1) where the documentary evidence resolves all factual issues as a matter of law; conclusively disposes of the claim; and utterly refutes claimant's factual allegations (Fortis Fin. Serv. v. Fimat Futures USA, 290 A.D.2d 383 [1<sup>st</sup> Dept., 2002]).

#### I. THE MEXICAN TAXES CLAIM

The allegations of the Mexican taxes claim are set forth in paragraphs 23-27 and 49-57 of the second amended answer and counterclaims. The claim alleges the following facts: "In July 2014, PIL incurred income tax liability of approximately \$540,000 in Mexico as a result of the transaction. Under the APA, PIL is responsible for paying this tax liability. See APA Section 2.3(b) (such taxes are 'Excluded Liabilities'). Additionally, the PIL parties represented and warranted that all such taxes were paid" (Counterclaims, para.

49).

PIP contends that PIL has not paid the taxes, and interest and penalties are accruing. Paragraph 52 of the counterclaim asserts that “PIP has incurred liability for these income taxes under Mexican law.”

During the summer of 2015, PIP states that it learned that PIL had not paid the taxes. PIP informed PIL that this failure caused liability for PIP as the current owner of the business in Mexico. In September 2015, PIL demanded that PIP sign an “amendment” to the APA that would have changed to \$0 the purchase price allocated to PIL Mexico. This retroactive alteration of the deal would have eliminated PIL’s Mexican tax liability.

PIP asserts that it is entitled to indemnification because of PIL’s breach of its obligation to pay taxes and the breach of the representation and warranty that the taxes had been paid. Accordingly, no escrow funds should be released until this claim is resolved.

As noted above, section 8.3(a) of the APA states that the PIL parties agreed to indemnify PIP from and against damages “imposed upon or incurred by Purchaser.” The term “incurred” is not defined in the asset purchase agreement or the escrow agreement.

It is undisputed that the substantive law of Delaware applies to this action based on a choice-of-law provision in the APA. The Court of Chancery of Delaware summarized the rules of contract construction under Delaware law in i/mx Info. Mgmt. Solutions, Inc., v. Multiplan, Inc., 2014 WL 1255944 [Del Chancery, 2014]. The Court wrote:

When interpreting a contract, the court will give effect to the parties’ intent based on the parties’ words and plain meaning of those words. The Court will give disputed terms their ordinary and usual meaning. Of paramount

importance is what a reasonable person in the position of the parties would have thought the language of the contract meant. If either party demonstrates that their construction of the contract is the only reasonable interpretation, that party may be entitled to summary judgment. In addition, if parties introduce conflicting interpretations of a term, but one interpretation better comports with the remaining contents of the document or gives effect to all the words in dispute, the court may, as a matter of law and without resorting to extrinsic evidence, resolve the meaning of the disputed term in favor of the superior interpretation.

(*id.*, at 5).

Black's Law Dictionary defines the word "incurred" as, "To have liabilities cast upon one by an act or operation of law, as distinguished by contract, where the party acts affirmatively" (Black's Law Dictionary 768 [6<sup>th</sup> ed. 1990]).

Here, the counterclaim fails to allege that the Mexican government ever assessed any taxes or presented a bill for taxes to any party. In the complete absence of such a bill or assessment, any potential tax liability would remain inchoate and speculative. Moreover, the specific allegation that the tax liability is an inexact amount – that is, "approximately \$540,000" – itself infers the speculative nature of the claim.

Accordingly, the Court finds the counterclaim predicated upon Mexican tax liability must be stricken (Katzman v. Helen of Troy Texas Corp., 2013 WL 325562 [S.D.N.Y., 2013]; AM General Holdings LLC on behalf of Ilshar Capital LLC v. Renco Group, Inc., 2013 WL 5863010 [Del. Ch. 2013]).

## II. THE MEXICAN CORPORATE DOCUMENTS CLAIM

The allegations of the "Mexican corporate documents" claim are set forth in paragraphs 58 through 67 of the answer and counterclaims.



PIP contends that, under the APA, PIL was obligated to provide PIP at the closing with all original books and records of PIL Mexico; PIL failed to provide all documents; PIP was required to file the documents with the Mexican government in order to register and do business in Mexico; PIP sustained significant costs of investigation and legal fees as a result of PIL's failure; and PIP is subject to fees and penalties by the Mexican government. Accordingly, PIP contends that it is entitled to indemnification from PIL, and no escrow funds should be released until this claim is resolved.

Section 7.1 of the APA states that the closing was subject to certain conditions. That section states further that the purchaser may waive any conditions, including the representations and warranties in Article 5 of the APA.

In section 5.6 of the APA, the PIL parties represented and warranted that PIP was provided with true, accurate and complete copies of all of PIL Mexico's books and records.

"Under Delaware law, contractual requirements and conditions may be waived, but the standards for proving waiver are quite exacting" (Tuscan/Lehigh Dairies, Inc. v. Beyer Farms, Inc., 136 A.D.3d 799, 804 [2<sup>nd</sup> Dept., 2016] (internal citations and quotation marks omitted). "Waiver is an intentional relinquishment of a known right, that implies knowledge of all material facts and an intent to waive, together with a willingness to refrain from enforcing those contractual rights" (id.).

This counterclaim states a cause of action. Whether or not PIP waived the condition that PIL was to provide all books and records at the closing is a fact-intensive inquiry that should not be decided at this early stage of the litigation. Accordingly, the motion to

dismiss the Mexican corporate documents counterclaim is denied.

### III. THE MANIPULATED RETURNS CLAIM

The allegations of the “manipulated returns” claim are set forth in paragraphs 41 through 48 of the answer and counterclaims.

Section 4.9 of the APA required the parties to adjust the purchase price based on the value of merchandise returned during the five month period after the closing. If the value of the returns during the period was greater than a certain reserve amount, PIL was required to pay PIP fifty percent of the excess (id.).

PIP alleges that the PIL parties breached the APA by engaging in willful and bad faith conduct in order to manipulate returns. Specifically, PIP contends that the PIL parties instructed customers to stop or limit the return of merchandise and failed and/or refused to timely process returns that were requested by customers, thereby delaying returns. PIP contends that it performed a preliminary econometric analysis to determine the impact of the PIL parties’ misconduct.

In short, the Court finds that the manipulated returns claim fails to state a cause of action, for PIP fails to identify any customers by name or any specific transactions. The allegation that the PIL parties instructed unidentified customers to stop or delay returns on unspecified dates, without providing even one example, is vague and conclusory.

Accordingly, it is

ORDERED that the motion to dismiss is granted, the Mexican taxes claim is dismissed without prejudice; and it is further

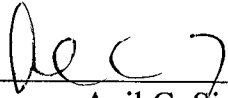
ORDERED that the manipulated returns claim is dismissed with leave to replead;  
and it is further

ORDERED that the counterclaim defendants are directed to serve an answer to the  
counterclaims within twenty days after service of a copy of this order with notice of entry;  
and it is further

ORDERED that counsel are directed to appear for a preliminary conference in  
Room 218, 60 Centre Street, on February 21, 2017, at 10:00 AM.

The foregoing constitutes the decision and order of the court.

Date: February 1, 2017  
New York, New York

  
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Anil C. Singh