

Brynwood Partners III L.P. v Lincoln Snacks Holding Co., Inc.

2006 NY Slip Op 30616(U)

March 21, 2006

Sup Ct, NY County

Docket Number: 602672/2005

Judge: Karla Moskowitz

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

PRESENT: Hon. KARLA MOSKOWITZ PART 03
Justice

_____x
BRYNWOOD PARTNERS III L.P.,

Plaintiff,

- against -

LINCOLN SNACKS HOLDING CO., INC.

Defendants.
_____x

INDEX NO 602672/2005

MOTION DATE _____

MOTION SEQ. NO. 001

MOTION CAL. NO. _____

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

Notice of Motion/ Order to Show Cause — Affidavits — Exhibits _____

Answering Affidavits — Exhibits _____

Replying Affidavits _____

PAPERS NUMBERED

Cross-Motion: Yes No

Upon the foregoing papers, it is

ORDERED that this motion is decided in accordance with the accompanying Decision and Order.

Dated: March 21, 2006

KARLA MOSKOWITZ

J.S.C.

FILED
MAR 23 2006
COUNTY CLERK'S OFFICE
NEW YORK

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: I.A.S. PART 3

-----X
BRYNWOOD PARTNERS III L.P.,

Plaintiff,

Index No. 602672/2005

- against -

DECISION and ORDER

LINCOLN SNACKS HOLDING CO., INC.

Defendants.

-----X
KARLA MOSKOWITZ, J:

This case is related to Lincoln Snacks Holding Co., Inc. v. Brynwood Partners III L.P. and Brynwood Management III L.P., Index No. 603890/2004 (the "Related Case"). The court refers the parties to decisions on motions in the Related Case for the underlying facts. By this motion, plaintiff Brynwood Partners III L.P., ("Brynwood Partners") moves for summary judgment against defendant Lincoln Snacks Holding Co. ("LSHC"), pursuant to CPLR 3212, on its single cause of action for breach of a provision in an agreement dated as of January 30, 2004 (the "Merger Agreement") for the sale of Lincoln Snacks Company.

On March 15, 2004, LSHC filed Lincoln Snack's Federal Income Tax Return for the pre-Closing Date period July 1, 2003 through June 30, 2004. Upon Brynwood's inquiry, on May 10, 2005, LSHC informed Brynwood by letter that Lincoln Snacks had received a refund in the amount of \$2,817,786.00. (See Affirmation of Matthew L. Craner, dated September 20, 2005, Ex D).

According to Brynwood Partners, the Merger Agreement requires LSHC to hand over tax refunds. Brynwood Partners relies upon section 5.11 of the Merger Agreement governing

“allocation of responsibility as between the parties for certain Tax matters following the Closing Date.” (See Craner Aff. Ex B § 5.11). Section 5.11(c) states that any “income Tax credit or refund of Income taxes or [sic] attributable to the Company for any Tax period ending prior to or that includes the Closing Date shall be the property of Brynwood.” The section continues:

[LSHC] shall pay to Brynwood as soon as possible following the receipt or utilization thereof, the amount of any such income or credit . . . provided however that Brynwood shall not be entitled to any such Income tax refund or credit to the extent such refund or credit is attributable to any losses incurred in any taxable year beginning after the Closing Date. Any Tax credit or refund of Taxes relating to a Tax period that begins before and ends after the Closing Date shall be taken into account as though the relevant Tax period ended on the Closing Date.

Despite the language in § 5.11, LSHC refused to turn over the tax refund, claiming rights to setoff and equitable recoupment because the collective amount of its claims that are pending in the Related Case exceed the amount of the tax refund. The May 10, 2005 letter assured Brynwood that LSHC had deposited the tax refund monies into a separate escrow account.

A. Contractual Arguments

Section 5.11(c) requires LHSC to pay to Brynwood all tax refunds attributable to periods in which Brynwood owned Lincoln Snacks Company “as soon as possible” upon receipt. It is undisputed that LSHC has received a \$2,817,786 federal income tax refund that is attributable to that period. Thus, it would appear that LSHC must turn over that amount to Brynwood now.

In opposition to Brynwood’s motion for summary judgment, LSHC first contends that section 8.6 permits it to apply the tax refund to reduce its losses alleged in the Related Case. Article VIII deals with Indemnification. Section 8.6 entitled “Indemnification Procedure for Third Party Claims Against Indemnified Parties.” Section 8.6 (a) under the heading “Limitation of Remedies” states:

Any insurance proceeds actually received shall reduce such Losses hereunder and, if indemnification payments shall have been received prior to the collection of such proceeds, the Indemnified Party shall remit to the Indemnifying Party the amount of such proceeds actually received . . . to the extent of indemnification payments received in respect of such Losses. To the extent any Loss of an Indemnified Party is reduced by receipt of payment (i) under insurance policies, or (ii) from third parties not affiliated with the Indemnified Party, such payments . . . shall be credited against any such Losses.

(Emphasis supplied)

LHSC argues that section 8.6(a) entitles it to offset the tax refund at issue against its alleged losses with respect to its claims for indemnification in the Related Case because it is a payment from an unaffiliated third party. (Opp. Mem. At 11). This argument is a non-sequitor. Section 8.6 is part of Article VIII of the Merger Agreement. Article VIII is entitled “Indemnification. Section 8.2 describes “Losses” as:

losses, damages, expenses, (including without limitation, court costs, amounts paid in settlement, judgments, reasonable attorney’s fees, or other expenses, including, without limitation, those arising from the enforcement of this Agreement), suits, actions, claims, deficiencies, liabilities, diminution in value, Taxes or obligations

Clearly, the “Losses” this section contemplates are payments to third parties. Here, the alleged “Losses” that LHSC claims to have suffered in the Related Case have nothing to do with payments to third parties. Hence, defendant cannot use the tax refund as an offset because it has not suffered a “Loss” as section 8.6(a) contemplated.

Further, that the Merger Agreement contemplates contribution from unaffiliated third parties supports Brynwood’s position that payment is only a credit against a “Loss” where that payment arises from and results in a reduction of that “Loss.” (See Reply Mem. at 6). The Merger Agreement does not contemplate that tax refunds would be available to offset any purported “Losses” as the section dealing with “Tax Matters” is entirely different from the section dealing

with indemnification. Section 8.6 is simply not applicable to this situation.

In holding that LHSC cannot invoke section 8.6 to avoid turning over the tax refund to plaintiff, the court notes that LHSC has taken a literal view of this Merger Agreement to avoid a motion to dismiss in the Related Case. It cannot now ignore the plain import of the Merger Agreement in an effort to avoid its own obligations under it.

B. Set off

LHSC next claims that it has a common law right to use the tax refund to set off amounts Brynwood allegedly owes to LHSC in the Related Case. Again, LHSC is wrong. To assert setoff, a party must hold a liquidated debt. (*See Willett v. Lincolnshire Mgmt, Inc.*, 302 AD2d 271, 271 [1st Dep't 2003] [no right to set off unliquidated liability against a liquidated claim that is due and payable]).

In *Ferguson v. Lion Holding Inc.*, 312 FSupp2d 484 (SDNY 2004), the plaintiffs sued for amounts due under an earnout provision in the parties' stock purchase agreement. As is the case here, the defendants asserted that their alleged breach of contract must be set off against monies plaintiff allegedly owed to them pursuant to the contract's general indemnification provision. The *Ferguson* court held that the defendants could not assert setoff because whether the plaintiff had an obligation to indemnify the defendants was in dispute in another case and therefore there was no payment due from plaintiffs. Similarly, here, whether Brynwood owes anything to LHSC is the subject of the pending dispute in the Related Case. (Although that case is partially stayed for the moment, the stay is only in the interests of judicial economy pending the determination of a review process before an independent accountant.) Thus, in no way can this court consider that LHSC holds a liquidated debt against Brynwood. Accordingly, LHSC is not entitled to setoff.

C. Recoupment

LHSC also claims it is entitled to retain possession of the Tax Refund pursuant to the recoupment doctrine. “Recoupment means a deduction from a money claim through a process whereby cross-demands arising out of the same transaction are allowed to compensate one another and the balance only to be recovered.” (*Ferguson*, 312 FSupp2d at 503). Thus, under New York law, for a party to assert recoupment, the claims must arise from the same transaction. (*See 182 Franklin Street Holding Corp. v. Franklin Pierrepont Associates*, 217 AD2d 508, 509 [1st Dep’t 1995]). Whether the two claims arise out of the same contract is not necessarily determinative. (*See Ferguson*, 312 FSupp2d at 504 [equitable recoupment did not apply where obligations under contract arose out of “discrete and independent units”]).

Here, Brynwood’s claim concerning LHSC’s unlawful withholding of the tax refund is unrelated to the claims that LHSC has asserted in the Related Case. The parties made section 5.11 a discrete and independent obligation. LHSC’s obligations under that provision are not contingent in any way upon any provision of the Merger Agreement that forms the basis of its claims against Brynwood in the Related Case. None of LHSC’s claims concern taxes. As this court has previously recognized, section 5.11 is in a different part of the Merger Agreement altogether. LHSC contends that both lawsuits are asserted pursuant to the same provisions of the Merger Agreement because both of the parties initiated suit invoking the Merger Agreement’s indemnification provision. However, this is merely the procedural mechanism through which to make a claim. The two lawsuits do not invoke the same substantive provisions of the Merger Agreement.

LHSC’s cases are not convincing. For example, in *Enrico & Sons Contracting Inc., v.*

Bridgemarket Associates, 252 AD2d 429, 430 (1st Department 1998), the court found that the claim for recoupment went to the very heart of the bargain between the parties and was “akin to a defense of lack or failure of consideration.” The same cannot be said of the claims in the related case. First, LHSC is not asserting a total failure of consideration, just that it paid too much for the Company. Further, the failure to hand over the tax refund is really peripheral to the Merger Agreement’s main purpose to effectuate a sale of the Company. *Bendat v. Premier Broadcasting Group, Inc.*, 175 AD2d 536 (3d Dep’t 1991) is not applicable because there the defendant did not contest that it had breached the agreement. *Fortin v. Hill & Markets, Inc.* 2 Ad3d 934 (3d Dep’t 2003) dealt with the timeliness of a counterclaim for recoupment under CPLR 203(f), as arising out of the same transaction and is inapposite.

Accordingly, it is

ORDERED THAT plaintiff Brynwood Partners III L.P.’s motion for summary judgment is granted and defendant Lincoln Snacks Holding Co., Inc. is directed to turn over the full amount of the tax refund that it is holding in escrow to plaintiff within 60 days from receipt of this decision and order with notice of entry; and it is further

ORDERED THAT the clerk is directed to enter judgment accordingly.

Dated: March 21, 2006

by **FILED**

 J.S.C
 MAR 23 2006
 COUNTY CLERK'S OFFICE
 NEW YORK