

Erickson Air-Crane Inc. v EAC Holdings, L.L.C.

2010 NY Slip Op 34006(U)

August 31, 2010

Supreme Court, New York County

Docket Number: 600325/09

Judge: Melvin L. Schweitzer

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to all the rights, property and interests of Acquisition, and, accordingly, is the plaintiff in this action. Holdings is the defendant.

Subsequent to this court's dismissal of plaintiff's initial complaint, the court granted plaintiff leave to amend its complaint, which it has done by filing the FAC. Defendant has moved to dismiss the FAC in its entirety.

In its FAC, plaintiff alleges that defendant made false representations and warranties in the SPA that constitute breaches of the SPA. Plaintiff alleges defendant's false statements included representations that defendant was operating in compliance with applicable law, that it disclosed all material contracts and that it would notify plaintiff of facts which might require an exception to be taken to defendant's representations or warranties prior to closing the transaction.

Plaintiff further alleges that the SPA contained a thoroughly negotiated indemnification provision that was intended to protect plaintiff against breaches of representations or warranties by defendant. This indemnification provision was limited to \$9,000,000 and contained detailed terms and conditions with respect to its operation. It was set forth in Article 9 of the SPA. Plaintiff alleges that it has complied in material respects with the terms of the indemnification provisions regarding the alleged breaches of representation and warranty, but that defendant has failed to pay the \$9,000,000 due plaintiff thereunder. Accordingly, plaintiff argues that defendant has breached its contractual duties set forth in the SPA.

Defendant contends that, on the contrary, in many material respects plaintiff has not complied with the required terms of the Article 9 indemnification provisions and, as a result of such failures, is not entitled to indemnification thereunder. Accordingly, defendant moves to dismiss the FAC pursuant to CPLR 3211 (a) (1) and (7).

Article 9 of the SPA provides, *inter alia*, that (i) the representations and warranties in the SPA survive for a period of twelve months after the closing date; (ii) notices for claims in respect of a breach of a representation or warranty must be received prior to the twelve month anniversary of the closing date for an indemnifiable loss to be recoverable; (iii) the seller indemnifies the buyer for losses resulting from inaccuracies of representations or warranties made by seller; (iv) if the buyer wishes to make a claim for indemnification it shall notify the seller of the matter buyer has determined gives rise to a right of indemnification within thirty days of such determination; (v) if a third party asserts a claim against buyer with respect to which seller may have indemnification liability, buyer shall notify seller within thirty days of such third party claim; (vi) failure to notify seller of such third party claim within thirty days does not relieve seller of its obligation to indemnify, except to the extent seller is prejudiced by such failure; (vii) if seller wishes to defend such third party claim, it shall notify buyer within thirty days of receiving buyer's notice of the third party claim; (viii) prior to receiving timely notice from seller of its desire to defend the claim, buyer shall defend such third party claim in any manner it sees fit and shall not make any admission of liability or settle such claim without the prior written consent of seller; (ix) without the prior consent of the indemnified person (which may not be unreasonably withheld), the indemnifying party may not make any admission of liability or settle or compromise certain third party claims; (x) without the prior written consent of the indemnifying party (which may not be unreasonably withheld), the indemnified party may not make any admission of liability or settle or compromise certain third party claims; and (xi) except for fraud, the indemnification provisions in Article 9 are the exclusive remedy of buyer for any misrepresentation of seller in the SPA.

It is uncontested that plaintiff (buyer) notified defendant (seller) of its claim for indemnification with respect to the alleged breaches of representations and warranties referred to above on August 12, 2008, well prior to the twelve month anniversary of the closing date. However, much had transpired before then.

According to plaintiff, shortly after the closing under the SPA, it discovered that a litigation matter of which it had notice before the closing date, and a litigation matter of which it was unaware on the closing date, turned out to be far more serious than plaintiff had been led to believe by defendant's representations and warranties. In fact, in its view, its litigation position was so poor that trial (which was imminent) of the matter of which it had knowledge before the closing date would risk a judgment so onerous that it might bankrupt the plaintiff. Consequently, it settled such matter and, as part of its litigation strategy, the second matter, for an aggregate amount in excess of \$9,000,000. It did not give defendant prior notice of such developments or of its plans to settle. It did not seek defendant's consent prior to settlement. Neither did it give defendant an opportunity to participate in, or to assume the defense of, such claims. As noted, it has now asserted claims against defendant arising out of such litigation matters under the indemnification provisions of the SPA.

For purposes of this opinion, the court has assumed that plaintiff's allegations of misrepresentations on the part of the defendant are correct and that plaintiff, indeed, is entitled to indemnification by defendant if plaintiff meaningfully complied with the indemnification procedures in Article 9. Whether or not it did so, is the question before this court. For the reasons set forth below, the court is of the opinion that plaintiff did not comply in a meaningful way with the indemnification provisions of Article 9, that defendant was materially prejudiced by

such failure on the part of plaintiff and, consequently, defendant's motion to dismiss the FAC in its entirety pursuant to CPLR 3211 (a)(1) is granted.

Discussion

On a motion to dismiss pursuant to CPLR 3211, the court should liberally construe the complaint. *See 511 West 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144, 152 (2002). This court must "accept the facts as alleged in the complaint as true [and] accord Plaintiffs the benefit of every possible favorable inference." *Leon v Martinez*, 84 NY2d 83, 87 (1994). Plaintiff's motion must be denied if from the pleadings' "four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Polonetsky v Better Homes Depot, Inc.*, 97 NY2d 46, 54 (2001). Dismissal under CPLR 3211 (a) is warranted "only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Leon*, 84 NY2d at 88.

The court concludes that pursuant to the terms of Article 9, plaintiff was required to notify defendant of third party claims with respect to which it determined it would make a claim for indemnification within thirty days of such determination. It simply did not do this. Rather, it contends it was not required to do so in the circumstances, as defendant already was aware of such claims and their serious nature. Further, argues plaintiff, it is uncontested that it did notify defendant on August 12, 2008, well within the one-year period of Article 9 referred to above. This, plaintiff asserts, is sufficient, because the requirement that it notify defendant within 30 days does not relieve defendant of its indemnification obligations except to the extent defendant is prejudiced by a failure to do so. In any event, plaintiff argues that *Steinbach v Aetna*

Co. & Sur. Co., 81 AD2d 382, 89 (1st Dept 1981) is clear precedent for the proposition that whether notice provisions have been complied with remains a question of fact for the trial court.

With regard to whether plaintiff was prejudiced by this failure to notify within 30 days, plaintiff points to defendant's indemnification liability being capped at \$9,000,000 and asserts that defendant could not have settled the cases for an amount less than this sum. Again, it contends, at a minimum, that whether or not there thus was prejudice to defendant is a factual matter which prevents granting plaintiff's motion to dismiss.

First, the court disagrees with plaintiff's position that plaintiff's failure to notify defendant within 30 days did not prejudice defendant, as it finds that, on the basis of the documents submitted to the court, there is no colorable question of fact in this regard. The court does not find the precedent cited by plaintiff, including *In re Brandon*, 97 NY2d 491 (2002), to be persuasive on this point. When plaintiff determined to make a claim for indemnification with respect to the third party claims at issue here, it had an obligation to notify defendant and permit defendant to participate in, or assume, the defense of the claims. Plaintiff's argument that the meaning of the contract in this regard is ambiguous and must be left to a trier of fact is unpersuasive. If plaintiff wanted to be indemnified, it was unquestionably not permitted to settle the litigations, which it characterizes as containing a substantial bankruptcy risk, without notifying defendant and affording defendant the opportunity to structure litigation strategy in an attempt to minimize loss. Its conclusory allegation that defendant could not have settled the claims for less than \$9,000,000 is thus untested and cannot be accepted.

Next, plaintiff posits that because consent to the settlements could not be unreasonably withheld, there is at least a question of fact as to whether plaintiff's option to settle without

consent, or even notice that it was going to settle, deprives plaintiff of its right to indemnity. The court sees no issue of fact in this regard. The terms of the contract are clear. There is no ambiguity. Thus, it is properly for the court to rule on this point. *See Vigilant Ins. Co. v Bear Stearns Co.*, 10 NY3d 170 (2008); *Goldman v Metropolitan Life Ins. Co.*, 5 NY3d 561 (2005). It simply is not permissible for plaintiff to completely deprive defendant of its negotiated contractual rights to participate in, or assume, the defense of a claim by failing to notify defendant of the claim, then settling it without defendant's consent, and then still seeking to assert a viable claim for indemnification. *Nat'l Fuel Dist. Corp. v Hartford Fire Ins. Co.*, 28 AD3d 4th Dept (2006). There is no colorable question of fact raised by plaintiff's contention that defendant, had it been alerted to the situation, would thus have been required to give its consent to the settlement. Such a notice provision is inserted in a contract to prevent an indemnitor from blocking a reasonable settlement, not to provide a basis for litigation when the indemnitee has ignored the essential provisions of the indemnity. Defendant was materially and severely prejudiced by plaintiff's behavior as far as the indemnification procedures are concerned.

Plaintiff's elaboration that it was not necessary to obtain defendant's consent because the situation demanded settlement to avoid a tragic financial result and its consent could not have been unreasonably withheld in any event also is without merit. *See Vigilant* at 110. It is premised upon the flawed assumption that plaintiff had more insights and capabilities with respect to litigation matters than did defendant. And, further, that it had the right to act on this assumption. Plaintiff's reliance on *Cellular Tel. Co. v 210 East 86th St. Corp.*, 14 AD3d 305 (1st Dept 2005) in this respect is misplaced.

Defendant was denuded of its litigation rights by plaintiff's unbridled behavior. It was severely prejudiced by plaintiff's actions. Plaintiff asserts that prejudice in this respect is a question of fact which precludes dismissal of the FAC. This assertion misreads the SPA. Lack of 30-day notice with respect to an assertion of indemnity does not defeat the right to indemnity if prejudice does not result therefrom. Failure to obtain consent to a litigation settlement has no such qualification. In effect, settlement without giving the required notice and requesting consent to settle constitutes a waiver of any indemnification rights with respect to the settled litigation. No other result can be reasonably obtained. *Argo Corp. v Greater New York Mut. Ins. Co.*, 4 NY3d 332 (2005).

Plaintiff's entire argument can be distilled to an assertion that it did the best possible job in the circumstances, or at least, it remains a question of fact whether it did so. Perhaps plaintiff did do the best possible job. That is not the point. The point is defendant had a right to try and do *its* best possible job, if it was to be an indemnitor responsible for damages. There is no other reasonable interpretation of the SPA. *Houdestadt v Interboro Mut. Indem. Ins. Co.*, 135 AD2d 783 (2nd Dept 1987).

There is ample precedent for this. As defendant points out, the plaintiff's right to indemnification with respect to third party claims is contingent upon observation of the terms of Section 9.05 of the SPA. Express conditions must be "literally performed." *MHR Capital Partners LP v Presstetz*, 12 NY3d 640, 645 (2009). As plaintiff did not comply with these express conditions, its warranty and contract claims are properly dismissed as a matter of law. *See MHR Capital*, 12 NY3d at 646. *See also Preferred Mortgage Brokers, Inc. v Byfield*, 282 AD2d 589, 590 (2d Dept 2001).

Plaintiff's contention that there are material issues of fact with respect to whether adequate notice was given to defendant because it is uncontested that defendant knew of the litigation claims before closing under the SPA also is flawed. *See Liberty Moving & Storage Co. v Westport Ins. Corp.*, 55 AD3d 1014 (3d Dept 2008). First, the notice provision was contained in the SPA, and as in many similar transaction contracts, was intended to afford defendant the opportunity to decide whether to participate in the litigation or assume the defense thereof. This decision necessarily is contingent upon knowing whether or not plaintiff is going to assert indemnification rights with respect to the litigation. Otherwise, defendant would be forced to step forward immediately after the closing of the transaction and involve itself in the defense of all litigations extant at the closing, whether active or dormant. This renders the sale of the company almost a nullity with respect to such extant, or even threatened, litigation matters. An interpretation such as this, as a matter of law, is not tenable.

The 30-day notice provision, as interpreted by plaintiff, would turn the SPA into a guessing game as to which litigations would involve third party claims for which buyers would seek indemnity. There would be no way of predicting where litigation assets of buyers or sellers should be deployed or who, in fact, was in charge of the given litigation (unless, of course, a seller immediately delivered a notice to the effect that it was stepping into a position of authority and responsibility with respect to all extant or threatened litigations). No party would benefit from such inefficiency. This cannot be the goal of well crafted transaction documents.

Additionally, plaintiff's interpretation of Article 9 would convert each situation involving a settlement without notice into a contested litigation over whether or not seller had, in fact, been prejudiced by such settlement. The contract was not drafted by sophisticated counsel to compel

such a result. Rather, the only reasonable interpretation of the contract is that settlement without notice and, obviously, consent, constitutes severe prejudice to the seller. *Chrysler First Fin. Servs. Corp. v Chicago Title Ins. Co.*, 226 AD2d 183 (1st Dept 1996); *Melhado v Catsimatidis*, 182 AD2d 576 (1st Dept 1992). Such is the case here. Otherwise, litigation over this point would be inherent in the contract, a result clearly unintended by the parties.

Finally, plaintiff attempts to excuse its failure to obtain the consent of defendant prior to settling the third party claims at issue here by reading the language of Section 9.05(e) of the SPA in a convoluted and untenable manner. Taking the language of the first sentence thereof to restrict the indemnifying party from settling certain claims involving potentially significant exposure of the indemnified person without the indemnified person's consent, it then turns the parallel language of the second sentence thereof on its head to permit the indemnified person to settle claims involving potentially significant exposure of the indemnifying party without the indemnifying party's consent.

This is not the plain, unambiguous meaning of the contract. The class of claims enumerated in the first sentence of Section 9.05(e) are referred to in the second sentence of Section 9.05(e). These are claims involving potentially significant exposure to the relevant party. Such claims could not be settled without the consent of the indemnified person, in the first instance, or the indemnifying person, in the second instance. In the matter at hand, the indemnified person settled such claims without the consent of the indemnifying person, in clear violation of Section 9.05(e) of the SPA. To read the second sentence in the manner plaintiff advocates would be to distort the meaning of the SPA so as to make the provisions thereof internally inconsistent. The first sentence of Section 9.05(e) would be interpreted to protect the

indemnified person from settlements which could expose it to significant loss or damage but the second sentence would be interpreted so as *not* to protect the indemnifying party from similar settlements which would expose it to significant loss or damage. The court does not agree with this interpretation and finds that plaintiff's settlement of the claims against it without notice or defendant's consent was a clear violation of the SPA which deprives it of the right to pursue defendant for indemnification at this point.

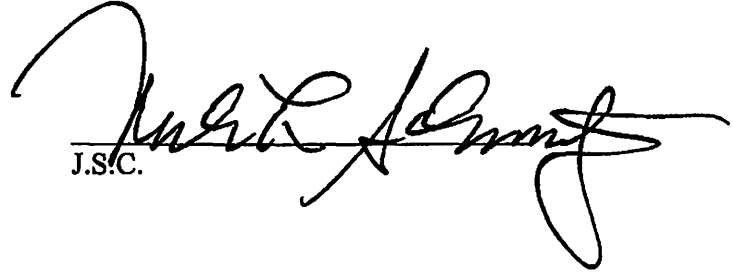
The claims settled by plaintiff, according to plaintiff's own submissions to the court, were of such magnitude that failure to settle them threatened plaintiff with bankruptcy. Such claims surely were not fully covered by defendant's indemnification, which was limited to \$9,000,000. As such, they were the type of claim which the first sentence of 9.05(e) prevented the indemnifying party from settling without the consent of the indemnified party. Similarly, they were precisely the class of claims the second sentence of 9.05(e), even read narrowly, prevented the indemnified party from settling without the indemnifying parties consent. Given a sensible reading, which plaintiff opposes, the second sentence of 9.05(e) prevents the indemnified party from settling *any* claim without the indemnifying parties consent. This is so, because the indemnifying party becomes liable for any such settlement, up to \$9,000,000. Under either interpretation, plaintiff was not entitled to settle the cases at issue here without notice to and the consent of defendant and retain a viable claim for indemnification.

Accordingly, it is

ORDERED that defendant's motion to dismiss the First Amended Complaint pursuant to CPLR 3211 (a)(1) is granted with costs and disbursements to defendant as taxed by the Clerk upon submission of an appropriate bill of costs.

Dated: August 31, 2010

ENTER:


J.S.C.