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

PRESENT: COHEN PART 49

Justice

LAWRENCE DANIEL ONEIL

- v -

WARNER PINCUS

INDEX NO. 116009/03

MOTION DATE 11/15/05

MOTION SEQ. NO. 004

MOTION CAL. NO.

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

Upon the foregoing papers, it is ordered that this motion

FILED
JAN 26 2006
COUNTY CLERK'S OFFICE
NEW YORK

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION IN MOTION SEQUENCE .....

Dated: 1/24/06

J.S.C.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

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

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

Plaintiffs,

-against-

Index No.
116009/2003
(Mot. Seq. No. 004)

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.

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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 E MONTFORT, WILLIAM 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
(Mot. Seq. No. 004)

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.
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CAHN, J.

Defendants move for summary judgment effectively limiting the plaintiffs' claims for damages in each action, CPLR 3212.

BACKGROUND

The underlying facts in this action have been detailed in a prior decision and order of this court, familiarity with which is presumed. Briefly, QoS Networks Limited (QoS or the Company) was an Irish telecommunications corporation formed on November 12, 1999, to develop a new type of global telecommunications service provider. It would use existing telecommunications infrastructure, along with new technology, to create a technologically leading-edge global data and VoIP network. Plaintiffs Lawrence Daniel O'Neill, James Valentine, and Michael Keane (the Management Investors), with non-party James Hendrickson, were the founders of QoS, and later its managers, directors, and/or officers.

On April 14, 2000, defendants Warburg, Pincus & Co. (Warburg), Pincus Equity Partners, L.P., Warburg, Pincus Netherlands Equity Partners I, C.V., Warburg, Pincus Netherlands Equity Partners II, C.V., Warburg, Pincus Netherlands Equity Partners III, C.V. (together, the Warburg defendants), and each of the Management Investors, executed Subscription and Shareholder Agreements, pursuant to which they each agreed to purchase Units of QoS at $2002.00 per Unit. Each Unit was comprised of one Series A Preference Share, 200 shares of ordinary Stock, and "Loan Stock" in the aggregate principal amount of $1,000.

The Warburg defendants invested a total of $30 million in QoS, and became its largest investor/shareholder, owning almost 61% of the Company's Preference and Ordinary shares.[1] The Management Investors invested a total of approximately $3.5 million, becoming minority shareholders. On May 3, 2000, the plaintiffs in Baillieu (together, the Other Investors), executed similar, but not identical Subscription and Shareholder Agreements, pursuant to which they collectively invested approximately $4.5 million in QoS, and also became minority shareholders.

During the following year, as QoS worked to build its global network, it ran into difficulties, including problems with critical equipment. The Company also was affected by adverse market conditions that affected the entire telecommunications industry, causing difficulties not only for itself, but for its suppliers and customers, as well. In addition, a management dispute over the performance of QoS' chief operating officer, James Hendrickson, led to his resignation and replacement in April 2001. As a result of all these problems, the roll out of the Company's network fell behind schedule, and QoS found itself burning through its remaining cash.

In March 2001, the Company announced a new budget mandating staff lay-offs. In April and May 2001, it restructured its operations and eliminated 42 positions. According to the report of the Company's independent auditor, prepared in late May 2001, between its inception on November 12, 1999 and December 31, 2000, the Company reported a loss of $13.9 million on ordinary activities (see Netzer Affirm., Exh. 8). In addition, the cash equivalents declined from $21 million on December 31, 2000, to $8 million on April 30, 2001 (id.). In their report, the

[1]In addition to becoming QoS' majority shareholders, the Shareholders' Agreement and the Articles of Association permitted Warburg to appoint two directors to the QoS Board. As of May 3, 2000, defendants Robert Glanville and Roberto Italia were the two Warburg directors.

auditors indicated that the Company's operating losses and limited cash on hand "raised substantial doubt about [its] ability to continue as a going concern" (id., at 14).

At a Board of Directors meeting on April 5, 2001, Italia and Granville, the two Warburg directors announced that Warburg had decided not to participate in any further funding of QoS and urged management to consider liquidating QoS immediately. The Management Investors opposed liquidation, favoring instead a further stock offering in conjunction with a financial restructuring. Subsequently, at a May 3, 2001 board meeting, the Management Investors proposed a stock rights offering, to be made to existing shareholders, which called for a capital restructuring of QoS. Italia and Glanville allegedly refused to vote on this issue at the meeting and, following a subsequent board meeting on May 7, 2001, resigned from the board.

On June 11, 2001, QoS produced a stock rights offering plan to sell 10,000 new Units. In this round of financing, each Unit would consist of one Series B Preference Share and 1,000 Ordinary Shares of the Company, at a price of $1,010.00 per unit (see Netzer Affirm., Exh. 14: Private Placement Memorandum). However, the consummation of this planned offering was expressly conditioned upon the holders of the Company's outstanding Series A Preference Shares, Ordinary Shares, and Loan Stock, approving changes to the Company's capital structure and amendments to the Articles of Association. These changes would permit the creation of the new Series B Preference Shares; provide for the conversion of the Company's outstanding Loan Stock and Series A Preference Shares into Ordinary Shares at a conversion ratio of 100 Ordinary Shares for each Loan Stock share and for each Series A Preference Share; and effect a one-for-ten reverse stock split of the Company's Ordinary Shares.

Plaintiffs allege that there was strong interest and offers from other venture capitalists to

provide up to $10 million in funding for QoS under the proposed stock rights offering plan. On August 3, 2001, QoS scheduled an extraordinary general meeting (EGM) of all shareholders, for the purpose of voting upon the resolutions regarding the financial restructuring and proposed stock rights offering. Warburg voted their shares against the resolutions, thereby allegedly frustrating the attempt to obtain new financing. Plaintiffs allege that, as a result of the inability of QoS to come up with a refinancing plan, it was forced to endure the Irish equivalent of a Chapter 11 bankruptcy, and plaintiffs lost substantially all of the value of their investment. Plaintiffs subsequently commenced the instant actions, asserting causes of action for breach of fiduciary duty and fraud.[2]

By decision and order dated February 4, 2005, this court dismissed the fraud causes of action in each suit.

In their claim for breach of fiduciary duty, plaintiffs allege that Warburg's votes against the resolutions and proposed stock rights offering, and their refusal to engage in any meaningful negotiations with respect thereto, breached the fiduciary duties these defendants owed to the minority shareholders, and caused plaintiffs to lose all or substantially all the "salvageable value" of plaintiffs' investments. Plaintiffs contend that Warburg had no legitimate basis to oppose the proposed stock rights offering, and that Warburg's votes against the restructuring resolutions was contrary to the best interests of QoS. Plaintiffs further allege that, at the time, "with the minimum commitment of $10,000,000 of outside investment through the resolutions for the restructuring of the Preferred Stock and loan notes, (had it not been defeated by the improper

[2] The plaintiffs in O'Neill also asserted causes of action for breach of contract and breach of the implied covenant of good faith in connection with personal loans from Warburg.

actions of Defendants), the equity value of QoS was approximately $14,000,000" (Netzer Affirm., Exh. 17 at ¶ 67; Exh. 18 at ¶ 109).[3]

Defendants move to dismiss plaintiffs' claims for damages, arguing that plaintiffs are not seeking the equitable restitution of their lost investment, but rather the potential value of their equity in QoS, based on lost profits that QoS would have earned but for Warburg's alleged misconduct. Defendants argue that lost profits of a start-up business with no record of profitability are too speculative to be recoverable.

Plaintiffs argue that defendants' assessment that QoS was a company with zero value, based on the absence of any recognizable profits, is in contrast to a January 2001 valuation memorandum prepared by PricewaterhouseCoopers, and projections made by Glanville in a March 2001 draft letter to Wachovia, indicating that QoS was projected to earn a profit in 2002 (Netzer Affirm., Exh. 6; Zack Affirm., Exh. 30). Plaintiffs have also submitted a report, prepared by a damages expert, concluding that QoS would have a value in excess of $100 million today, "had it completed its rights offering in August 2001 and continued in business to pursue its strategy and plan of business operations" (Zack Affirm., Exh. 43 [Segal Report], p. 1). In any event, plaintiffs argue that their damages' claims should not be dismissed because they are seeking to recover their initial investments in QoS, as well.

DISCUSSION

A motion for summary judgment will be granted where the movant has made "a prima

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[3]According to plaintiffs' evidentiary submissions, as of August 3, 2001, the date of the EGM, QoS had outstanding liabilities of $76,362,166.00 and an unrestricted cash book balance of $2,139,712.00 (Zack Affirm., Exh. 41).

facie showing of entitlement to judgment as a matter of law, tendering sufficient evidence to eliminate any material issues of fact from the case" (Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985]). Once the movant has established entitlement to summary judgment relief, the party opposing the motion must tender evidentiary proof sufficient to require a trial of material questions of fact, or to demonstrate an acceptable excuse for not doing so (Zuckerman v City of New York, 49 NY2d 557 [1980]). "[M]ere conclusions, expressions of hope or unsubstantiated allegations or assertions are insufficient" (Id. at 562).

Assuming, solely for purposes of deciding this motion, that the Warburg defendants' conduct in voting down the capital restructuring resolutions constituted a breach of fiduciary duty to the minority shareholders, to the extent plaintiffs seek to recover the projected, "salvageable" value of their equity in QoS, based on anticipated profits the Company might have earned had QoS been able to secure sufficient financing, continue operating, and become successful, defendants' motion to dismiss the damages claim is granted.

Plaintiffs' predictions as to the potential current value of QoS are based upon projections of future profitability, which assume that the Company would have secured the necessary financing and continued operating as a going concern. While lost profits are recoverable as the natural consequence of the commission of a tortious act, including breach of fiduciary duty, they must be demonstrated with sufficient certainty, and may not be speculative or contingent (Levine v American Federal Group, Ltd., 180 AD2d 575 [1st Dept 1992]). To recover damages for lost earnings or profits one must prove with certainty that the loss was caused by the breach (see Stoeckel v Block, 170 AD2d 417 [1st Dept 1991]). One must also prove with reasonable certainty, though not mathematical precision, the amount of the loss; damages must be capable of

measurement based upon known reliable factors without undue speculation (see e.g. Ashland Mgt. Inc. v Janien, 82 NY2d 395 [1993]). "In other words, the damages may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach, not remote or the result of other intervening causes" (Kenford Co., Inc. v Erie County, 67 NY2d 257, 261 [1986]). "In the case of a new business seeking to recover loss of future profits, a stricter standard is imposed because there is no experience from which lost profits may be estimated with reasonable certainty and other methods of evaluation may be too speculative" (Ashland Mgt. Inc. v Janien, 82 NY2d at 404; citing Kenford Co., Inc. v Erie County, 67 NY2d at 261).

The evidence submitted on this motion establishes that, even as of August 3, 2001, when Warburg voted against the resolutions and stock rights offering, QoS was still at a developmental stage and had yet to achieve profitability. The earliest attempts at valuing the Company were based on financial information and projections provided solely by the Company's Management (see Netzer Affirm., Exh. 6) and were necessarily and admittedly subjective (see Zack Affirm., Exh. 30). The later valuation contained in the Segal Report relied heavily on the Company's business plan, developments in the telecommunications industry in later years, as well as on assumptions that QoS would have received sufficient funding through its planned rights offering in August 2001, would have continued to develop its business, and would still be operating as a viable going concern today.

The evidence shows, however, that the offers of funding, upon which QoS was depending, were not unconditional commitments, but were expressly contingent on factors other than just shareholder approval of the capital restructuring, including further due diligence post

EGM (see Zack Affirm., Exh. 16 and 18). The fact that any future valuation or profit estimation of QoS requires an assumption that the Company would have been able to obtain the requisite funding through the planned stock rights offering, and that it would continue operating and become successful in the economic climate then existing, renders any damage claim based on such anticipated value or profits too speculative, and too uncertain to calculate with reasonable certainty.

While plaintiffs now claim that they also seek equitable restitution equal to the amount of their initial investment, the parties dispute whether plaintiffs previously articulated this claim for damages. Defendants argue that plaintiffs never articulated such a claim in their complaints, discovery requests, prior briefs, or deposition testimony; never previously defined the loss of the value of their investments in this manner before; and cannot, and do not, establish that such a claim is warranted now.

It is noted that while plaintiffs alleged the loss of their investment in connection with their previously dismissed fraud claim, it does not appear that they ever specifically sought to recover their initial investment on either that claim, or their fiduciary duty claim. Nevertheless, insofar as defendants also seek dismissal of any claim for equitable restitution, the motion to dismiss will not be granted at this time; instead, if necessary, this court will address the issue of such damages upon later motion.

Accordingly, it is

ORDERED that defendants' motion to dismiss plaintiffs' claims for damages (motion sequence number 004 in O'Neill v Warburg Pincus & Co., Index No. 116009/2003 and Baillieu v Warburg Pincus & Co., Index No. 116263/2003) is granted solely to the extent of dismissing

plaintiffs' claims insofar as they are based on lost profits or the "salvageable" value of QoS, and the motion is otherwise denied.

Dated: January 24, 2006

ENTER:
J.S.C.