Shareholder Representative Servs. LLC v The NASDAQ OMX Group, Inc.
2018 NY Slip Op 33019(U)
November 29, 2018
Supreme Court, New York County
Docket Number: 651145/2014
Judge: Marcy Friedman

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 60

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SHAREHOLDER REPRESENTATIVE SERVICES LLC, IN ITS CAPACITY AS THE REPRESENTATIVE OF THE SELLING SHAREHOLDERS OF FTEN, INC.,

Plaintiff,

- v -

THE NASDAQ OMX GROUP, INC. AND FTEN, INC.,

Defendants.

INDEX NO. 651145/2014

MOTION DATE

MOTION SEQ. NO. 006

DECISION AND ORDER

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HON. MARCY S. FRIEDMAN:

The following e-filed documents, listed by NYSCEF document number (Motion Seq. No. 006) 171, 172, 173, 174, 175, 176, 177, 178, 179, 180, 181, 183, 184, 185, 186, 188 were read on this motion for LEAVE TO AMEND.

Plaintiff Shareholder Representative Services LLC (SRS) brings this action in its capacity as representative of the former shareholders (Selling Shareholders) of defendant FTEN, Inc. (FTEN). The Selling Shareholders sold their equity interests in FTEN to defendant The NASDAQ OMX Group, Inc. (NASDAQ) in a 2010 Merger (the Merger). The terms of the Merger were memorialized in an Agreement and Plan of Merger, dated as of December 15, 2010 (the Merger Agreement). By Escrow Agreement, dated as of December 23, 2010, SRS and NASDAQ provided for the deposit of $11 million into an Escrow Account for payment of any indemnification claims arising from the Merger Agreement. Both sides claim entitlement to the balance of the Escrow Account. The underlying facts of this case were discussed at length in this court's prior decision and order, dated July 5, 2016, which determined SRS's motion for summary judgment. (2016 NY Slip Op 31266 [U], 2016 WL 3618647 [Sup Ct, NY County

2016] [Prior Decision].) Defendants now move, pursuant to CPLR 3025 (b), for an order granting defendants leave to file a second amended answer (proposed answer) adding a second counterclaim for breaches of representations and warranties and a third counterclaim for fraud.

It is well settled that the decision whether to permit amendment of pleadings is committed to the discretion of the court. (Edenwald Contr. Co. v City of New York, 60 NY2d 957, 959 [1983].) In general, leave to amend a pleading should be freely granted absent prejudice or surprise resulting from the delay. (CPLR 3025 [b]; Thomas Crimmins Contr. Co., Inc. v City of New York, 74 NY2d 166, 170 [1989].) It is further settled that the amendment should be denied if the amendment "plainly lacks merit." (Thomas Crimmins Contr. Co. Inc., 74 NY2d at 170; Herrick v Second Cuthouse, Ltd., 64 NY2d 692, 693 [1984].) As the Appellate Division of this Department has repeatedly held, on a motion for leave to amend a pleading, the movant "need not establish the merit of its proposed new allegations, but [must] simply show that the proffered amendment is not palpably insufficient or clearly devoid of merit." (MBIA Ins. Corp. v Greystone & Co., Inc., 74 AD3d 499, 500 [1st Dept 2010] [internal citation omitted]; accord e.g. Miller v Cohen, 93 AD3d 424, 425 [1st Dept 2012]; Kocourek, 85 AD3d at 505.)

NASDAQ's prior answer pleaded a sole counterclaim for a declaratory judgment. This counterclaim sought a declaration that SRS was obligated to indemnify NASDAQ for FTEN's unpaid taxes for taxable periods ending on or prior to the Closing Date of the merger (pre-merger taxes). (Am. Answer, ¶ 74.) This claim was based on the existence of pre-merger tax liabilities and not on breaches of representations and warranties regarding such liabilities. The counterclaim also sought a declaration that SRS was obligated to indemnify NASDAQ for FTEN's unpaid taxes for taxable periods ending after the Closing Date (post-merger taxes). (Id.,

¶ 75.) This branch of the counterclaim was based on FTEN's alleged misrepresentations in the Merger Agreement about its tax liabilities. (Id.)

The Prior Decision granted summary judgment to SRS dismissing NASDAQ's counterclaim to the extent that it sought a declaration that NASDAQ was entitled to indemnification for post-merger taxes based on FTEN's breaches of representations and warranties. (Prior Decision, at * 7-8.) The Prior Decision also rejected SRS's claim that NASDAQ was not entitled to indemnification for pre-merger taxes because it did not actually incur damages until after the Claim Expiration Date. (Id., at * 5-7.) In upholding NASDAQ's indemnification claim for pre-merger taxes, the court reasoned that Article IX of the Merger Agreement, which governs indemnification, does not require damages to have been incurred prior to the Claim Expiration Date provided that the Claim Notice is timely and contains "a reasonable estimate" of the Damages "expected to be incurred." (Id., at * 5.) The Prior Decision did not involve a claim for indemnification for pre-merger taxes based on breaches of representations and warranties. In its proposed answer, NASDAQ now seeks to plead a second counterclaim for this relief. (Proposed Answer, ¶¶ 77-80.)

The court holds that the representations and warranties on which this counterclaim is based expired and were not preserved by defendants' Claim Notice. The counterclaim is therefore not maintainable.

Section 4.13 of the Merger Agreement (Aff. of Edward Wipper [Pl.'s Atty.] In Opp. [Wipper Aff.], Ex. A) sets forth certain representations and warranties concerning the tax returns and tax liabilities of FTEN and its subsidiaries (the Target Companies). The representations and warranties in section 4.13 regarding taxes include "(a) The Target Companies have timely filed when due . . . all federal income Tax Returns, and all other material Tax Returns that they were

required to file under applicable laws and regulations. . . ."; and (b) to FTEN's knowledge, "no Taxing Authority has any reasonable basis to assess any additional Taxes against any of the Target Companies for any period up to and including the Closing Date. . . ."

Article IX of the Merger Agreement provides NASDAQ with a right of indemnification from the Escrow Account for breaches of representations and warranties made in section 4.13, and a separate right of indemnification for certain tax liabilities of FTEN and its subsidiaries. Section 9.01 provides, in the pertinent part:

> "Subject to the limitations set forth in this Article IX and elsewhere in this Agreement . . . [NASDAQ] and its Affiliates (including the Surviving Corporation) [Collectively NASDAQ] . . . shall be indemnified from, and solely to the extent of, the Escrow Account against any Damages that [NASDAQ] incurs arising out of or resulting from:
>
> (a) any breach of any representation or warranty contained in Article IV . . . ;
>
> . . .
>
> (e) any Taxes of the Target Companies for taxable periods (or portions thereof) ending on or before the Closing Date . . . ."

Pursuant to section 9.03 (a), the representations and warranties in section 4.13, among others, expire on the 18 month anniversary of the closing date. Section 9.03 (a) provides in its entirety:

> "Except as set forth in Section 9.03(b), all of the representations and warranties of the parties set forth in [the Merger Agreement] terminate and expire, and shall cease to be of any force or effect, at 5:00 p.m. (Eastern Time) upon the date that is the 18 month anniversary of the Closing Date (the 'Claim Expiration Date'), and all liability of the parties hereto with respect to such representations (including for indemnification for breach of such representations and warranties under this Article IX), shall thereupon be extinguished. It is the express intent of the parties that, except as set forth in Section 9.03(b), notwithstanding any applicable statute of limitations, upon the Claim Expiration Date

> no further claims for indemnification can be initially asserted by [NASDAQ] under [the Merger Agreement]."

As discussed in this court's Prior Decision (id., at * 3, 3 n 3), the Claim Expiration Date is, at the latest, June 24, 2012. Sections 9.03 (b) and 9.06 of the Merger Agreement provide, however, that claims for indemnification survive if a party delivers a Claim Notice.

Section 9.03 (b) states, in the pertinent part:

> "Notwithstanding anything in this Section 9.03 to the contrary, if, prior to the Claim Expiration Date, [NASDAQ] or [SRS], as applicable, shall have duly delivered in good faith a conforming Claim Notice to [NASDAQ] or [SRS], as applicable or [NASDAQ] has duly delivered a notice of Tax Controversy to [SRS]. . . , then the specific indemnification claim set forth in such Claim Notice (to the extent of the matter specified in the Claim Notice) or any indemnification claim resulting from the Tax Controversy shall survive the Claim Expiration Date and shall not be extinguished thereby until resolution of the matter specified in the Claim or the Tax Controversy in accordance with this Agreement and the Escrow Agreement. In no event shall an indemnification claim by [NASDAQ], regardless of whether its expiration is delayed pursuant to this Section 9.03(b), create any liability for Damages except to the extent of the amount then available in the Escrow Account."

Section 9.06 of the Merger Agreement requires that the Claim Notice set forth the following information:

> "(i) the specific representation, warranty, or covenant alleged to have been breached . . . or other indemnifiable matter described in Section 9.01 or Section 9.02,[1] as applicable; (ii) taking into account the information available to [NASDAQ] at such time, a reasonably detailed description of the facts and circumstances giving rise to the alleged breach of such representation, warranty or covenant or other indemnifiable matter described in Section 9.01 or Section 9.02, as applicable; and (iii) taking into account the information available to [NASDAQ] at such time, a reasonably detailed description of, and a reasonable estimate of the total

[1] Section 9.02, not relevant here, sets forth the Selling Shareholders' right of indemnification from NASDAQ and its subsidiaries and from FTEN for any Damages resulting from breaches by NASDAQ of any representations and warranties or any covenants in the Merger Agreement.

> amount of, the Damages incurred or expected to be incurred by [NASDAQ] as a direct result of such alleged breach or other indemnifiable matter described in Section 9.01 or Section 9.02, as applicable."

Defendants' "Claim Notice / Notice of Tax Controversy," dated June 21, 2012 (Wipper Aff., Ex. B) (Claim Notice), asserts a claim "for incurred Damages in respect of unpaid sales Taxes . . . , plus certain costs and expenses. . . ." The Claim Notice further states: "These Damages are indemnified against pursuant to Section 9.01(e) of the Merger Agreement because they were incurred as a result of the failure of the Company [FTEN] to file sales Tax Returns and pay sales Taxes" for certain services and products for taxable periods ending on or prior to the Closing Date.

Defendants contend that the Claim Notice also "contained" NASDAQ's claim that FTEN breached representations and warranties pursuant to section 9.01 (a). (Defs.' Reply Memo., at 9-10 [emphasis omitted].) In arguing that the Claim Notice asserts a claim for indemnification not only for tax liabilities, but also for breaches of representations and warranties regarding those tax liabilities, defendants selectively rely on a statement in the Claim Notice that NASDAQ's damages were incurred as a result of breaches of representations regarding taxes. (Id., at 10.) The statement, however, provides in full:

> "Although these Damages were also incurred as a result of breaches of certain representations in respect of Taxes set forth in Section 4.13 of the Merger Agreement, which would be indemnified against under Section 9.01(a) of the Merger Agreement, Section 9.01(e) provides that to the extent an indemnification claim can be made under both Sections 9.01(a) and 9.01(e), the claim shall first be indemnified against under Section 9.01(e)."

(Claim Notice, at 3-4.) The Claim Notice thus, by its terms, asserts a claim for indemnification pursuant to section 9.01 (e) for "Taxes of the Target Companies," not a claim for indemnification

pursuant to section 9.01 (a) for "any breach of any representation or warranty contained in Article IV. . . ."[2]

Moreover, the Claim Notice fails to comply with section 9.06 (quoted above), as it does not set forth the information required by that section—namely, the specific representations and warranties of section 4.13 that are alleged to have been breached, the circumstances giving rise to the breach, and the damages. As this Claim Notice therefore cannot serve as the basis for the counterclaim for breaches of representations and warranties, and as no other notice was served prior to the Claim Expiration Date, "all liability" with respect to the representations and warranties has been "extinguished" pursuant to section 9.03 (a).[3]

Defendants' fraud counterclaim is also barred by section 9.03 (a) of the Merger Agreement. Defendants' fraud claim is based on the representations and warranties made in section 4.13 of the Merger Agreement. Specifically, defendants' proposed answer alleges that "[t]he Section 4.13 warranties were false because FTEN did owe sales tax for its sales made in Chicago, New Jersey, New York, and Texas," and that "FTEN's warranties, in Section 4.13, were intended to deceive Nasdaq and to induce Nasdaq to purchase FTEN at the sales price of approximately $110 million." (Proposed Answer, ¶¶ 82, 86.) The proposed answer also alleges that "Nasdaq relied upon FTEN's warranties, in Section 4.13, that FTEN did not owe sale taxes.

[2] In summarizing the Claim Notice in the Prior Decision, the court stated that the Claim Notice asserted a claim for indemnification pursuant to section 9.01 (e) of the Merger Agreement for "incurred Damages in respect of unpaid sales Taxes. . . ." The court also stated that "[a]lternatively, the Claim Notice asserted an indemnification claim for these Damages under Merger Agreement § 9.01 (a)." (Prior Decision, at * 3, 8.) As discussed above, however, no claim had been made for indemnification for pre-merger taxes based on breaches of representations and warranties. This statement as to the alternative claim was therefore not necessary to the Prior Decision.

[3] In denying NASDAQ leave to amend to add a second counterclaim for indemnification for pre-merger taxes based on breaches of representations and warranties regarding those taxes, the court notes that NASDAQ already has a viable pending counterclaim for a declaratory judgment that it is entitled to indemnification for pre-merger tax liabilities. NASDAQ claims that it will be entitled to statutory interest on the pending counterclaim but explains that it brought the motion for leave to amend in order to "eliminate any possible question" over its entitlement to such interest. (Defs.' Memo. In Supp., at 9.)

If the Selling Shareholders had not made this representation, Nasdaq would not have purchased FTEN at the agreed-upon purchase price." (Id., ¶ 87.)

Defendants correctly assert that the Merger Agreement provides that indemnification shall be the sole remedy for breach of any representation or warranty, except in the case of "actual fraud" with respect to an Article IV representation or warranty. (Defs.' Reply Memo., at 10-11 [internal quotation marks omitted].) Section 9.05 provides that except in the case of such actual fraud, NASDAQ's relief against various individual representatives of FTEN shall be limited to indemnification under Article IX or recourse to specified accounts. Section 9.10 further provides, in the pertinent part:

> "Exclusive Remedy. Except in the case of actual fraud (i.e., an intentional misrepresentation in bad faith or with malicious intent of a material fact) by a member of the Knowledge Group[4] with respect to a representation or warranty in Article IV of this Agreement, the right of each party hereto to assert indemnification claims and receive indemnification payments pursuant to this Article IX shall, from and after the Effective Time,[5] be the sole and exclusive right and remedy exercisable by such party with respect to any breach by any other party hereto of any covenant, representation, warranty, or otherwise under this Agreement. . . ."

As defendants also correctly assert, the Merger Agreement does not require a Claim Notice for claims asserting actual fraud. (Defs.' Reply Memo., at 11.) Sections 9.03 (b) and 9.06 of the Merger Agreement, quoted above, provide for a Claim Notice only for indemnification claims specified in section 9.01, also quoted above. These provisions do not address the timeliness of defendants' fraud claim. Contrary to defendants' apparent contention (see Defs.' Reply Memo.,

[4] "Knowledge Group" is a group of individuals defined in section 1.01 of the Merger Agreement.

[5] "Effective Time" is the date and time at which the Merger shall become effective—i.e., "the date and time that the filing of the Certificate of Merger has been accepted by the Secretary of State of the State of Delaware, or at such later time as is specified in the Certificate of Merger." (Merger Agreement, §§ 1.01, 2.03.)

at 10-11), although sections 9.05 and 9.10 exempt actual fraud claims from the exclusive remedy of indemnification, those sections do not affect the limitations period for claims, including fraud claims, based on breaches of representations and warranties. That limitations period is set forth in section 9.03 (a), which provides in pertinent part:

> "Except as set forth in Section 9.03(b) [i.e. unless a Claim Notice has been delivered setting forth an indemnification claim], all of the representations and warranties of the parties set forth in this Agreement terminate and expire, and shall cease to be of any force or effect, at 5:00 p.m. (Eastern Time) upon the date that is the 18 month anniversary of the Closing Date (the "Claim Expiration Date"), and all liability of the parties hereto with respect to such representations and warranties (including for indemnification for breach of such representations and warranties under this Article IX), shall thereupon be extinguished."

(emphasis added.)

By its terms, section 9.03 (a) extinguishes "all liability" with respect to breaches of representations and warranties, and not only liability for indemnification for such breaches. It is undisputed that the fraud counterclaim is based on the Article IV representations and warranties, and that the fraud claim was not asserted before these representations and warranties "terminate[d]" and liability based upon them was "extinguished." NASDAQ's proposed third counterclaim for fraud is therefore not viable.

It is accordingly hereby ORDERED that the motion of defendants NASDAQ OMX Group, Inc. and FTEN, Inc. for leave to file the second amended answer is denied.

This constitutes the decision and order of the court.

11/29/2018
DATE

MARCY S. FRIEDMAN, J.S.C.

CHECK ONE:		CASE DISPOSED		X	NON-FINAL DISPOSITION		
		GRANTED	X DENIED		GRANTED IN PART		OTHER
APPLICATION:		SETTLE ORDER			SUBMIT ORDER		
CHECK IF APPROPRIATE:		INCLUDES TRANSFER/REASSIGN			FIDUCIARY APPOINTMENT		REFERENCE