SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : IAS PART 61

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CYPRESS GROUP HOLDINGS, INC., Index No. 651721/16

Plaintiff, Motion Seq. No. 001

-against-

ONEX CORPORATION; CYPRESS MANAGER LLC; GARY HARGER; MARY ELLEN HARGER; DAVID J. MANSELL; DAVID R. HIRSCH; GRATTLE STREET INVESTMENTS, L.P.; STEVEN KOTLER; 1170821 ONTARIO INC.; 1170809 ONTARIO INC.; 1170812 ONTARIO INC.;1170698 ONTARIO INC.; KYZALEA COMPANY; CYPRESS EXECUTIVE INVESTCO II LTD.; 1320976 ONTARIO INC.; ONEX CYPRESS PARTNERS II LLC; 3062601 NOVA SCOTIA COMPANY; AMERICAN FARM INVESTMENT CORPORATION; 1301449 ONTARIO INC.; 1352536 ONTARIO INC.; 1352537 ONTARIO INC.; 1376653 ONTARIO INC.; 1170819 ONTARIO INC.; EHON CANADIAN HOLDINGS LTD (FORMERLY EHON CANADIAN INVESTMENTS LTD.); JOHN TROIANO; and ERIC ROSEN,

Defendants.

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OSTRAGER, J:

This action involves a stock purchase agreement ("SPA") dated March 18, 2014 under which defendants Onex Corporation and various related entities and individuals sold Cypress Insurance Group, Inc. and its subsidiaries to plaintiff Cypress Group Holdings, Inc. for approximately 63 million dollars(Exh 2 to moving papers). Plaintiff in its Complaint asserts five causes of action against all defendants: (1) breach of contract; (2) indemnification; (3) fraudulent concealment; (4) common law fraud; and (5) a declaratory judgment as to the rights and obligations of the parties (Exh 1 to moving papers).

Simply put, plaintiff claims that defendants breached the SPA because the software Application Cypress Insurance used for its business was defective and that defendants fraudulently concealed that fact and misrepresented that the Application would be in good working condition by closing. Plaintiff also raises claims relating to the Third Addendum with the software manufacturer MajescoMastek and argues that defendants should indemnify plaintiff for having failed to pay certain taxes and for having overcharged policyholders certain fees in Texas. At oral argument on the record on January 25, 2017, plaintiff withdrew the claim relating to taxes.

Before the Court is defendants' pre-answer motion to dismiss the Complaint pursuant to CPLR 3211(a)(1), (5) and (7). For the reasons stated below, the motion is granted in part and denied in part.

Defendants' central argument under CPLR §3211(a)(5) is that the claims are barred "because of arbitration and award, collateral estoppel, [and/or] res judicata" by virtue of the dispute resolution process in SPA §2.5. Section 2.5(a) required defendants as Seller to provide a Closing Date Statement "[a]s soon as practicable, but in no event later than forty-five (45) days after the Closing Date ... setting forth the Adjusted Book Value" of Cypress Insurance as of June 30, 2014. If plaintiff Buyer notified defendant Seller in writing of detailed objections, SPA §2.5(b) required the parties to negotiate in good faith to settle any disputes. If such efforts failed, the parties were obligated to jointly "engage Deloitte or another nationally recognized firm of independent public accountants ... (the "Neural Accounting Firm") ... to render a written decision resolving the matters submitted to the Neutral Accounting Firm ..." If the parties were unable to

mutually agree upon a Neutral Accounting Firm, the American Arbitration Association would select one.

Significantly for this motion, §2.5(b) narrowly defined the scope of disputes that could be submitted to and determined by the Neutral Accounting Firm, indicating that:

> the disputes to be resolved [via that process] shall be limited to whether the items in dispute that were included in the Buyer's Objection were prepared in accordance with this Agreement and the Neutral Accounting Firm shall determine, on such basis, whether and to what extent, the Closing Date Statement and the Final Adjusted Book Value reflected therein require adjustment.

The chief objection asserted by plaintiff to defendants' Closing Date Statement was that the "asset value of certain software should have been reported as impaired."

The parties engaged BDO USA, LLP to act as the Neutral Accounting Firm to resolve the dispute. Defendants argued that no impairment of the value of the software was necessary, as the company had been using the software and intended to continue to do so had the company not been sold. Plaintiff claimed that the value of the software should have been stated as $0, rather than the $7,578,905.90 claimed in the Closing Statement, due to performance issues.

BDO rendered its written determination on May 19, 2015 (Exh 11). While acknowledging that the software had some functionality issues as of the Closing Date, BDO rejected the plaintiff's claim that the software was valueless, stating that: "[defendants] did transfer a system that [defendants] thought would eventually provide the full functionality that was originally intended at a cost that would provide a substantial cost savings to the Company." Accordingly, the narrow holding of the

Neutral Accounting Firm was that: "under GAAP and the Balance Sheet rules, the [software] Application must be accounted for at fully amortized cost as of the Closing Date [and] no change is required to [defendants'] most current calculation of the Adjusted Book Value."[1] As SPA §2.5(b) provided that the decision would be "final, conclusive and binding on the parties," the parties executed an agreement on July 20, 2015 providing that defendants Seller would pay plaintiff Buyer the amount ordered by the arbitrator "in full satisfaction of all claims raised in the Buyer's Objection" (Exh 12). Neither the indemnification claim nor the fraud claims, nor any other claim raised here, was determined by BDO, the Neutral Accounting Firm that presided over the proceedings. As indicated earlier, the sole issue determined was the calculation of the Adjusted Book Value based on objections raised by plaintiff Buyer relating to the functionality of the software Application.

Citing cases such as *O'Brien v City of Syracuse,* 54 NY2d 353, 357 (1981), defendants argue that the claims here are barred as the arise out of the same transaction as the claims before the Neutral Accounting Firm, even if based upon different theories. *See also Waverly Mews Corp. v Waverly Stores Associates,* 294 AD2d 130, 132 (1st Dep't 2002) (a final determination on the merits in an arbitration award, even if never confirmed, may have collateral estoppel effect in a subsequent action). Specifically, defendants assert that the issue underlying all claims here — whether the software application was valued in accordance with the terms of the SPA — was expressly decided by the Neutral Accounting Firm.

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[1] BDO did order that $1,863,921.00 be reduced from the purchase price for plaintiff's other objections, not relevant here.

Defendants' request for dismissal on this ground must fail. First and foremost, the SPA does not contain a broad arbitration clause for the resolution of all disputes, in contrast to the various cases cited by defendants.[2] Rather, the procedure at issue, described under the heading "Purchase Price Adjustment," is expressly limited in scope to the determination of the sole dispute relating to the Final Adjusted Book Value of the Company based upon the Closing Date Statement. Nowhere is the term "arbitration" used in the SPA to describe the dispute resolution process.

What is more, while general background information may have been presented to the Neutral Accounting Firm for context, the broader issues raised in this lawsuit beyond the Final Adjusted Book Value of the Company were not raised in the proceedings before the Neutral Accounting Firm or determined by BDO (see Exh 11 to moving papers). That the parties may have referred to the proceeding in shorthand fashion as an arbitration, or that they agreed to accept the determination as final and binding, does not and cannot convert the limited dispute resolution process into a full-blown arbitration that has preclusive effect as to all aspects of the parties' contract.

Further, as plaintiff's counsel noted at oral argument, Section 10 of the SPA contains various provisions that suggest that the parties in fact intended to preserve their right to have disputes heard in a court of competent jurisdiction. For example, 10.12 is a forum selection clause requiring that suits be brought in federal or state court

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[2] The absence of the term "arbitration" in the dispute resolution process described in the SPA also stands in sharp contrast to the broad arbitration clause that BDO included in its retainer agreement with the parties (Exh 1 to BDO determination, attached as Exh 11 to moving papers).

in New York County and also requires that the parties submit to the jurisdiction of those courts. Section 10.13 is a choice of law provision, and 10.14 is a waiver of the right to a trial by jury should litigation proceed. While it may be possible, on a fuller record, to ascertain that the determination of the sole issue of Purchase Price Adjustment determined by the Neutral Accounting Firm is entitled to some collateral estoppel effect in this action, that sole issue does not dispose of all the issues raised between the parties to this lawsuit and thus cannot support dismissal of the entire case or even the entire First Cause of Action for breach of contract.

Defendants next seek to dismiss the fraudulent concealment claim (the Third Cause of Action) and the common law fraud claim (the Fourth Cause of Action) for failure to state a cause of action and as duplicative of the contract claims. The essence of the fraud claims is that defendants misrepresented that the software application was functioning properly when Cypress and Mr. Harger knew otherwise. These allegations are substantially the same as the allegations in the Complaint central to the breach of contract and misrepresentation claims and are material to those claims and not collateral to them. Further, the damages sought in the contract and fraud claims are identical. Notwithstanding plaintiff's conclusory claims to the contrary, no legal duty exists on the part of defendants beyond the duties set forth in the SPA. For these reasons, the fraud claims must be dismissed as duplicative of the contract claim. *See, e.g., TSL (USA) Inc. v OppenheimerFunds, Inc.*, 113 AD3D 410 (1st Dep't 2014); *Clark-Fitzpatrick, Inc. v Long Is. R.R. Co.*, 70 NY2d 382, 389 (1987).

Additionally, the essential elements of fraud simply do not exist. Plaintiff is a highly sophisticated party that spent months undertaking due diligence before agreeing to the deal and executing the SPA. Plaintiff had full access to Cypress and Majesco and, as confirmed by SPA § 5.6, is barred by the contract from relying on any representations made outside the contract before closing. Further, in light of its extensive knowledge about the software application before the closing, plaintiff cannot demonstrate that it justifiably relied on any statements made about the software thereafter or that it suffered any loss proximately caused by any misstatement or omission by defendants, including any related to Harger's role in the company.[3] Therefore, dismissal of the fraud claims is granted.

The final issue relates to the Second Cause of Action seeking indemnification. Pursuant to Sections 9.2 and 9.4 of the SPA, defendants are obligated to indemnify plaintiff for any loss, liabilities, claims, damages or expenses, including costs of investigation and defense and reasonable attorneys' fees, arising from any breach of the SPA or any warranties stated therein. Specifically, plaintiff seeks indemnification for damages incurred in connection with a claim that policy holders were overcharged.

Defendants urge dismissal of the claim on the ground that plaintiff failed to give timely notice of the claim so as to give defendants an opportunity to "assume the conduct and control the settlement or defense" of the claim. Here, defendants assert

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[3] To the extent the parties argue about the import of the Third Addendum and Harger's role related to the Addendum, the Court sees no need to reach those issues as they are fairly encompassed in the breach of contract claim, which the Court declines to dismiss.

that plaintiff did not give them notice of the policy fee dispute until shortly before signing a consent order on October 29, 2015 (Exh 17), in contravention of the requirement in SPA §9.4 that notice be given "promptly". Defendants do, however, acknowledge receipt of written notice of the claim, while disputing the timeliness and substantive sufficiency of the notice.

Dismissal under CPR 3211(a)(1) based on documentary evidence is warranted "only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Leon v Martinez*, 84 NY2d 83, 88 (1994). The Court finds that defendants have failed to meet that burden, as issues of fact exist based on the documents provided as to the timeliness and sufficiency of the notice. Therefore, dismissal of the Second Cause of Action is denied. However, dismissal of the Fifth Cause of Action for declaratory relief is warranted, as the Court will necessarily determine the rights and obligations of the parties when determining the remaining causes of action, rendering declaratory relief superfluous.

Accordingly, it is hereby

ORDERED that defendants' motion to dismiss this action is granted to the extent of directing the Clerk to sever and dismiss the Third, Fourth and Fifth Causes of Action and is otherwise denied. Defendants shall serve an Answer by March 1, 2017, and appear in Room 341 for a preliminary conference on March 21, 2017 at 9:30 a.m.

Dated: February 2, 2017

BARRY R. OSTRAGER J.S.C.
JSC