

O'Neill v Warburg Pincus & Company

2005 NY Slip Op 30291(U)

February 4, 2005

Supreme Court, New York County

Docket Number: 116009/2003

Judge: Herman Cahn

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SUPREME COURT OF THE STATE OF NEW YORK -- NEW YORK COUNTY

PRESENT: Herman Cohen
0116009/2003

PART 49

O'NEILL, LAWRENCE DANIEL
vs
WARBURG PINCUS & CO.

INDEX NO. _____
MOTION DATE 2/14/05
MOTION SEQ. NO. _____
MOTION CAL. NO. _____

SEQ 1
DISMISS ACTION

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause -- Affidavits -- Exhibits ...	_____
Answering Affidavits -- Exhibits _____	_____
Replying Affidavits _____	_____

Cross-Motion: Yes No

FILED

Upon the foregoing papers, it is ordered that this motion

FEB 15 2005

NEW YORK
COUNTY CLERK'S OFFICE

*Motion is decided in accordance
with accompanying memorandum
decisions in motion sequence 01.*

Dated: 2/4/05 Herman Cohen
J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

MOTION/CASE IS RESPECTFULLY REFERRED TO
JUSTICE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: TAS PART 49

-----X
LAWRENCE DANIEL O'NEILL, JAMES VALENTINE
and MICHAEL KEANE,

Plaintiffs,

-against-

Index No.
116009/2003

WARBURG PINCUS & COMPANY, WARBURG
PINCUS EQUITY PARTNERS, L.P., E.M.
WARBURG, PINCUS & CO., INC., WARBURG,
PINCUS NETHERLANDS EQUITY PARTNERS I,
C.V., WARBURG PINCUS NETHERLANDS EQUITY
PARTNERS II, C.V., WARBURG, PINCUS
NETHERLANDS EQUITY PARTNERS III, C.V.,
ROBERTO ITALIA and ROBERT GLANVILLE,

Defendants.

-----X
PHILIP BAILLIEU, BANCO NOMINEES
(GUERNSEY) LTD, SIMON BREWER, CADDER
LIMITED, BART CARNAHAN, CHAMONIX
HOLDINGS ENTERPRISES LIMITED individually
and as assignee of STEVE WYATT,
GERALD CREAGH, MICHAEL CREAGH,
PIERS LT F MONTFORT, WILJAM EDGERLEY,
THE REISSE FAMILY FOUNDATION, INVESTEC
TRUST GUERNSEY LIMITED, SHARANBIR
BRIJNATH as assignee of KENNETH KARMIN,
THOMAS KEANE, BEATRICE M. LOWENTHAL,
MR. & MRS. MATTHEW PATRICK, PETER REDDEN,
THE SRILA FOUNDATION, ROBIN J. START,
NOHA AL-TURKI and WEATONS HOLDINGS
LIMITED,

Plaintiffs,

-against-

Index No.
116263/2003

WARBURG PINCUS & COMPANY, WARBURG
PINCUS EQUITY PARTNERS, L.P., E.M.
WARBURG, PINCUS & CO., INC., WARBURG,
PINCUS NETHERLANDS EQUITY PARTNERS I,
C.V., WARBURG PINCUS NETHERLANDS EQUITY
PARTNERS II, C.V., WARBURG, PINCUS
NETHERLANDS EQUITY PARTNERS III, C.V.,
ROBERTO ITALIA and ROBERT GLANVILLE,

Defendants.

-----X

[* 3]
CAHN, J.

Motion sequence number 001 in O'Neill v Warburg Pincus & Co., Index No. 116009/2003 (the O'Neill action), and motion sequence number 001 in Baillieu v Warburg Pincus & Co., Index No. 116263/2003 (the Baillieu action) are consolidated for disposition.

Defendants move to dismiss the fraud cause of action asserted in the amended complaints in each of these actions,¹ CPLR 3016(b), 3211(a)(3) and 3211(a)(7).

BACKGROUND

QoS Networks Limited (QoS or the Company) was an Irish telecommunications corporation formed for the purpose of providing audio and visual transmissions using an internet protocol. The O'Neill plaintiffs, Lawrence Daniel O'Neill, James Valentine, and Michael Keane, were directors, officers and minority shareholders of QoS (together, the Management Investors).² The Baillieu plaintiffs were minority shareholders in QoS (together, the Other Investors).

¹Each of the original complaints also asserted a cause of action for tortious interference, which defendants had moved to dismiss, as well. The plaintiffs' subsequent cross-motions for leave to amend the complaints by, inter alia, withdrawing the tortious interference claims, was granted previously on the record.

²Defendant O'Neill was Chairman of the Company's Board of Directors; defendant Valentine was a director, Chief Executive Officer and President of QoS; defendant Keane was a director and the Company's Chief Financial Officer.

The complaints in each action allege that, following considerable negotiations, in February 2000, defendant Warburg, Pincus & Co. agreed to a term sheet setting forth its intention to invest \$50 million in QoS. On April 14, 2000, Warburg, along with defendants Pincus Equity Partners, L.P., Warburg, Pincus Netherlands Equity Partners I, C.V., Warburg, Pincus Netherlands Equity Partners II, C.V., and Warburg, Pincus Netherlands Equity Partners III, C.V. (together, the Warburg Funds), executed Subscription and Shareholder Agreements, pursuant to which they directly invested an initial \$15 million in QoS, and agreed to invest another \$15 million, in a second tranche, in or around June, 2001. Following this second investment, the Warburg Funds became QoS's largest investor/shareholder, owning almost 61% of its preferred and common stock.

The complaints allege that, from the outset of the preliminary negotiations with Warburg, through the February 2000 term sheet, the April 14, 2000 Closing, and thereafter, until April 5, 2001, one of the primary factors in the Company's business plan, and decisions made in accordance with that plan, was Warburg's stated intent to "follow its money," by indicating that the Warburg Funds would make further investments in QoS. Specifically, the Management Investors allege that, in "February 2000, Warburg, through its agent, James Thomas, represented to each Plaintiff, on an individual basis, that defendant would be

providing an initial investment of at least \$50 million dollars in QoS" (O'Neill Complaint, at ¶ 72). The Management Investors further allege that on the date of the first closing, "Warburg once again represented to Plaintiffs, on an individual basis that defendants would be providing a total of \$50 million to QoS" (Id., at ¶ 74). The Management Investors allege that, in reliance on those representations, each was induced to invest in QoS, and to execute contracts with QoS representing that they were borrowing additional funds solely for the purpose of purchasing Company stock and loan notes. On April 14, 2000, the Management Investors executed the same Subscription and Shareholders Agreements executed by Warburg, pursuant to which they agreed to invest a total of approximately \$3.5 million in QoS.

The Other Investors allege that during February 2000, Warburg encouraged O'Neill, Valentine, and Keane to pursue additional investments in the Company, by representing to potential investors that Warburg was committed to funding at least \$50 million in QoS, would stand behind QoS and "follow its money." The Baillieu complaint alleges that O'Neill, Valentine and Keane made these representations to the Other Investors, and that the Other Investors relied on them in deciding to invest in QoS. On May 3, 2000, the Other Investors executed Subscription and Shareholder Agreements similar, but not identical, to those

executed by the Warburg defendants and the Management Investors, pursuant to which they collectively invested approximately \$4.5 million in QoS.

The complaints allege that, pursuant to the Shareholders' Agreement and the Articles of the Company executed at the closing on April 14, 2000, Warburg was permitted to appoint two directors to the QoS Board of Directors. The Shareholders Agreement further provided that any action by the Board would require a majority vote, including the affirmative vote of at least one of the Warburg-appointed directors. As of May 3, 2000, defendants Robert Glanville and Roberto Italia were the two Warburg designated directors. Warburg and its two appointed directors took an active "hands on" role in the management and business decisions of QoS.

Apparently, shortly after its inception, the Company began experiencing problems, and a dispute arose over its management and direction. Plaintiffs allege that, between November 2000 and February 2001, defendants thwarted certain changes in management personnel favored by a majority of the Company's executives and non-Warburg directors, and indicated that if Warburg was to "follow its money," things had to be done Warburg's way. The Management Investors also allege that Warburg began to devise a secret plan or scheme to remove them from the Board of Directors, and to replace Valentino, the President of QoS.

The complaints further allege that: In March 2001, following extensive discussions, a new QoS budget, mandating staff layoffs, was to be announced at a Company-wide meeting on March 28, 2001. On that same day, defendants, without obtaining approval from the Board, began attempting to elicit support from rank and file personnel of QoS for their plan to remove O'Neill, Valentine, and Keane from their positions. Defendants allegedly represented that the removal of these officers and directors was necessary, if Warburg was to provide additional funding. Later that same evening, defendant Glanville allegedly informed Valentine and Keane that Warburg had determined that there must be substantial changes to QoS's management in order for Warburg to provide further funding, and that one of the conditions for such funding was that O'Neill, Valentine and Keane step down from active management of the Company.

After several days of turmoil, the Company's management allegedly agreed to hold company-wide meetings during early April 2001, to air some of these issues. Plaintiffs allege that, around this time, Warburg devised a "proof of concept," and represented that if said "proof of concept" could be achieved, Warburg would support all necessary funding by matching all other funding on a dollar-for-dollar basis, but only if O'Neill, Valentine and Keane were removed from all management and operational responsibilities.

[* 8]

On April 4, 2001, Glanville presented this "proof of concept" to QoS employees at a Company-wide meeting, again representing that if the "proof of concept" were achieved, Warburg would provide additional funding. However, on April 5, 2001 Glanville and Italia announced, at a Board of Directors meeting, that Warburg had decided not to participate in further funding and urged management to consider liquidating QoS immediately. O'Neill, Valentine, and Keane allegedly opposed liquidation, favoring instead a further stock offering in conjunction with a financial restructuring.

At a Board meeting, held on April 11, 2001, Italia and Glanville allegedly informed the Board that, since Warburg would not be providing any additional financing, and since any continued operation and funding would require a restructuring of the Company, they were not prepared to make any further decisions with respect to the financing and operations of the Company, without first reviewing a proposed restructuring plan. At a May 3, 2001 Board Meeting, Keane allegedly proposed a plan for a stock rights offering, to be made to existing shareholders, which called for a capital restructuring. Plaintiffs allege that Warburg opposed the terms of this offering. Italia and Glanville allegedly refused to vote on this issue at the meeting, or to propose an alternative.

Following another Board meeting on May 7, 2001, Italia and

Glanville resigned from the Board, Warburg thereafter waived its right to require that at least one Warburg-appointed director approve any Board action.³ QoS continued to pursue the proposed stock rights offering and allegedly obtained strong interest from other venture capitalists to provide up to \$10 million in funding. On August 3, 2001, QoS scheduled an extraordinary general meeting of the shareholders, for the express purpose of voting on the resolution regarding the financial restructuring of the Company. Plaintiffs allege that Warburg voted their shares against the resolution, thereby frustrating QoS's attempt to enable a new financier to invest in the Company.

The Management Investors allege that, in reliance upon Warburg's later misrepresentations that it would provide additional funding if its "proof of concept" were achieved, plaintiffs revised their priorities and business plan to accomplish the "proof of concept," and, in fact did accomplish said "proof of concept" within a few months of its first delineation in early April 2001. Plaintiffs contend that, notwithstanding this fact, the Warburg defendants not only declined to provide further funding, but obstructed plaintiffs' efforts to obtain other financing. Plaintiffs argue that Warburg had no legitimate basis to oppose the proposed stock rights

³Warburg reserved the right, however, to withdraw the waiver at any time.

offering, and that its vote against the resolution was contrary to the best interests of QoS and the minority shareholders. Plaintiffs allege that, as a result of QoS' inability to come up with a refinancing plan, in July 2002, QoS was forced to endure the Irish equivalent of a Chapter 11 bankruptcy, and plaintiffs lost substantially all of their investment.

The O'Neill plaintiffs now assert causes of action for (1) breach of fiduciary duty, (2) fraud, (3) breach of contract, and (4) breach of the implied covenant of good faith; and the Baillieu plaintiffs assert causes of action for (1) breach of fiduciary duty and (2) fraud.

Defendants move to dismiss the fraud claims in both actions for lack of standing, for failure to state a cause of action, and for failure to plead fraud with the requisite specificity.

DISCUSSION

On a CPLR 3211(a)(7) motion to dismiss, the court must accept the facts alleged as true, accord the plaintiff the benefit of every possible inference, not evaluate the merits of the case, and determine only whether the facts as alleged fit within any cognizable legal theory (Leon v Martinez, 84 NY2d 83 [1994]). Allegations consisting of bare legal conclusions, as well as factual claims either inherently incredible or clearly contradicted by documentary evidence, are not entitled to such consideration. Skillgames, LLC v Brody, 1 AD3d 247 [1st Dept

2003]; Kliebert v McKeon, 228 AD2d 232 [1st Dept], lv denied 89 NY2d 802 (1996).

Initially, defendants argue that, insofar as plaintiffs' fraud claims are based on the diminution in value of plaintiffs' investments, due to Warburg's alleged misconduct toward QoS, plaintiffs lack standing to assert this cause of action as individuals, because these claims are derivative in nature.

In any event, defendants argue that the dismissal of the fraud claims is warranted, as Warburg's allegedly fraudulent representations, that it would "follow its money" by making further investments in QoS, were non-actionable expressions of future intent, and plaintiffs have failed to plead facts from which it could be inferred that the representations were false when made. In addition, defendants note that, insofar as plaintiffs seek to base the fraud claims on any of the alleged misrepresentations which defendants made after they became investors in QoS, such misrepresentations cannot support their claims for fraudulent inducement.

Defendants additionally argue that the Management Investors' reliance on the claimed misrepresentations of Warburg's future intent, was unreasonable as a matter of law, since they are wholly inconsistent with express provisions contained in both the February 2000 Term Sheet, and the April 14, 2000 Subscription and Shareholders Agreements, which were executed by both the Warburg

defendants and the Management Investors. Defendants further argue that the Other Investors' alleged reliance on the vague and contingent statements of Warburg's future plans or expectations, which were allegedly communicated by the Management Investors in some unspecified way and at some unspecified time, was unreasonable as a matter of law.

Finally, defendants argue that the Other Investors' fraud claim should be dismissed, as their pleading lacks sufficient particularity, in that they have failed to particularize, *inter alia*, exactly what was said to them, when, and by whom.

Where shareholders seek to vindicate a wrong done to the corporation, any recovery will be for the benefit of the injured corporation, and the action must be brought derivatively. However, if shareholders sue in an individual capacity to recover damages resulting in harm, not to the corporation, but to the individual investors, the action is personal, not derivative, and may be brought in their individual capacities (see Glenn v Hoteltron Systems, Inc., 74 NY2d 386 [1989]).

Here, insofar as the alleged misrepresentations by Warburg are alleged to have injured plaintiffs, only insofar as they were shareholders of the corporation, plaintiffs have no standing to sue in their individual capacities. Thus, to the extent that plaintiffs base their claim on the director defendants' alleged misrepresentation that Warburg would provide further funding if

its "proof of concept" were achieved, the claim, if actionable, would be derivative in nature. Since the complaint further alleges that the Warburg defendants retracted this representation almost the very next day, any reliance on such misrepresentation would have been unreasonable as a matter of law; thus the claim fails to state a cause of action in any event.

However, to the extent that plaintiffs can plead that they were each individually induced to invest in QoS by defendants' allegedly fraudulent misrepresentations, the claims would not be derivative in nature, and may be brought individually. To maintain such a cause of action, plaintiffs must allege "a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury" (Lama Holding Co. v Smith Barney, Inc., 88 NY2d 413, 421 [1996]; see also, Channel Master Corp. v Aluminium Ltd. Sales, Inc., 4 NY2d 403 [1958]). Further, each of the foregoing elements must be supported by factual allegations containing the details constituting the wrong sufficient to satisfy CPLR 3016(b) (see Lanzi v Brooks, 54 AD2d 1057, 1058 [3^d Dept 1976]), affd, 43 NY2d 778 [1977]).

Initially, this court notes that, except for the alleged oral representation attributed to James Thomas in February 2000,

plaintiffs have failed to identify who, on behalf of Warburg, made any of the other alleged oral representations that Warburg would "follow its money" by making further investments in QoS. In any event, even if these representations were pleaded with sufficient particularity, promises or statements of future expectations or intent are, generally, not actionable as fraud absent a preconceived and undisclosed intent not to honor them (see Non-Linear Trading Company, Inc., v Braddis Assocs., Inc., 243 AD2d 107 [[1st Dept 1998]]) see also Deerfield Communications Corp. v Chesebrough-Ponds, Inc., 68 NY2d 954 [1986]; Channel Master Corp. v Aluminium Ltd. Sales, supra; Sabo v Delman, 3 NY2d 155 [1957]). A fraud claim based upon a statement of future intent must allege facts to show that the defendant, at the time such promissory representation was made, never intended to honor or act on the statement (Non-Linear Trading Co., Inc., supra; see also Fiala v Metropolitan Life Ins. Co., 6 AD3d 320 [1st Dept 2004])). Thus, plaintiffs' pleadings must contain some "rational basis for inferring that the alleged misrepresentation was knowingly made," by, for example, providing some "particularized factual assertion which supports the inference of scienter," (Houbigant, Inc. v Deloitte & Touche LLP, 303 AD2d 92, 98 [1st Dept 2003])).

Here, plaintiffs allegations that defendants

... knew that such statements were false and misleading, and/or had a pretense or actual knowledge

when knowledge did not exist, and/or made the representations recklessly and without regard to the actual facts, and they knew the Warburg defendants and the Warburg Funds had no intention of funding QoS as represented

(O'Neill complaint at ¶ 74; Baillieu complaint at ¶ 118) are wholly conclusory. Nevertheless, plaintiffs argue that defendants' knowledge of the falsity of the representation, can be inferred from defendants later refusal to consent to management changes, and subsequent attempts to dismantle the existing management structure of QoS. However, this argument is unavailing, especially, as none of the conduct is alleged to have occurred close to, or shortly after, the time of the alleged misrepresentations (see Coppola v Applied Electric Corp., 288 AD2d 41 [1st Dept 2001]).

Additionally, to the extent that plaintiffs base their fraud claims on the February 2000 representation by Thomas, that Warburg would provide an initial investment of at least \$50 million dollars, plaintiffs claims of reliance are negated by the express terms of both the February 2000 Term Sheet, and the April 14, 2000 Subscription and Shareholders Agreements, which directly contradict this claimed oral representation (see Bernstein v Golden Press Holdings, L.L.C., 293 AD2d 414 [1st Dept 2002]; Coutts Bank (Switzerland) Ltd. v Anatian, 261 AD2d 307 [1st Dept 1999], lv dismissed 94 NY2d 875 [2000]; Societe Nationale D'Exploitation Industrielle des Tabacs et Allumettes v Salomon

Bros. Intl., Ltd., 249 AD2d 232 [1st Dept 1998], lv denied 95 NY2d 762 [2000]; Bango v Naughton, 184 AD2d 961 [3^d Dept 2002]). While the non-binding February 2000 Term Sheet, executed by Warburg, indicated a total investment of \$53 million, it provided only for an initial investment of \$33 million at Closing, of which \$30 million was to be provided by the Warburg Funds, and \$3 million by the Management Investors. As for additional funding, the Term Sheet provided only for a Second Funding as follows:

Through March 31, 2001, the Company shall have the right to request that [the Warburg Funds] invest up to an additional \$20 million in the Company to purchase an additional 20,000 Units, with each Unit consisting of 1 share of Series A [Redeemable Preferred Stock] and 100 shares of common stock. Upon receipt of such a request from the Company, [the Warburg Fund]'s decision to make the Second Funding will be at [the Warburg Fund]'s sole discretion, based on QoS' execution of its business plan, among other criteria. (Underlining added).

(See Eaton Aff., Ex 1).

More importantly, at the April 14, 2000 closing, the Warburg Funds and the Management Investors each executed the same Subscription Agreement and Shareholders Agreements, which set forth the terms of their respective investments in QoS. These Agreements specifically provided that on April 14, 2000, the Warburg Funds would invest \$15 million to purchase an initial 7500 subscription units of QoS, and that, no later than July 31, 2000, the Warburg Funds would invest another \$15 million to purchase an additional 7500 subscription units. The Subscription Agreement further provided that if, on or before December 1,

2001, QoS determined that additional capital was needed for the operation and expansion of its operations, all of the investors would have the right, but not the obligation, to subscribe for additional Units, in one or more tranches, at a purchase price to be agreed, in an aggregate amount not to exceed \$20 million.

Finally, to the extent that the fraud claim in the Baillieu complaint is based on the allegedly false representations made to the Management Investors, it, too, must fail, for the reasons set forth above. In any event, the Baillieu complaint lacks the particularity, required under CPLR 3016 (b), for pleading a fraud cause of action, as it fails to allege with sufficient specificity exactly when, or by whom, these alleged misrepresentations were made to the Other Investors (Eastman Kodak Co. v. Roopak Enterprises, Ltd., 202 AD2d 220 [1st Dept 1994]).

Accordingly, it is

ORDERED that defendants' motion to dismiss (motion sequence number 001) in O'Neill v Warburg Pincus & Co., Index No. 116009/2003 is granted, and the second cause of action is dismissed; and it is further

ORDERED that defendants' motion to dismiss (motion sequence 001) in Baillieu v Warburg Pincus & Co., Index No. 116263/2003 is granted, and the second cause of action is dismissed; and it is further

ORDERED that defendants are directed to serve an answer to the complaint in each of the actions within 10 days after service of a copy of this order with notice of entry.

Dated: February 4, 2005

ENTER: *Re Col*
 J.S.C.

FILED
FEB 15 2005
NEW YORK
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