SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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WARBERG OPPORTUNISTIC TRADING FUND, L.P., OPTION OPPORTUNITIES CO., and WATERSTONE CAPITAL MANAGEMENT, L.P.,

Index No. 652332/12

Plaintiffs,

DECISION AND ORDER

-against-

GEORESOURCES, INC.,

Defendant.

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HON. SALIANN SCARPULLA:

In this case involving a warrant to buy stock, defendant GeoResources, Inc. ("GeoResources" or "defendant") moves, pursuant to CPLR 3211, to dismiss the complaint (motion seq. No. 011); GeoResources also moves, pursuant to CPLR 3212, for summary judgment dismissing the complaint (motion seq. No. 014). Plaintiffs Warberg Opportunistic Trading Fund, L.P. ("Warberg"), Option Opportunities Co. ("Option Opportunities"), and Waterstone Capital Management, L.P. ("Waterstone") (collectively "plaintiffs") also move for summary judgment on their claims against GeoResources (motion seq. No. 012), and for a sealing order pursuant to CPLR 2214 (motion seq. No. 013). The motions are consolidated for disposition.

Background

In August 2012, GeoResources, an oil and gas company, was acquired by nonparty Halcon Resources Corporation ("Halcon"). Prior to the acquisition, GeoResources' stock was traded on Nasdaq; in June 2008, Waterstone, a hedge fund sponsor, purchased 444,445 shares of GeoResources at $22.50 per share. It also purchased warrants to purchase 177,778 additional shares at an exercise price of $32.43 at a future time. Several other large investors made similar deals with GeoResources at that time.

The warrants contained anti-dilution provisions, one of which set up an adjustment formula that was to be triggered if GeoResources sold stock at a price lower than the exercise price. Another section provided a floor below which the adjustment formula could not lower the exercise price of the warrants. Waterstone argues that it agreed to a floor price of $28.07, but that, through a scrivener's error, the warrants were issued with a floor price set at $32.43. As that is the same amount as the original exercise price of the warrants, an identical floor price would render the anti-dilution provisions of the warrant inoperable and meaningless. GeoResources position is that there was no scrivener's error and that the parties agreed that the anti-dilution clauses should be inoperable and meaningless.

Unlike Waterstone, co-plaintiff hedge funds Warberg and Option Opportunities did not acquire warrants directly from GeoResources in June 2008, but instead acquired them through a series of secondary market transactions in July, August, and December

2010. As such, Warberg and Option Opportunities did not negotiate any of the terms of the warrants, and the warrants they acquired plainly contained the meaningless anti-dilution provisions with identical exercise price and floor price.

Plaintiffs argue that they are entitled to reformation, and accordingly that the anti-dilution adjustment formula would have been triggered by stock sales made by GeoResources in December 2009 and January 2011. However, they did not make an effort to exercise the warrants at the time of either of those trigger events. Instead, in July 2012, on the eve of Halcon's acquisition of GeoResources, plaintiffs made an effort to exercise the warrants at the floor price of $28.07. Plaintiffs allege that their attempt to exercise was rebuffed by GeoResources' attorneys, who indicated that the exercise price of the warrants could not be adjusted down from $32.43.

Plaintiffs initiated this action by filing a summons and complaint the following day. The complaint alleged six causes of action: breach of contract, specific performance, declaratory relief, fraudulent inducement, promissory estoppel, and unjust enrichment. This Court (Kapnick, J.), in a decision and order entered December 11, 2012, partially granted defendant's motion to dismiss, dismissing plaintiffs' claims for declaratory relief, promissory estoppel and unjust enrichment. The Court also dismissed, with leave to replead, plaintiffs' claim for fraudulent inducement. Finally, the Court partially denied the motion, and declined to dismiss plaintiffs' claims for breach of contract and specific performance. Defendant appealed and the Appellate Division, First

Department upheld the denial of dismissal with respect to the breach of contract and specific performance claims.[1]

Two months after the Appellate Division issued its decision, on December 23, 2013, plaintiffs filed an amended complaint alleging one cause of action for reformation. Following motion practice, plaintiffs filed a second amended complaint on August 28, 2014, alleging two causes of action for reformation and breach of contract. The second cause of action, for breach of contract, alleges breach of the purchase agreement of the warrants, rather than the warrants itself. In essence, plaintiffs allege that GeoResources breached the purchase agreement by failing to furnish the warrants in the form the parties agreed on, *i.e.*, with an operative anti-dilution clause and floor price set at $28.07.

Discussion

Previously, I notified the parties that GeoResources' motion to dismiss will be converted to a summary judgment motion pursuant to CPLR 3211 (c), and that the arguments made in that motion will be read alongside the arguments it makes in its separate motion for summary judgment.

"Summary judgment must be granted if the proponent makes 'a prima facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact,' and the opponent fails to rebut that showing." *Brandy B. v Eden Cent. School Dist.*, 15 N.Y.3d 297, 302 (2010) (quoting

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[1] *Warberg Opportunistic Trading Fund, L.P. v GeoResources, Inc.*, 112 A.D.3d 78 (1st Dep't 2013).

Alvarez v Prospect Hosp., 68 N.Y.2d 320, 324 [1986]). However, if the moving party fails to make a prima facie showing, the court must deny the motion, "'regardless of the sufficiency of the opposing papers.'" *Smalls v AJI Indus., Inc.*, 10 N.Y.3d 733, 735 (2008) (quoting *Alvarez*, 68 N.Y.2d at 324).

Reformation

Courts have long held that "[i]n the proper circumstances, mutual mistake or fraud may furnish the basis for reforming a written agreement." *Chimart Assoc. v.* Paul, 66 N.Y.2d 570, 573 (1986). For mutual mistake, as alleged here, this equitable remedy is available when "the parties have reached an oral agreement and, unknown to either, the signed writing does not express that agreement." *Id.*

Because reformation is a drastic remedy, and one that can suspend application of the parol evidence rule and the Statute of Frauds, courts place a heavy presumption on the validity of the written agreement, *id.* at 574, and place the burden of showing "clear and convincing" evidence of the mistake on the party trying to overcome that presumption. *Warberg Opportunistic Trading Fund, L.P. v GeoResources, Inc.*, 112 A.D.3d 78 (1st Dep't 2013); *Timber Rattlesnake, LLC v Devine*, 117 A.D.3d 1291, 1292 (3d Dep't 2014); *Matter of Union Indem. Ins. Co. of N.Y.*, 162 A.D.2d 398 (1st Dep't 1990).

The Court of Appeals has stated that reformation based on mutual mistake is an exceptional remedy:

> The mutual mistake must exist at the time the contract is entered into and must be substantial. Put differently, the mistake must be so material that it goes to the foundation of the agreement. Court-ordered relief is therefore

> reserved only for exceptional situations. The premise underlying the doctrine of mutual mistake is that the agreement as expressed, in some material respect, does not represent the meeting of the minds of the parties.

Simkin v Blank, 19 N.Y.3d 46, 52-53 (2012) (internal quotation marks and citations omitted).

A. Reformation as to Waterstone

Plaintiffs submit a series of emails sent by Wachovia Capital Markets, LLC ("Wachovia"), which served as placement agent for the subject offerings. In the first, sent on May 27, 2008, Wachovia's lead negotiator on the deal, Craig Horstmann ("Horstmann"), emailed Stephen Blevit ("Blevit"), a lawyer for Wachovia's outside counsel who drafted the purchase agreement and the form of warrant, directing him to add anti-dilution protection language to the warrants. On June 5, 2008, Wachovia's Nicholas Wunderlich ("Wunderlich") emailed Waterstone's Jeff Davies ("Davies") confirming Waterstone's investment of $10,000,000 – for which it was receiving 444,445 shares of GeoResources' stock and a warrant to purchase 177,778 more shares at a price of $32.43 – and attaching "the final Purchase Agreement, Registration Rights Agreement and the Form of the Warrant."

The attached form of warrant, among other omissions, contained a blank space where the floor price for the anti-dilution adjustments was to be listed at section 8 (h). While the form of warrant did not need to be signed, Waterstone's Davies responded to the email by executing the purchase agreement and the registration agreement.

Wachovia's Wunderlich followed up with an email to the initial purchasers, including Waterstone, on June 6, 2008. Wunderlich's email attached the same documents, countersigned by GeoResources' CEO Frank Lodzinski ("Lodzinski"), with some of the omissions corrected. Wunderlich stated that "[s]ince the minor changes are to the benefit of investors we have been advised that there is no need to re-sign the documents." On June 9, Wunderlich followed up with another email to the initial investors, including Waterstone, which corrected the rest of the omissions, including the floor exercise price for the anti-dilution provision, which was now filled in as $28.07. Wunderlich told Waterstone and the other investors that the information "does not differ from what was communicated to you last week." Wunderlich added that documents were being provided "in their final form."

Wachovia communicated to GeoResources that the warrants would have an operative anti-dilution provision. On June 5, 2008, Horstmann, Wachovia's lead negotiator, wrote to Lodzinsky, stating: "I confirmed that the warrant exercise price floor (in the case of any future adjustments) will be set at today's closing stock price." Jones & Keller, P.C.'s Reid Godbolt ("Godbolt"), GeoResources' outside counsel, among others, received an email from Blevit on June 5, 2012, in which Blevit states that:

> I wanted to make sure you are using this right share price in Sec 8 (h) of the warrant. That number needs to be no lower than the 'consolidation closing price' of GEOI stock today, which is $28.07 per Nasdaq MarketWatch. The Nasdaq official close price was $28.20 and you could use that number as well.

Godbolt also received Wunderlich's response to Blevit, which was: "I think we should use $28.07." There is no response from Godbolt in the record. Finally, on June 9, 2008, Lodzinski sent various members of the Wachovia team an email attaching a "post mortem" document that discussed the terms of the deals made with the initial investors, which Lodzinski also shared with his board of directors. The attached document stated: "In summary . . . [t]he warrant price is $32.43 and is subject to exercise price revision in the event of selling equity below this transaction, the anti-dilution formula is complex and I don't have the model here . . ."

The warrants that GeoResources eventually delivered to investors, and filed with the SEC, contained a floor price of $32.43, rather than $28.07. The $32.43 figure first appears as a floor price in warrants attached to a June 10, 2008 email from a Jones & Keller attorney, Adam Fogoros ("Fogoros"), GeoResources' outside counsel, to Howard Ehler ("Ehler"), GeoResources' CFO. The email attached 22 warrants, and Fogoros directed Ehler to have Lodzinski sign them.

None of the initial investors, including Waterstone, were listed on Fogoros' email. At his deposition, Fogoros testified that he was not involved in the negotiations for the warrants, and that he did not know the origin of the $32.43 floor price listed in the warrants attachment. On June 11, 2008, the day after Fogoros emailed Ehler, GeoResources filed an SEC Form 8-K report attaching a form of warrant with $32.43 listed as the floor price.

Horstmann, Wachovia's lead negotiator, testified that the $32.43 floor price was filed with the SEC in error. Similarly, Blevit, the drafter of the warrants, testified that $32.43 was "not what we had agreed" and that "we had agreed on $28.07 and so I assume someone made a mistake here."

GeoResources argues that Horstmann's and Blevit's testimony is nondispositive and nonbinding on it, claiming that while Wachovia served as its placement agent for the subject transaction, it was not GeoResources' agent and thus did not have authority to make an offer on its behalf. GeoResources relies heavily on a limitation-of-engagement clause in its engagement letter with Wachovia which states that Wachovia will serve as independent contractor and disclaims the creation of a fiduciary or agency relationship. However, the engagement also grants Wachovia the exclusive right to offer and sell the subject securities. This exclusivity goes so far as to bar GeoResources itself from offering or selling the securities.

Here, the engagement letter plainly made Wachovia GeoResources' agent with respect to the transactions that are the subject of this suit. While the above referenced language of the engagement letter limits the scope of that agency, it does not strip the rest of the engagement letter of meaning. *See Gulf Ins. Co. v Transatlantic Reins. Co.*, 69 A.D.3d 71, 96 (1st Dep't 2009) (citing *Rubenstein v. Small*, 273 A.D. 102 (1st Dep't 1947) ("a court is not bound by the disclaimer of agency between the parties in determining their true relationship). The documentary evidence submitted and the

parties' actions plainly show that GeoResources had an agency relationship with Wachovia such that it made binding offers with respect to the warrants at issue here.

With Wachovia's agency firmly established, it is clear from the record that $28.07 is the floor price to which the parties agreed, and that $32.43 was entered into the warrants that were filed with the SEC and sent to the initial investors due to a scrivener's error made by GeoResources' counsel. GeoResources attempts to avoid this conclusion, by arguing that in setting the warrant exercise price and the anti-dilution floor price at the same number, the parties intentionally nullified the anti-dilution provision. This nonsensical argument would require acceptance of the proposition that during their extensive negotiations, rather than simply strike the anti-dilution provision, these sophisticated parties, and their sophisticated counsel, kept in the provision, but made it worthless by setting the identical warrant exercise price and price anti-dilution floor price. However, Horstmann, Blevit, and Godbolt all testified that they had never seen, or could not recall, a warrant with an anti-dilution provision rendered meaningless by having identical exercise and anti-dilution floor prices.

GeoResources also relies on the deposition testimony of its CEO Lodzinski and CFO Ehler. However, neither Lodzinski nor Ehler actually remembered anything about the floor price. When asked whether he had any opinion about whether $32.43 floor price was mistakenly placed into the agreement, Ehler responded: "No, I do not. I can only point to the fact that 8 (h) provides for the floor of $32.43 and that's the agreement." Lodzinski testified that he could not remember plaintiffs stating that they believed $28.07

was the correct floor price. None of this testimony raises a question of fact as to whether $32.43 floor number was mistakenly inserted into the warrants.

Finally, GeoResources cites the testimony of its erring scriveners. Fogoros, the GeoResources outside counsel who forwarded the first document containing the $32.43 floor price on June 10, 2008, testified that he could not recall any document containing that figure before June 10, 2008. Like Ehler, Fogoros pointed to the final form of the warrants: "What I can tell you is that the final warrant that was sent to the investors that was signed by the company ... the only final warrant contained $32.43."

Godbolt, another GeoResources outside attorney at Jones & Keller, went further, testifying that the floor price was not the result of a mistake. Godbolt's testimony, however, is without probative value because he had no actual knowledge of how the floor price was set. It is undisputed that Wachovia had the exclusive right to negotiate with investors, and it was Wachovia who actually did negotiate with the investors and set the floor price. Godbolt himself confirmed the lack of probative value of his testimony when he was asked if he had "any idea" where the $32.43 floor price came from: "I can't recall," he testified, "where it came from or, you know, where it was agreed upon."

In short, Waterstone has shown, by clear and convincing evidence, that Waterstone and GeoResources agreed to a $28.07 floor price, and that the anti-dilution clause was subsequently rendered meaningless by a mutual mistake arising from a scrivener's error. GeoResources offers no evidence that raises a question of fact as to this

issue. In these circumstances, Waterstone is entitled to reformation substituting $28.07 for $32.43 in section 8 (h) of the form of warrant.

B. Reformation as to Warberg and Option Opportunities

Unlike Waterstone, Warberg and Option Opportunities purchased their warrants from the secondary market. As a result, Wachovia never communicated to them that the floor price would be $28.07, as it did to Waterstone. Warberg and Option Opportunities present no evidence that they had reason to believe that the floor price was $28.07. Instead, they argue that if the initial purchasers are entitled to reformation, so are they, relying on the principle that "the assignee stands in the shoes of the assignor" (*Wald v Marine Midland Bus. Loans*, 270 AD2d 73, 74 [1st Dep't 2000]). GeoResources, on the other hand, argues that Warberg and Option Opportunities acquired the warrants through novation, rather than assignments.

Warberg and Option Opportunities submit the relevant warrant purchase agreements, as well as the "Assignment Forms," by which the previous holders assigned them warrants to buy stock and "and all rights evidenced" by the warrants. GeoResources contends that novations were effected because the initial purchasers' warrants were stamped cancelled and new warrants were issued to Warberg and Option Opportunities.

"[N]o particular words or writing are necessary to effect an assignment" (*Textiles v Rafaella Sportswear*, 293 AD2d 261, 262 [1st Dep't 2002] [internal quotation marks and citation omitted]). Instead, "the sole requisite," in the creation of an assignment, is a

"perfected transaction between the assignor and assignee, intended by those parties to vest in the assignee a present right to the things assigned" (*id.*). Similarly, in determining whether a novation has been effected, "intent is a relevant and material factor" (*see, e.g., Tunnell Publ. Co. v Straus Communications*, 169 AD2d 1031 [3d Dep't 1991] [finding that questions of fact preclude summary judgment on the issue of whether a novation was effected]). The technical elements of a novation are: "a previously valid obligation, agreement of the parties to the new obligation, extinguishment of the old contract, and a valid new contract" (*Old Oak Realty v Polimeni*, 232 AD2d 536 [2d Dep't 1996] [finding that these elements had been satisfied and a novation had been effected]).

Here, the warrants were assigned, as well as "all rights evidenced" by the warrants. The right to reformation of the warrants, based on a mutual mistake, is clearly not evidenced by the warrants. As the discussion above shows, a thorough examination of the negotiation process to which the secondary purchasers were not privy is required to find the mutual mistake giving rise to reformation. Thus, the language of the assignments indicate that the parties intended to limit the conveyance to the documents themselves and to sever any rights arising from the negotiations between GeoResources and the initial purchasers.

To remove any doubt, the parties effected a novation and replaced the initial warrants with new ones issued directly to Warberg and Option Opportunities. All of the elements of a novation are in place: the initial warrants, as well as the agreement to extinguish the initial warrants and to create valid new warrants. By accepting the new

warrants issued directly to them, Warberg and Option Opportunities agreed that their relationship with GeoResources was governed by the warrants issued to them, rather than the cancelled warrants they acquired from the initial purchasers. Thus, their link to the mutual mistake was severed. As a result, Warberg and Option Opportunities are not entitled reformation.

Breach of the Purchase Agreement

In the second cause of action for breach of the purchase agreement, plaintiffs allege that GeoResources breached section 2.1 of the purchase agreement. Plaintiffs also argue, in their first cause of action for reformation, that GeoResources breached the form of warrant by refusing to honor the warrants at the floor price of $28.07.

As to the breach of the purchase agreement, section 2.1 of that agreement provides:

> Subject to the terms and conditions of this Agreement, on the Closing Date, each of the Investors shall severally, and not jointly, purchase, and [GeoResources] shall sell and issue to the Investors, the Shares and Warrants in the respective amounts set forth opposite the Investors' names on the signature pages attached hereto in exchange for the Purchase Price as specified in Section 3.1 below.

Plaintiffs argue that GeoResources breached this provision by failing to issue warrants with the floor price of $28.07. As discussed above, Waterstone's application for reformation is granted. Because Waterstone's warrants are reformed with the $28.07 floor price, and GeoResources otherwise performed its other obligations under section 2.1 of the purchase agreement, there is no breach of that agreement.

However, the analysis is different as to the claim by Waterstone against GeoResources for breach of the form of warrants. Plaintiffs allege that GeoResources repudiated its obligation under the form of warrant on July 2, 2012. Plaintiff's attorney Stephen Warren testified that he spoke with Fogoros, GeoResources' attorney, on that date and that Fogoros "said that GeoResources' position was that there were no anti-dilution protections . . ." This admission is uncontested, and reflects the position GeoResources has taken in this litigation. By repudiating its obligation to honor the warrants at a price adjusted by the anti-dilution protections in the form of warrant, GeoResources breached its obligation to Waterstone. *See Harris v Seward Park Hous. Corp.*, 79 A.D.3d 425, 426 (1st Dep't 2010). As such, GeoResources is liable to Waterstone for breach of contract.

As to Warberg and Option Opportunities, these plaintiffs did not acquire their warrants until more than two years after the purchase agreement was finalized. The purchase agreement contains a survival provision that states: "The representations, warranties, covenants and agreements contained in this Agreement shall survive the Closing of the transactions contemplated by this Agreement for a period of two years after the Closing." Even if Warberg and Option Opportunities were correct that the obligations under the purchase agreement were assigned to them when they acquired their warrants, it is clear that any rights under that agreement had already expired. As to the breach of the form of warrants, because Warberg and Option Opportunities are not entitled to reformation, there was an inoperative anti-dilution clause in their warrants, and

GeoResources did not breach those warrants by refusing to make an anti-dilution adjustment to the exercise price.

Sealing Order

The motion for the sealing order is granted, for the reasons set forth on the record on June 11, 2015.

Conclusion

In accordance with the foregoing, it is

ORDERED that the motion by plaintiffs Warberg Opportunistic Trading Fund, L.P., Option Opportunities Co. and Waterstone Capital Management, L.P. for summary judgment (motion seq. No. 012) is granted only to the extent that plaintiff Waterstone Capital Management, L.P. is entitled to summary judgment on its first cause of action for reformation of the form of warrant and for breach of the warrants;

ORDERED that plaintiffs' Warberg Opportunistic Trading Fund, L.P., Option Opportunities Co. and Waterstone Capital Management, L.P.'s motion for a sealing order (motion seq. No. 013) is granted; and it is further

ORDERED that defendant GeoResources, Inc.'s motions to dismiss and for summary judgment (motion seq. Nos. 011 and 014) are granted only to the extent that: (1) all claims of plaintiffs' Warberg Opportunistic Trading Fund, L.P. and Option Opportunities Co. are dismissed; and (2) Waterstone Capital Management, L.P.'s claim of breach under the purchase agreement are dismissed; and it is further

ORDERED that the parties are directed to appear on January 20, 2015 at 2:15 p.m. to discuss the most expeditious manner of determining damages.

This constitutes the decision and order of the Court.

Dated: New York, New York
November 30, 2015

ENTER:

Hon. SALIANN SCARPULLA, J.S.C.