Project Cricket Acquisition, Inc. v Florida Capital Partners, Inc.
2017 NY Slip Op 31383(U)
June 27, 2017
Supreme Court, New York County
Docket Number: 652524/2015
Judge: Saliann Scarpulla

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PROJECT CRICKET ACQUISITION, INC.,

Plaintiff,

-against-

FLORIDA CAPITAL PARTNERS, INC., FLORIDA CAPITAL PARTNERS II, INC., FCP INVESTORS VI, LP, FCP INVESTORS VI (PARALLEL FUND), LP, FCP PARTNERS VI, LLC, FELIX J. WONG, GREGORY JOHNSON, BARRY J. THIBODEAUX, THOMAS P. BAYHAM, THOMAS R. SUMNER, GEORGE T. MALVANEY, LARRY N. LEE, ROBERT WILLIAMS, RODNEY POWELL, ROBERT KEESEE, ERIC HOFFMAN, DAVID ZACHARY, CLAY COX, CRICKET STOCKHOLDER REP, LLC,

Defendants.

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DECISION/ORDER

Index No. 652524/2015
Motion Seq. No. 004, 005, & 006

HON. SALIANN SCARPULLA, J.:

Motion sequence numbers 004, 005, and 006 are consolidated for disposition.

In motion 004, defendant Gregory Johnson ("Johnson") moves, pursuant to CPLR § 3211 (a)(8) and CPLR §§ 3211 (a)(1) and (7), for dismissal of the eighth, ninth, eleventh, and twelfth causes of action in the first amended complaint as against him.

In motion 005, defendants Felix J. Wong ("Wong"); FCP Investors VI, LP; FCP Investors VI (Parallel Fund), LP (with FCP Investors VI, LP, "FCP Signatory Parties"); Florida Capital Partners, Inc.; Florida Capital Partners II, Inc.; FCP Partners VI, LLC (with Florida Capital Partners, Inc. and Florida Capital Partners II, Inc., "FCP Non-Signatory Parties") (the FCP Signatory Parties and the FCP Non-Signatory Parties, together the "FCP Parties"); and Cricket Stockholder Rep, LLC ("Seller Rep") (collectively, "FCP Defendants"), move for dismissal of all causes of action in the first amended complaint as to the FCP Defendants on the basis of documentary evidence, lack of personal jurisdiction as to Wong and the FCP Non-Signatory

Parties, failure to satisfy conditions precedent, failure to state a claim upon which relief may be granted, and failure to plead fraud with particularity, pursuant to CPLR 3211 (a)(1), 3211 (a)(7), 3211 (a)(8), and 3016 (b).

In motion 006, defendants Barry J. Thibodeaux, Thomas P. Bayham, Thomas R. Sumner, George T. Malvaney, Larry N. Lee, Robert Williams, Eric Hoffman, David Zachary, and Clay Cox (collectively, "Selling Shareholders") move, pursuant to CPLR §§ 3211 (a)(1) and (7), for dismissal of all causes of action in the first amended complaint as to them.

Background

Plaintiff Project Cricket Acquisition, Inc. is a Delaware corporation that is majority owned by The Halifax Group, LLC, through Halifax Capital Partners III, L.P. Plaintiff purchased USES Holding Corp. and its wholly owned subsidiaries (collectively, "USES") under a Stock Purchase Agreement ("SPA") on March 31, 2014 for approximately $100 million. Pursuant to the SPA, USES provided a series of representations and warranties in the SPA regarding USES's financial statements and operating condition, and this action largely arises out of these allegedly false and inaccurate representations.

Plaintiff alleges that defendants (1) Florida Capital Partners, Inc. and (2) Florida Capital Partners II, Inc. are Delaware corporations operating as investment firms that control USES's majority shareholders, defendants (3) FCP Investors VI, LP and (4) FCP Investors VI (Parallel Fund) LP, through their general partner defendant (5) FCP Partners VI, LLC.

Wong serves as either an executive or manager at various FCP Defendants. Plaintiff alleges that Wong oversaw USES through his involvement in FCP Defendants' management, including serving on USES's Board of Directors. Johnson served as USES's president both before and after the SPA, and plaintiff alleges that Wong hired Johnson. Both Wong and Johnson signed the SPA in

their corporate capacities, and Johnson allegedly received a $5 million transaction bonus from the deal.

The Selling Shareholders are either former or current USES employees who held USES stock or stock appreciation rights. The Selling Shareholders are sued in their limited capacity as Sellers[1] who, under the SPA, are required to return sales proceeds to remedy plaintiff for its losses. The Seller Rep is a Delaware limited liability company appointed to serve under the SPA as the agent and attorney-in-fact for matters requiring any form of Seller approval or consent.

USES provides environmental services, most notably emergency response, remediation, and industrial cleaning services for oil spills and hazardous material. Prior to the sale, USES was engaged in a profitable clean-up project, and plaintiff alleges that defendants exploited USES's positive financial position to sell USES at an inflated price. To that end, defendants directed the sale process through Houlihan Lokey's ("Houlihan") New York office in August 2013, where Wong and Johnson attended a meeting and participated in multiple teleconferences directed to New York office. In October 2013, Wong and Johnson allegedly provided Houlihan materials that marketed USES to prospective buyers, including plaintiff. Plaintiff contends that these marketing materials contain false information.

Between November 2013 and January 2014, plaintiff conducted due diligence on USES. When valuing USES, plaintiff determined the purchase price based on USES's earnings before interest, taxes, depreciation, and amortizations ("EBITDA") from financial statements USES provided. Plaintiff alleges that Johnson, with FCP Parties and Wong's consent, did not disclose materially adverse information regarding USES's deteriorating performance. To make USES more

[1] "Sellers" refers collectively to defendants: (1) FCP Investors VI, LP; (2) FCP Investors VI (Parallel Fund), LP; (3) Barry J. Thibodeaux; (4) Thomas P. Bayham; (5) Thomas R. Sumner; (6) George T. Malvaney; (7) Larry N. Lee; (8) Robert Williams; (9) Rodney Powell; (10) Robert Keesee; (11) Eric Hoffman; (12) David Zachary; and (13) Clay Cox.

attractive, plaintiff alleges that Johnson, with FCP Parties and Wong's approval, used improper accounting tactics to fabricate revenue by, among other things, manipulating USES's revenues, costs, and reserves. Plaintiff further alleges that USES hid key issues, such as potential tax liabilities, technological shortcomings, and deteriorating customer relationships. Plaintiff also alleges that Johnson placed informational restrictions throughout the sale process, thereby impairing plaintiff's due diligence.

On March 31, 2014 ("Closing"), plaintiff executed the SPA with Sellers and USES. The SPA provides a series of representations and warranties regarding its condition and financial statements, including, *inter alia*, that its financial condition was fairly reflected in accordance with Generally Accepted Accounting Principles ("GAAP"); that certain liabilities and obligations were either reserved against or reflected in its financial statements; and that senior management had not received any notice that certain customers intended to terminate or reduce their relationships with USES. The SPA further provides that Sellers would indemnify plaintiff for losses arising out of certain breaches of USES's representations and warranties.

Johnson continued to manage USES in its newly acquired form after the SPA closed. USES eventually terminated Johnson's employment on August 15, 2014 because of alleged poor financial performance and other issues. Plaintiff alleges that it later discovered that Johnson, under Wong's direction and approval, made a series of false and misleading statements about USES's financial reporting, its systems, and its growth prospects. Plaintiff alleges that, contrary to the requirements of multiple SPA provisions, USES's financial records were not maintained in accordance with GAAP and instead materially misrepresented the company's financial state. Additionally, the amended complaint specifically details a litany of undisclosed expenses and overstated revenue. Plaintiff alleges that FCP's, Wong's, and Johnson's overstatement of USES's EBITDA resulted in a purchase price that was inflated by more than $23 million.

Under the SPA, the purchase price was subject to adjustment after the Closing based on the net amount of assets and liabilities ("Working Capital") at USES as of the Closing. Prior to the Closing, USES prepared a Preliminary Net Working Capital Statement ("Preliminary NWC Statement") that estimated the Working Capital that would be delivered. Following the Closing, USES prepared a Closing Net Working Capital Statement ("Closing NWC Statement") using USES's historical financial records. The difference in Working Capital between the Preliminary NWC Statement and the Closing NWC Statement provided the amount of the purchase price adjustment. Johnson was responsible for the preparation of both the Preliminary NWC Statement and the Closing NWC Statement (together, "NWC Statements"), which was to be provided in accordance with GAAP. Plaintiff claims that because of the alleged errors in USES's financial records, at least $7.4 million less in Working Capital was delivered at Closing than would have been delivered had USES's financial statements accurately reflected the company's financial position.

The amended complaint contains twelve causes of action. The first seven are against Sellers for indemnification based on alleged breaches of USES's representations and warranties in the SPA. The remaining causes of action are: (1) the eighth cause of action for fraud in the inducement against FCP Parties, Wong, and Johnson; (2) the ninth cause of action for negligent misrepresentation against Johnson; (3) the tenth cause of action for breach of section 2.3 of the SPA for inaccurate NWC Statements against Sellers and the Seller Rep; (4) the eleventh cause of action for breach of the implied convent of good faith and fair dealing against all defendants; and (5) the twelfth cause of action for civil conspiracy against the FCP parties, Wong, and Johnson.

Each defendant moves on various grounds to dismiss the claims asserted against them.

Discussion

The parties agree to the application of Delaware law pursuant to section 10.6 of the SPA, which provides:

> "This Agreement shall be governed by and construed and enforced in accordance with the internal laws (both substantive and procedural) of the State of Delaware, without giving effect to any choice or conflict of law provision or rule (whether of the State of Delaware or any other jurisdiction) that would cause the application of the Laws of any jurisdiction other than the State of Delaware"

"Generally, courts will enforce a choice-of-law clause so long as the chosen law bears a reasonable relationship to the parties or the transaction." *Welsbach Elec. Corp. v MasTec N. Am., Inc.*, 7 N.Y.3d 624, 629 (2006). Here, the complaint alleges that plaintiff is a Delaware corporation, as are defendants Florida Capital Partners, Inc., Florida Capital Partners II, Inc, and Seller Rep. Delaware law therefore bears a reasonable relationship to parties to the suit and will be applied.

I. Jurisdiction

Johnson, Wong, and the FCP Non-Signatory Parties argue that I should dismiss the amended complaint as to each because the Court lacks jurisdiction over them. The burden of establishing jurisdiction rests on plaintiff as the party asserting jurisdiction. *O'Brien v Hackensack Univ. Med. Ctr.*, 305 A.D.2d 199, 200 (1st Dep't 2003).

A. Johnson

Johnson argues that the SPA's forum selection clause does not subject him to personal jurisdiction in New York because he is not a party to the SPA. Plaintiff argues that the forum selection clause binds Johnson, although a non-signatory to the SPA, because he has a sufficiently close relationship to the signatories and the dispute.

Section 10.9(g) of the SPA provides:

> "Each party agrees that any suit, action or proceeding brought by such party against the other in connection with or arising from this Agreement ('Judicial Action') shall be brought solely in the United States District Court for the Southern District of New York

(or any New York state court located in the Borough of Manhattan, City of New York State of New York), and each party consents to the jurisdiction and venue of each such court."

Johnson, as non-party to the SPA, did not contractually agree to New York asserting jurisdiction over him. Nevertheless, under New York law, "a nonparty that is 'closely related' to one of the signatories can enforce [or be bound by] a forum selection clause." *Freeford Ltd. v Pendleton*, 53 A.D.3d 32 (1st Dep't 2008), *lv denied* 12 N.Y.3d 702 (2009). "The relationship between the nonparty and the signatory in such cases must be sufficiently close so that enforcement of the clause is foreseeable by virtue of the relationship between them." *Id.* at 38-39.

Johnson's significantly close relationship with USES and the dispute makes it foreseeable that plaintiff would seek to invoke the forum selection clause against Johnson. Johnson signed the SPA on USES's behalf and played an instrumental role in the transaction at issue because he was the conduit for information passed from USES to plaintiff.

The amended complaint alleges that Johnson also had a strong interest in the transaction because he received a sales bonus of approximately $5 million based on the purchase price paid under the SPA. Plaintiff also alleges that after the sale, Johnson continued working as an executive of the newly acquired company, and perpetuated the misrepresentations central to this dispute. Johnson's intimate involvement from the inception of the deal making process, to the execution of the deal, to his alleged post-deal obfuscation demonstrates that he is far more than an executive signing an agreement on behalf of a corporation. *See Tate & Lyle Ingredients Americas, Inc. v Whitefox Tech. USA, Inc.*, 98 A.D.3d 401, 402 (1st Dep't 2012). Accordingly, I find that it was reasonably foreseeable that the forum selection clause in the PSA could be asserted to permit New York to assert jurisdiction over Johnson.

B. Wong

Wong also argues that the Court lacks jurisdiction because, as a non-signatory, he is not bound by the SPA's forum selection clause. I reach the same conclusion regarding Wong and find that Wong's relationship with USES and the transaction at issue is sufficiently close to bind him to the SPA's forum selection clause. Like Johnson, Wong signed the SPA on behalf of the FCP Signatory Parties and Seller Rep. Plaintiff alleges that Wong served on USES's Board of Directors throughout FCP Parties' investment in USES and led FCP Parties' efforts to sell USES. Wong allegedly hired Johnson to serve as USES's president. Wong, allegedly, engaged Houlihan on behalf of Sellers, and he collaborated on, reviewed, revised, and authorized the use of marketing materials that defendants used to sell USES. These allegations demonstrate a relationship that is sufficiently close with USES as a signatory and the dispute for Wong to foresee being subject to the SPA's forum selection clause. *See Tate & Lyle Ingredients Americas, Inc. v Whitefox Tech. USA, Inc.*, 98 A.D.3d 401, 403 (1st Dep't 2012). Accordingly, I find that Wong is subject to this Court's jurisdiction based on the SPA's forum selection clause.[2]

C. FCP Non-Signatory Parties

FCP Non-Signatory Parties argues that the Court lacks jurisdiction: 1) because, as non-signatories, the SPA's forum selection clause does not bind the FCP Non-Signatory Parties, and 2) because plaintiff is unable to establish long-arm jurisdiction over the FPC Non-Signatory Parties. In opposition, plaintiff argues that: 1) FCP Non-Signatory Parties are closely related to the signatories and, in turn, equally bound by the SPA's forum selection clause, and 2) also subject to this Court's long-arm jurisdiction.

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[2] Because I find that the Court has jurisdiction over Johnson and Wong based on the SPA's forum selection clause, I do not address whether plaintiff established long-arm jurisdiction over either individual defendant.

Unlike Johnson and Wong, plaintiff has not demonstrated jurisdiction exists over the FCP Non-Signatory Parties. Plaintiff alleges that "Florida Capital Partners controlled the two largest shareholders of USES' stock, Defendants FCP Investors VI, LP and FCP Investors VI (Parallel Fund), LP through their general partner Defendant FCP Partners VI, LLC." This sole allegation of an interrelationship between FCP Parties, alone, is insufficient to establish a closely-related theory of jurisdiction.

For example, in *Tate & Lyle Ingredients Americas, Inc. v Whitefox Tech. USA, Inc.*, 98 A.D.3d 401 (1st Dep't 2012), the Court held that "[d]efendant sufficiently established that [the non-signatory's] involvement with [the signatory] in many phases of the licensing agreement and the dispute arising from it, was such that the forum selection clause was properly asserted against it." *Id.* at 403. In contrast, here plaintiff fails to allege how each of the FCP Non-Signatory Parties were involved in either the SPA or this dispute. The general allegations of control are entirely insufficient to disregard the separate legal identities of these corporations. *See Dempsey v Intercontinental Hotel Corp.*, 126 A.D.2d 477, 478 (1st Dep't 1987). Accordingly, the FCP Non-Signatory Parties are not subject to the SPA's forum selection clause.

Plaintiff's assertion of long-arm jurisdiction over the FCP Non-Signatory Parties is equally unavailing. Plaintiff provides no specific allegation attributable to each defendant. Instead, plaintiff conflates Wong's alleged contacts with New York and attributes it to all the FCP Parties. This is insufficient to establish long-arm jurisdiction as to each of the FCP Non-Signatory Parties. *See Keeton v Hustler Mag., Inc.*, 465 U.S. 770, 781 n.13 (1984) ("Each defendant's contacts with the forum State must be assessed individually."). The amended complaint contains no allegation that any of the FCP Non-Signatory Parties, as separate legal entities, had any contact with New York. Merely because the FCP Parties share a common management structure does not justify attributing Wong's activity to all corporations, particularly when plaintiff does not allege that Wong

ignored each separate legal identity. Accordingly, I find that plaintiff has not established either contractual or long-arm jurisdiction over the FCP Non-Signatory Parties and the complaint is dismissed against them on this ground.

II. Fraudulent Inducement

The eighth cause of action asserted against the FCP Parties, Wong, and Johnson for fraud in the inducement alleges that they knowingly or recklessly made numerous false statements or material omissions that were intended to induce plaintiff to purchase USES at an artificially inflated purchase price.

The FCP Parties, Wong, and Johnson contend that the fraudulent inducement claim fails because plaintiff has not plead fraud with particularity as CPLR § 3106 (b) requires. The FCP Parties, Wong, and Johnson also argue that the fraud claim fails because it is based on information outside the SPA that plaintiff explicitly disclaimed reliance on when it executed the SPA.

Under Delaware law, "[t]o state a claim for fraud a plaintiff must allege: 1) a false representation, usually one of fact []; 2) the defendant's knowledge or belief that the representation was false, or was made with reckless indifference to the truth; 3) an intent to induce the plaintiff to act or to refrain from acting; 4) the plaintiff's action or inaction taken in justifiable reliance upon the representation; and 5) damage to the plaintiff as a result of such reliance" *Hauspie v Stonington Partners, Inc.*, 945 A.2d. 584, 586 (Del. 2008). In addition, CPLR §.3016 (b) requires that a claim for fraud be plead with the requisite particularity; however, "that requirement should not be confused with unassailable proof of fraud." *Pludeman v Northern Leasing Sys. Inc.*, 10 N.Y.3d 486, 492 (2008).[3]

[3] Because the pleading requirements are a matter of procedure governed by the law of the forum, New York's CPLR § 3016 (b) applies in assessing plaintiff's fraud claim. *See Westdeutsche Landesbank Girozentrale v. Learsy*, 284 A.D.2d 251, 252 (1st Dep't 2001).

Plaintiff has sufficiently alleged fraud to appraise Wong and Johnson of their complained-of conduct. *See Pludeman*, 10 N.Y.3d at 491. The amended complaint contains a myriad of detailed allegations regarding Wong and Johnson's fraud, in which they manipulated the profitability and marketability of USES by hiding key issues, such as potential tax liabilities, technological shortcomings, and poor customer relations. Though many of the allegations relate to Wong and Johnson's purported conduct on behalf of USES, "[a]n officer actively participating in the fraud cannot escape personal liability on the ground that the officer was acting for the corporation." *Prairie Capital III, L.P. v Double E Holding Corp.*, 132 A.3d 35, 60 (Del. Ch. 2015).

Plaintiff alleges that Johnson exercised sufficient control over USES, closely managed the day-to-day operations of USES, and was the "face" of USES in communications with potential buyers, including plaintiff. Johnson was a "primary actor" in the transaction and made the operative decisions on behalf of USES that resulted in both (1) the consummation of the transaction, and (2) the alleged misrepresentations made to plaintiff throughout the process. Regarding Wong, plaintiff alleges that as one of USES's directors, he was responsible for the oversight of USES and led FCP Parties' efforts to sell it. Further, plaintiff alleges that together with Johnson, Wong was one of the "primary authors" of materials marketed to plaintiff, and Wong allegedly approved, throughout the process, various misrepresentations.

Conversely, plaintiff has failed to sufficiently allege fraud against the FCP Signatory Parties because the allegations vis-à-vis FCP Signatory Parties are conclusory and group all the FCP Parties together without alleging what specific tortious conduct the FCP Signatory Parties committed.[4]

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[4] Even though the amended complaint asserts fraud against all the FCP Parties, my determination here as to FCP Parties only applies to FCP Signatory Parties in light of this Court lacking jurisdiction over the FCP Non-Signatory Parties as discussed in Part I.C above.

Further, and with respect to Wong and Johnson, I find that the SPA's disclaimers are not dispositive of whether plaintiff has stated a claim against them. Under Delaware law, a "knowingly false contractual representation can form the basis for a fraud claim, regardless of the degree to which the agreement purports to disclaim or eliminate tort remedies." *Airborne Health, Inc. v Squid Soap, LP*, 984 A.2d 126, 136–37 (Del. Ch. 2009). Therefore, even if the SPA's disclaimers prevent plaintiff from relying on extra-contractual representations, plaintiff's fraud claim may still be based on internal contractual misrepresentations.[5]

Accordingly, I find that plaintiff has sufficiently alleged fraud under Delaware law solely as against Wong and Johnson, and that, at the pleading stage Wong and Johnson have not demonstrated that the SPA's contractual disclaimers require dismissal of plaintiff's fraud claim.

III. Negligent Misrepresentation

The ninth cause of action alleges that Johnson negligently misrepresented or acted with negligent or grossly negligent disregard for the truth when he made numerous misleading statements or material omissions that he intended plaintiff to rely upon in determining whether to purchase the USES shares.

Under Delaware law, "negligent misrepresentation is essentially a species of common law fraud with a lesser state of mind requirement—*i.e.*, scienter is replaced by negligence." *Vichi v Koninklijke Philips Elecs., N.V.*, 85 A.3d 725, 762 (Del. Ch. 2014). "It [also] requires special equities, typically the existence of some form of fiduciary relationship, such as that between a director and stockholder or a trustee and *cestui que trust,* although other circumstances might be cited." *Airborne Health, Inc. v Squid Soap, LP*, 984 A.2d 126, 144 (Del. Ch. 2009).

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[5] To the extent that Wong and Johnson assert that plaintiff improperly bootstraps its breach of contract claim into a claim for fraud, I disagree. Plaintiff alleges multiple misrepresentations constituting fraud and rather than specify which misrepresentation(s) duplicate plaintiff's breach of contract claim, Wong and Johnson simply seek a categorical dismissal.

Plaintiff has failed to plead a special relationship, prior to the Closing, between the parties. The parties were counterparties in a business deal who negotiated at arm's length and whose interests were not aligned. Neither occupied a relationship of trust or confidence with respect to the other. Both were sophisticated parties advised by capable counsel.

Plaintiff, nevertheless, argues that because Johnson expected to profit from the transaction, he had a duty to provide accurate information arising from his pecuniary interest. *See, e.g., Corp. Prop. Assoc. 14 Inc. v CHR Holding Corp.*, 2008 WL 963048 at 8 (Del. Ch. Apr. 10, 2008) (stating that to "assert a claim for negligent misrepresentation [the plaintiff] must adequately plead that [] the defendant had a pecuniary duty to provide accurate information"). More recently, the Chancery Court, in *Fortis Advisors LLC v Dialog Semiconductor PLC*, 2015 WL 401371, at 9 n.59 (Del. Ch. Jan. 30, 2015) addressed an identical argument, and decided "that [the special relationship requirement] must exist to bring a claim for negligent misrepresentation or equitable fraud" despite plaintiff alleging a pecuniary interest. Because this action arises from a transaction that was the product of arm's length negotiation between sophisticated parties, no special relationship exists. Accordingly, I dismiss the ninth cause of action against Johnson.

IV. Implied Covenant of Good Faith[6]

The eleventh cause of action, against all defendants for breach of the implied covenant of good faith and fair dealing, alleges that they (1) asserted the NWC Statements were accurate when they were not prepared in accordance with GAAP, (2) caused USES to provide inaccurate and incomplete representations and warranties in the SPA; and (3) failed to indemnify plaintiff for its losses resulting from USES's breaches of its representations and warranties.

[6] Plaintiff does not oppose dismissal of this claim against Johnson, Florida Capital Partners, Inc., Florida Capital Partners II, Inc., FCP Partners VI, LLC, and Wong, so it is accordingly dismissed as unopposed, against each of these defendants.

The claim fails against all defendants because, to the extent that the "implied covenant claim merely duplicates breach of contract claims brought under the SPA, it is fatally flawed." *Osram Sylvania Inc. v Townsend Ventures, LLC*, 2013 WL 6199554 at 18 (Del. Ch. Nov. 19, 2013). Because the SPA addresses the allegations underpinning plaintiff's implied covenant claim, there is no gap for the implied covenant to fill. Accordingly, the eleventh cause of action is dismissed in its entirety against all defendants.

V. Civil Conspiracy

The twelfth cause of action, against FCP Parties, Wong, and Johnson, for civil conspiracy, alleges that they conspired to make numerous false statements or material omissions that were intended to defraud and induce plaintiff to overpay for USES.

"To make a case for civil conspiracy, a plaintiff must show: '(i) a confederation or combination of two or more persons; (ii) an unlawful act done in furtherance of the conspiracy; and (iii) damages resulting from the action of the conspiracy parties.'" *Vichi v Koninklijke Philips Elecs., N.V.*, 85 A.3d. 725, 759 (Del. Ch. 2014). In requesting that I dismiss this claim, the FCP Parties, Wong and Johnson argue that plaintiff's civil conspiracy claim is predicated on a defective fraud cause of action and that, absent conclusory allegations, plaintiff has failed to allege that the FCP Parties, Wong and Johnson agreed to conspire together.

As discussed above, plaintiff has sufficiently alleged fraud, at this stage, as a predicate for its civil conspiracy cause of action against Wong and Johnson.[7] Plaintiff has also sufficiently alleged a confederation between Wong and Johnson, alleging throughout the amended complaint that Wong not only knew about Johnson's misrepresentations, but also actively oversaw and approved those

[7] However, because I dismiss the eighth cause of action for fraud against the FCP Parties, I also dismiss the twelfth cause of action for civil conspiracy against the FCP Parties. *See Kuroda v SPJS Holdings, L.L.C.*, 971 A.2d 872, 892 (Del. Ch. 2009) ("Civil conspiracy is not an independent cause of action; it must be predicated on an underlying wrong.").

same misrepresentations. Having adequately pled fraud against Wong and Johnson, it is a reasonable inference that Wong and Johnson acted in concert to defraud plaintiff, particularly given their relationship and alleged exchange of corporate documents. *See In re Am. Intern. Group, Inc.*, 965 A.2d 763, 806 (Del. Ch. 2009), *affd sub nom. Teachers' Retirement Sys. of Louisiana v PricewaterhouseCoopers LLP*, 11 A.3d 228 (Del. 2011) ("[T]o survive a motion to dismiss, all that is needed is a reasonable inference that [defendant] was part of this conspiracy. Given [defendant's] relationship with [the co-defendant] and others involved in the [] Transaction, a fair inference of [defendant's] complicity in concerted misconduct exists."). Accordingly, I decline to dismiss plaintiff's twelfth cause of action for civil conspiracy against Wong and Johnson.

VI. Indemnification

Sellers move to dismiss the first through seventh causes of action in the amended complaint, pursuant to CPLR §§ 3211 (a)(1) and (a)(7).

A. Mediation as Condition Precedent

The Sellers' request to dismiss the causes of action for indemnification (the first through seventh) for the alleged breaches of certain of the SPA's representations, for failure to comply with section 10.9 of the SPA, is denied.[8]

Section 10.9(b) of the SPA requires that the parties mediate any dispute arising from the SPA before a JAMS mediator prior to filing suit. It is undisputed that the parties participated in a JAMS mediation on December 11, 2014. However, Sellers argue: (1) that the mediation involved a discrete issue; (2) that plaintiff only notified the Seller Rep regarding the alleged breaches of representations and warranties after the December 11, 2014 mediation session; and (3) that

[8] FCP Signatory Parties only argue to dismiss the first through seventh cause of action on this ground. Part VI.B discussed below only pertains to Seller Shareholders.

mediation has not taken place regarding the disputes raised in those claim notices. Therefore, according to Sellers, plaintiff's first through seventh causes of action must be dismissed as premature.

Plaintiff asserts that it satisfied section 10.9 as a condition precedent, and commenced this action only after the Seller Rep made it clear that further discussions would be futile. As for the subject matter of the mediation held on December 11, 2014, plaintiff submits a memorandum of understanding (MOU) entered between the parties on December 11, 2014, that: (1) acknowledged that "disputes have arisen under the [SPA]"; (2) "the parties have begun a mediation seeking to resolve their disputes with the assistance of Kenneth M. Kramer as the JAMS mediator"; and (3) "the parties would like to establish a procedure for potentially resolving their disputes."

The MOU established a procedure for the resolution of plaintiff's claims, including "potential indemnity claims," and provided further that neither party would commence litigation prior to March 1, 2015. The MOU supports plaintiff's assertion as to the breadth of the subject matter, and I find that plaintiff has sufficiently alleged that it has satisfied section 10.9 as a condition precedent to litigation.

B. Remaining Arguments to Dismiss

The first cause of action alleges that USES breached sections 3.7 and 3.21 of the SPA, because USES's financial statements were not prepared in accordance with GAAP, improperly overstated USES's EBITDA, and did not present fairly, in all material respects, the revenue, expenses, assets, and liabilities of USES. USES's EBITDA was based on (1) understatement of accrued costs and other corporate expenses; (2) inadequate allowance for doubtful accounts; and (3) overstatement of accounts receivable.

Section 3.7 of the SPA provides, in relevant part:

> "The Financial Statements . . . present fairly, in all material respects, the consolidated financial condition of the USES Companies as of the referenced dates and the consolidated results of operations of the USES Companies for the periods presented, in accordance with GAAP on a consistent basis . . . . [N]o USES Company has any liability, obligation (absolute, accrued, contingent, or otherwise) or commitment, including any guaranty with respect to any obligation, except such liabilities or obligations (a) as are set forth or described on any other Schedule of this Agreement, (b) as are reserved against or reflected in the Financial Statements or are of a nature not otherwise required pursuant to GAAP to be reserved against or reflected therein, and/or (c) as have been incurred in the Ordinary Course of Business since December 31, 2012. The Company maintains a standard system of accounting in accordance with GAAP"

Seller Shareholders argue that the amended complaint does not allege a violation of section 3.7 because the alleged understatement of costs relates to alleged problems with USES's information technology ("IT") systems and failure to process paperwork, which is unrelated to accounting methodologies. They further contend that the amended complaint does not allege how these processing issues are related to GAAP. Moreover, it "appears" that these allegedly understated or unbooked costs were incurred in the ordinary course of business close in time to or after the closing of the transaction, which is outside the scope of the representation.

Seller Shareholders have not demonstrated as a matter of law that any IT failures that caused the alleged financial misrepresentations would absolve them from any possible breach of the above cited representations. Arguably, the technologies and methodologies are related; the purchaser of the business is concerned with financial accuracy, and not with the reason for the alleged financial misrepresentation. Moreover, the documentary evidence relied upon does not conclusively dispose of the issue in their favor. "Dismissal pursuant to CPLR 3211 (a)(1) is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *VisionChina Media Inc. v Shareholder Representative Servs., LLC*, 109 A.D.3d 49, 56 (1st Dep't 2013).

Section 3.21 of the SPA provides:

> "The accounts receivable reflected on the Unaudited Financial Statements and the accounts receivable arising after the date thereof have arisen from bona fide transactions entered into by the Company involving the sale of goods or the rendering of services in the ordinary course of business consistent with past practice. The reserves for credit memos and doubtful accounts included in the Financial Statements are in accordance with GAAP consistently applied and in accordance with past practices of the Company. Notwithstanding the foregoing, no representation is made as to collectability of such accounts receivable and/or credit memos"

According to Seller Shareholders, USES specifically disclaimed any representations concerning the collectability of receivables or credit memos. To the extent plaintiff alleges that USES violated GAAP by accounting for doubtful accounts receivable, Seller Shareholders argue that the amended complaint does not cite or identify any provision or requirement of GAAP that USES supposedly violated. Further, Seller Shareholders argue that plaintiff has not alleged that certain receivables are uncollectible and, therefore, plaintiff has not alleged any damages with respect to those receivables.

Plaintiff argues that the issue is not collectability, but rather the inadequacy of USES's reserve for doubtful accounts, given the information available to USES before Closing. For example, in the amended complaint, plaintiff alleges that USES failed to adjust its reserve for doubtful accounts in light of a customer's bankruptcy in late 2012.

Plaintiff also argues that, in 2013, USES issued between 116 and 143 credit memos each quarter but during the period immediately preceding Closing, USES issued only 62 credit memos. In violation of GAAP requirements, as alleged, USES's failure to timely record credit memos resulted in a failure to reduce USES's accounts receivable balance to its realizable value, resulting in the overstatement of USES's accounts receivable.

Based on the foregoing, I find that, as with section 3.7, above, the dispute here is not conclusively resolved by reference to documentary evidence, *i.e.*, the SPA and the amended complaint. Accordingly, I deny the motion to dismiss plaintiff's first cause of action.

The second cause of action alleges that USES breached section 3.5 (c) of the SPA because USES's IT systems lack an integrated purchase order module and other functionalities. Seller Shareholders argue that section 3.5 (c) pertains to the company's "buildings, plants, structures, furniture, machinery, equipment, vehicles and other items of tangible personal property" and not to IT systems. Seller Shareholders have not shown that IT systems could not be encompassed by the items listed in this section, especially because the SPA uses the broad term "equipment." Although Seller Shareholders may ultimately prevail on this point, they have not now shown an entitlement to a pre-answer dismissal.

The third cause of action alleges that three separate tax liabilities constitute breaches of section 3.7 and 3.9(a) of the SPA. First, in August 2014, the Arkansas Department of Finance and Administration issued an assessment seeking approximately $5.6 million in unpaid taxes, penalties, and interest relating to the period August 2008 to July 2014. Second, in October 2014, four parishes in Louisiana informed USES that it faced a potential tax liability for almost $2.6 million for the period January 2009 to December 31, 2011. Third, the Mississippi Department of Revenue conducted an audit, which resulted in plaintiff allegedly paying sales taxes of $203,501.

Section 3.9 (a)(i) of the SPA provides in material part:

"Except as set forth in Schedule 3.9:

> (i) each USES Company has filed, or has had filed on its behalf, all federal, state and material other Tax Returns required to have been filed and has directly, or has had on its behalf, paid, withheld, or made provision for the payment of, all Taxes due, whether or not shown on any such Tax Return, other than Taxes which are being contested in good faith and for which adequate reserves have been made on the Financial Statements . . . ."

Seller Shareholders argue that this representation does not apply to tax issues that were disclosed on Schedule 3.9. However, Seller Shareholders do not dispute that Schedule 3.9 is silent regarding potential tax liabilities in Mississippi. Regarding the tax issues in Arkansas and Louisiana, Seller Shareholders do not address plaintiff's allegation that the disclosures in Schedule 3.9 were inadequate and grossly failed to reserve for such liabilities in violation of sections 3.7 and 3.9. Therefore, Seller Shareholders have not demonstrated their entitlement to a pre-answer dismissal here either.

Plaintiff's fourth cause of action asserts that USES failed to disclose the existence of a pending litigation with one of its subcontractors, Weisser, in violation of section 3.10 of the SPA. Section 3.10 of the SPA requires disclosure of any "claim, suit, [or] action . . . that would reasonably be expected to result in damages that would exceed $500,000 . . . ." Seller Shareholders argue that Weisser's claim is outside the scope of the representation because the alleged damages were $454,834.02. However, the amended complaint alleges that Weisser currently seeks, in addition to $454,834.02 in contractual damages, approximately $450,000 more in pre- and post-judgment interest and attorney's fees and costs. On this motion to dismiss, Seller Shareholders have not demonstrated, as a matter of law, that damages do not include the total amount of the liability. *See, e.g., Clarkson v Goldstein* , 2005 WL 1331776 at 9 (Del. Sup. Ct. May 31, 2005) (stating that actual damages include attorney's fees).

Plaintiff's fifth cause of action alleges that USES breached section 3.20 (a) of the SPA because USES failed to disclose a fractured relationship with Chevron, one of its material customers, in 2012 and 2013. Section 3.20 (a) of the SPA provides that "senior management has not received any notice that any of its Material Customers has ceased or intends to cease after the Closing, to use its goods or services or to otherwise terminate or materially reduce its relationship with the Company."

Seller Shareholders argue that plaintiff fails to sufficiently state an actionable claim for breach because it only alleges a reduction in revenues from Chevron, which does not necessarily result from a damaged relationship. Seller Shareholders also argue that plaintiff does not allege any damage resulting from the alleged breach of section 3.20 (a), and Seller Shareholders are only obligated to indemnify plaintiff to the extent its losses exceed $735,000 pursuant to section 8.4 (a)(i) of the SPA.

Contrary to Seller Shareholders' position, the amended complaint details specific issues Chevron had with USES's services that lead to the alleged $3.2 million reduction in Chevron revenue from 2013 to 2014. Specifically, plaintiff alleges that the dispute underlying the Weisser claim involved Chevron, and that USES poorly performed and inaccurately billed the Chevron Products Co. refinery in Pascagoula, Mississippi. Moreover, Article 8 of the SPA provides that plaintiff can "aggregate [the] amount of all Losses" to reach the $735,000 threshold, and plaintiff has sufficiently alleged damages for "[l]osses suffered . . . arising out of any breach of or any inaccuracy in any representation or warranty . . . in Article 3" that, in the aggregate, exceed the deductible. Seller Shareholders have not demonstrated their entitlement to a pre-answer dismissal here as well.

The sixth cause of action alleges that USES breached section 3.7 of the SPA because USES overcharged Shell Oil Company ("Shell"), a key USES customer, for federal and state unemployment taxes due in connection with services that USES provided. Plaintiff alleges that USES improperly collected federal and state unemployment taxes from Shell of at least $71,060 in 2013 and $172,210 in 2014, thereby overstating its earnings in violation of section 3.7's representation that its "Financial Statements . . . present fairly . . . the consolidated financial condition of [USES] . . .. in accordance with GAAP on a consistent basis . . ..".

Seller Shareholders argue that the amended complaint does not allege that plaintiff paid Shell the alleged overcharges and, therefore, plaintiff has not alleged any damages. Seller Shareholders also argue that there is no allegation that anyone at USES was aware of this issue prior to the Closing, and that the alleged obligation to Shell was "incurred in the Ordinary Course of Business since December 31, 2012," and, therefore, outside the scope of section 3.7.

Although plaintiff has not alleged payment to Shell, the overcharges allegedly resulted in an inaccurate EBITDA, which lead to an inflated purchase price, *i.e.*, damages. Similarly, although the amended complaint does not allege knowledge, section 3.7 does not have a knowledge requirement. Moreover, whether the alleged overcharge is outside the scope of section 3.7 as a liability incurred in the ordinary course of business is an issue of fact that is inappropriate for determination here.

The seventh cause of action alleges that USES's liquid vacuum trucks were in poor condition and failed to comply certain regulations, laws, and contracts in breach of sections 3.5 (c), 3.12, and 3.18 of the SPA. Seller Shareholders argue that litigation as to this claim is premature because the SPA requires mediation as a condition precedent, and plaintiff did not provide the Sellers with notice of this claim until September 29, 2015. As addressed in Part VI.A herein, plaintiff has satisfied that requirement.

VII. Breach of Section 2.3

The tenth cause of action against Sellers and the Seller Rep, alleges that, by refusing to accept the corrected Closing NWC Statement that was prepared in accordance with GAAP, the Seller Rep breached section 2.3 of the SPA.

Section 2.3 of the SPA provides the mechanism for adjusting the purchase price after Closing to account for the difference between the Preliminary NWC Statement and plaintiff's Closing NWC Statement as calculated after the Closing. It is undisputed that neither party

challenged the NWC Statements within the SPA's time limitations. Sellers and the Seller Rep argue that plaintiff is unable to assert breach of section 2.3 because the corrected Closing NWC Statement, which plaintiff provided on February 12, 2015, is beyond the SPA's 90 day-limitations period.

Plaintiff opposes, asserting that Sellers and the Seller Rep breached section 2.3 of the SPA because the NWC Statements were not prepared in accordance with GAAP as required. Allegedly, Johnson prepared both the Preliminary NWC Statement and the Closing NWC Statement, which was ostensibly on behalf of plaintiff, that violated GAAP. Thus, plaintiff argues, the GAAP requirement remains unsatisfied, and therefore, the SPA's purchase price adjustment is still subject to proper calculation.

Delaware courts have previously discussed two alternative mechanisms for resolving post-closing calculation disputes, specifically whether GAAP compliant disputes are questions to be resolved under the purchase price adjustment provision or a claim for beach of a representation. *Compare OSI Sys., Inc. v Instrumentarium Corp.,* 892 A.2d 1086 (Del. Ch. 2006) (finding that, under the transaction agreement at issue, the parties' dispute over the accounting method should be resolved pursuant to the indemnity provision rather than the terms of the purchase price adjustment provision), *with Alliant Techsystems, Inc. v MidOcean Bushnell Holdings, L.P.,* 2015 WL 1897659 at 12 (Del. Ch. Apr. 24, 2015) (finding that, under the transaction agreement at issue, the parties' dispute over the accounting method should be resolved pursuant to the purchase price adjustment provision rather than the terms of indemnity provision).

Unlike here, the disputes in *Alliant* and *OSI* occurred during the purchase price adjustment period. However, Sellers and the Seller Rep have not demonstrated that this distinction, alone, at this stage, is dispositive.

For one, Sellers have not addressed plaintiff's contention that Wong affirmatively concealed USES's non-compliance with GAAP, because Johnson, under the direction of Wong, actively worked to hinder plaintiff's access to USES's true financial data, which was only discovered after Johnson was fired. *See Alliant Techsystems, Inc. v MidOcean Bushnell Holdings, L.P.*, 2015 WL 1897659 at 8 (Del. Ch. Apr. 24, 2015) (stating that the buyer could put forward a GAAP-complaint calculation pursuant to the purchase price adjustment provision because if the seller had not followed GAAP, it would read the GAAP requirement out of the same provision). Therefore, an issue exists regarding whether this concealment causes the SPA's purchase price adjustment to remain subject to proper calculation under the terms of the SPA.

Second, neither party addresses how the SPA here operates to resolve GAAP-compliant disputes. For example, plaintiff's first cause of action for indemnification for breach of section 3.7 may subsume plaintiff's tenth causes of action and/or more appropriately resolve the GAAP-complaint under the terms of the SPA at this juncture. *See Chicago Bridge & Iron Co. N.V. v Westinghouse Electric Co. LLC*, 2016 WL 7048031, at 7 (Del. Ch. Dec. 5, 2016) (finding that, after comparing the outcomes in *Alliant* and *OSI*, the contract in dispute more closely resembled *Alliant* and, in turn, resolved the accounting dispute pursuant to the purchase price adjustment provision).

Accordingly, movants are not entitled to a pre-answer dismissal of this cause of action pursuant to CPLR 3211 (a)(1).

In accordance with the foregoing, it is

ORDERED that defendant Gregory Johnson's motion to dismiss is granted to the extent that the ninth and eleventh causes of action are dismissed, and otherwise denied; and it is further

ORDERED that defendant Felix J. Wong's motion to dismiss is granted to the extent that the eleventh cause of action is dismissed, and otherwise denied; and it is further

ORDERED that defendants Florida Capital Partners, Inc., Florida Capital Partners II, Inc., and FCP Partners VI, LLC's motion to dismiss the complaint is granted as to each; and it is further

ORDERED that defendants FCP Investors VI, L.P. and FCP Investors VI (Parallel Fund), L.P.'s motion to dismiss is granted to the extent that the eighth, eleventh, and twelfth causes of action are dismissed, and otherwise denied; and it is further

ORDERED that defendant Cricket Stockholder Rep, LLC's motion to dismiss is granted to the extent that the eleventh cause of action is dismissed, and otherwise denied; and it is further

ORDERED that defendants Barry J. Thibodeaux, Thomas P. Bayham, Thomas R. Sumner, George T. Malvaney, Larry N. Lee, Robert Williams, Eric Hoffman, David Zachary, and Clay Cox's motion to dismiss is granted to the extent that the eleventh cause of action is dismissed, and otherwise denied; and it is further

ORDERED that defendants shall serve an answer to the amended complaint or otherwise respond thereto pursuant to the time limits set forth in the CPLR as of the date of this order; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 208, 60 Centre Street, on August 30, 2017 at 2:15 p.m.

This constitutes the decision and order of the Court.

DATE: 6/27/17

SALIANN SCARPULLA, JSC