

IN THE SUPERIOR COURT OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

Hudson's Bay Company)	
Luxembourg, S.A.R.L.,)	
)	
Plaintiff,)	
)	
v.)	C.A. No. 10C-12-107-JRJ CCLD
)	
JZ LLC and AGZ LLC,)	
)	
Defendants.)	

Date Submitted: April 28, 2011

Date Decided: July 26, 2011

Upon Plaintiff's Motion to Dismiss the Counterclaim: **GRANTED**

Upon Defendants' Motion to Compel: **DENIED**

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Jurden, J.

INTRODUCTION

Before the Court is Plaintiff Hudson's Bay Company Luxembourg, S.A.R.L.'s ("HBCL") Motion to Dismiss Defendants JZ LLC and AGZ LLC's (collectively "JZ") Counterclaim. Also before the Court is JZ's Motion to Compel Discovery. For the reasons that follow, HBCL's Motion to Dismiss is **GRANTED** and JZ's Motion to Compel is **DENIED**.

BACKGROUND

In July 2008, HBCL paid approximately \$202 million to defendants JZ LLC and AGZ LLC (together "JZ") to acquire their interests in True North Retail Investments I, Inc. ("True North"), the then parent company of Hudson's Bay Company ("Hudson's Bay" or the "Company"), one of Canada's largest retailers.¹ In order to induce HBCL to acquire Hudson's Bay, JZ agreed to indemnify HBCL for breaches of certain representations and warranties in a securities purchase agreement dated April 25, 2008 (as amended, the "Purchase Agreement"), concerning, among other things, the Company's financial condition and the payment of various taxes.²

After the closing, HBCL learned information that caused it to believe that JZ breached these representations and warranties and sent JZ a notice of claim (the "Claim Notice").³ The Claim Notice identified four specific breaches of representations and warranties in the Purchase Agreement, and sought indemnification based solely for breaches of these four identified representations and warranties. The Claim Notice did not assert a claim for any act or omission relating to due diligence. JZ refused to indemnify HBCL for the alleged breaches of

¹ True North is a holding company that indirectly owns 100 percent of Hudson's Bay stock; *see* Complaint at ¶ 2 (Trans. ID 34799870).

² *See* Exh. A to Plaintiff's Opening Brief in Support of its Motion to Dismiss Defendants' Counterclaim (the "Purchase Agreement") (Trans. ID 35756405); *see* Complaint at ¶ 3.

³ *See* Exh. C to Plaintiff's Opening Brief in Support of its Motion to Dismiss Defendants' Counterclaim (the "Claims Notice") (Trans. ID 35756405).

representations and warranties, and HBCL filed this action seeking indemnification for losses incurred as a result of the alleged breaches. To be clear, HBCL is not seeking damages for any alleged failure on the part of JZ relating to the due diligence phase of the transaction.⁴ JZ asserts a counterclaim for “indemnification” of all its costs and expenses for defending against the statement in the Claim Notice that HBCL had limited access to management and did not receive detailed inventory records during the due diligence phase. JZ alleges that this statement breached a representation and warranty that HBCL had “adequate access” to the Company’s personnel and records during the due diligence phase.⁵

THE PARTIES’ CONTENTIONS

HBCL argues that JZ’s Counterclaim is “legally defective” because it mischaracterizes the Claim Notice as seeking indemnification on the basis of acts or omissions arising from the due diligence process, rather than for breaches of the representations and warranties identified in the Claim Notice and the Complaint.⁶ HBCL points out that paragraph six of JZ’s Counterclaim avers that the claims asserted in the Claim Notice were based on plaintiff’s contentions that during the due diligence phase, only limited access to management was provided and detailed inventory records were not made available.⁷ According to HBCL, even a “cursory reading” of the Claim Notice establishes that HBCL’s claims are not based on JZ’s conduct during the due diligence phase and have “nothing to do with due diligence.”⁸ Instead, HBCL’s claims are based on JZ’s obligation to indemnify HBCL for specific breaches of the contractual representations and warranties identified in the Claim Notice and the Complaint. HBCL argues that a buyer is

⁴ See generally Complaint.

⁵ See Answer and Counterclaim p. 10-1, ¶ 5 (Trans. ID 35387505).

⁶ See Plaintiff’s Opening Brief in Support of its Motion to Dismiss Defendants’ Counterclaim at p. 2 (“Pltf’s. Op. Br.”) (Trans. ID 35756405).

⁷ See Answer and Counterclaim at p. 11, ¶ 6.

⁸ Pltf’s. Op. Br. at p. 2.

entitled to rely upon the accuracy of a representation regardless of what the buyer's due diligence process may have or should have revealed,⁹ and maintains that JZ's Counterclaim must be dismissed. As an additional ground for dismissal, HBCL avers that JZ has failed to allege it suffered recoverable damages. According to HBCL, because neither the Claim Notice nor the Complaint asserts claims relating to due diligence, JZ cannot recover the cost of defending against such claims.¹⁰ HBCL argues that there is nothing in the Purchase Agreement requiring a party to pay the other party's costs of defending a claim for breach of contractual representations and warranties. According to HBCL, such a requirement would "undermine and render meaningless the representations and warranties that HBCL bargained for and received in the Purchase Agreement."¹¹ JZ acknowledges that if the Hudson's Bay inventory was not valued in accordance with "generally accepted accounting principals" as of the financial statement dates, or if HBCL otherwise is able to prove a breach of JZ's representations and warranties as alleged in the Complaint, JZ would be obligated to indemnify HBCL for covered losses under the Purchase Agreement. However, JZ contends that the inventory was not overvalued according to "generally accepted accounting principals." Instead, JZ argues that HBCL is inappropriately attempting to recover from JZ the cost of marking down inventory in order to implement HBCL's post-closing strategy because its due diligence was not "adequate to ascertain that the inventory was not consistent with that strategy."¹²

⁹ See *id.* (citing *Interim Healthcare v. Sperion Corp.*, 884 A.2d 513, 548 (Del. Super. 2005)); *Cobalt Operating, LLC v. James Crystal Enters.*, 2007 WL 2142926, at *28 (Del. Ch. July 20, 2007).

¹⁰ See Pltf's. Op. Br. at p. 3. HBCL characterizes the Counterclaim as "pleading chicanery," and accuses JZ of attempting to "foist onto HBCL its cost of defending against HBCL's claims for breaches of the contractual representations and warranties that JZ agreed to honor."

¹¹ See *id.*

¹² See Defendants' Answering Brief in Opposition to Plaintiff's Motion to Dismiss the Counterclaim ("Def. Ans. Br.") at p. 4 (Trans. ID 36442436).

DISCUSSION

Plaintiff's Motion to Dismiss the Defendants' Counterclaim

The threshold showing a plaintiff must make to survive a motion to dismiss is low. Delaware is a notice pleading jurisdiction. Thus, for a complaint to survive a motion to dismiss, it need only give general notice of the claim asserted.¹³ Pursuant to Superior Court Civil Rule 12 (b)(6), a motion to dismiss should be denied if the non-moving party “may recover under any reasonably conceivable set of circumstances susceptible of proof under the complaint.”¹⁴ A claim for indemnification resulting from the breach of a representation and warranty is a claim for breach of contract.¹⁵ Under Delaware law, the elements of a breach of contract are: (1) a contractual obligation; (2) a breach of that obligation; and (3) resulting damage to the plaintiff.¹⁶ JZ avers in its Counterclaim that the Claim Notice is based on HBCL’s contention that limitations were placed on it during the due diligence process.¹⁷ Yet it is evident from the Claim Notice and the well pleaded allegations in the Complaint that HBCL seeks indemnification for “Covered Losses”¹⁸ based solely on JZ’s breach of explicit representations and warranties in the Purchase Agreement.¹⁹ None of those specifically identified representations and warranties involve the due diligence process. It is well settled under Delaware law that the extent or quality of the buyer’s due diligence is not relevant to the determination of whether the seller breached its

¹³ *Doe v. Cahill*, 884 A.2d 451, 458 (Del. 2005) (internal quotations omitted).

¹⁴ *See Crowhorn v. Nationwide Mut. Ins. Co.*, 2001 WL 695542, at *2 (Del. Super. Apr. 26, 2001).

¹⁵ *Interim Health Care, Inc. v. Spherion Corp.*, 884 A.2d 513, 548 (Del. Super. 2005).

¹⁶ *See id.*; *H-M Wexford LLC v. Encorp, Inc.*, 832 A.2d 129, 144 (Del. Ch. 2003).

¹⁷ *See* Counterclaim and Answer at p. 11, ¶ 6.

¹⁸ Purchase Agreement at ¶ 1.1.27 (“Covered Losses means any and all losses, liabilities, claims, fines, awards, deficiencies, damages, obligations, payments (including those arising out of any settlement, judgment or compromise relating to any Legal Proceeding), reasonable costs and expenses (including interest and penalties due and payable with respect thereto and reasonable attorneys’ and accountants’ fees and any other reasonable out of pocket expenses incurred in investigating, preparing, defending, avoiding or settling any Legal Proceeding), including any of the foregoing arising under, out of or in connection with any Legal Proceeding, Governmental Order or award of any arbitrator of any kind, or any Law or Contract;”).

¹⁹ *See* Complaint ¶¶ 17-28.

representations and warranties in the agreement.²⁰ Moreover, the Third Amendment to the Purchase Agreement, which contains the representation and warranty upon which JZ relies, demonstrates that HBCL did not breach the due diligence representation by seeking indemnification from JZ. The due diligence representation makes clear that HBCL is entitled to bring claims based upon JZ’s explicit representations and warranties notwithstanding the due diligence process. It does so by carving out the representations and warranties in Sections 3.1 and 3.2 of the Purchase Agreement from the language stating that HBCL was relying on its own investigation, and the language barring JZ from liability for other types of claims:

In entering into this Agreement, the Purchaser acknowledges that it has relied solely upon the aforementioned investigation, review and analysis and not on any factual representations or opinions of the Vendors, True North I, HBC or their representatives (*except the specific representations and warranties of the Vendors set forth in Section 3.1 and True North I set forth in Section 3.2*).

* * * * *

...except to the extent specifically covered by the representations and warranties in Section 3.1 and Section 3.2, none of the Vendors, True North I, HBC, or any of their respective Affiliates...will have or be subject to any liability or indemnification obligation to the Purchaser or to any other Person resulting from the distribution to the Purchaser, its Affiliates or representatives of, or the Purchaser’s use of, any information relating to the Business....²¹

In addition, the deletion of language in Section 5.1.1 requiring True North to provide “full access” to HBCL, and the addition of the language in the due diligence representation whereby HBCL represented that it had “adequate access” during the due diligence period, are not inconsistent with the statement contained in the Claim Notice suggesting that HBCL received

²⁰ See *Interim Health Care, Inc.* 884 A.2d at 548; see also *Cobalt Operating, LLC.*, 2007 WL 2142926, at *28.

²¹ See Exh. B to Plaintiff’s Opening Brief in Support of its Motion to Dismiss Defendants’ Counterclaim (the “Third Amendment to the Purchase Agreement”) at § 1, Amendment (i) (Trans. ID 35756405) (emphasis added).

less than full access during the due diligence period.²² That statement does not support a reasonable inference that HBCL breached the due diligence representation. Rather, it highlights HBCL's need to rely on JZ's explicit representations and warranties given the lack of full access during due diligence.

The Counterclaim is also defective because JZ fails to plead a cognizable injury resulting from the alleged breach of the due diligence representation. JZ contends it has suffered damages flowing from HBCL's alleged breach of the due diligence representation. JZ argues that the aforementioned damages include the costs and expenses incurred in defending HBCL's claims against JZ for True North's alleged breaches of the financial statements and tax representations. The Court agrees with HBCL that this claim is "a *non-sequitur* because the injury does not logically flow from the breach. Nothing in the complaint links the alleged breach and the claimed injury...."²³ JZ alleges a breach of the due diligence representation. The full text of this representation makes clear that the due diligence representation is distinct from, and has no affect on, claims for True North's breaches of its own representations and warranties.²⁴

The due diligence representation makes clear that HBCL was entitled to rely on JZ's explicit representations and warranties regardless of anything that occurred during the due diligence phase. Further, JZ cannot link any damages resulting from HBCL's assertion of claims

²² Compare the Third Amendment to the Purchase Agreement at § 1, Amendment (j), with the Claims Notice at p. 2.

²³ Pltf.'s Op. Br. at 14 (quoting *Great Lakes Chem. Corp. v. Pharmacia Corp.*, 788 A.2d 544, 549 (Del. Ch. 2001)).

²⁴ See the Third Amendment to the Purchase Agreement at Amendment (i):

3.3.7 **Independent Investigation; JZ and True North I Representations:** The Purchaser has conducted its own independent investigation, review, and analysis of the business, operations, assets, liabilities, results of operations, financial condition, including tax related matters, software, technology and prospects of the Business, which investigation, review and analysis was done by the Purchaser and its Affiliates and representatives. The Purchaser acknowledges that it and its representatives have been provided adequate access to the personnel, properties, premises and records of the Business for such purpose. In entering into this Agreement, the Purchaser acknowledges that it has relied solely upon the aforementioned investigation, review and analysis and not on any factual representations or opinions of the Vendors, True North I, IBC or there representatives (*except the specific representations and warranties of the Vendors set forth in Section 3.1 and True North I set forth in Section 3.2*) . . . (emphasis added).

for breach of True North's financial statements and tax representations to the alleged breach of the due diligence representation. Consequently, JZ's Counterclaim must be dismissed. Plaintiff's Motion to Dismiss the Defendants' Counterclaim is **GRANTED**.

Defendants' Motion to Compel

On April 8, 2011, JZ filed a Motion to Compel discovery. JZ seeks to compel HBCL to produce documents concerning its post-closing strategies and business plans.²⁵ HBCL argues that because the Complaint asserts claims related to pre-closing valuation and methodologies it alleges were not in accordance with "generally accepted accounting principals," post-closing strategies and business plans are neither admissible nor likely to lead to admissible evidence.²⁶ JZ argues that because HBCL's "post-closing markdowns are the alleged basis for the majority of its inventory claim," the post-closing strategies and business plans are necessary to prove JZ's defense.²⁷

At this point in the litigation, the Court is not convinced that HBCL's *post*-closing strategies and business plans are reasonably likely to lead to the discovery of admissible evidence.²⁸ The inventory claim centers on HBCL's allegation that JZ did not value Hudson's Bay inventory in accordance with "generally accepted accounting principals" at the time of closing, not post-closing. JZ's argument related to damages fails for the same reason. Any damages HBCL has allegedly suffered occurred because JZ's representations in the Purchase Agreement regarding the Company's inventory related to valuations which allegedly were made in violation of "generally accepted accounting principals."²⁹ These violations allegedly occurred

²⁵ See Defendants' Letter Motion to Compel Plaintiff to Produce Documents Concerning Plaintiff's Post-Closing Strategies and Business Plans ("Def. Mot. to Compel") (Trans. ID 36939664).

²⁶ See Plaintiff's Letter Responding to Defendants' Motion to Compel (Trans. ID 37068869).

²⁷ See Defendants' Reply Letter in Support of its Motion to Compel (Trans. ID 37179413).

²⁸ See Sup. Ct. Civ. Rule 26 (b)(1).

²⁹ See Complaint at ¶ 57.

pre-closing, and the Court is not persuaded at this point, that HBCL's post-closing strategies and business plans are discoverable.

CONCLUSION

WHEREFORE, the Plaintiff's Motion to Dismiss the Defendants' Counterclaim is **GRANTED** and the Defendants' Motion to Compel is **DENIED**.³⁰

IT IS SO ORDERED.

Jan R. Jurden, Judge

³⁰ The Defendants' Motion to Compel is denied **without prejudice**. If after further discovery, the Defendants believe they have a good faith basis to renew their Motion, they may do so.