[* 1]

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

PRESENT: HON. DORIS LING-COHAN PART 36

Justice

Pavonix, Inc. et al.

- v -

Sumtotal Systems, Inc. et al.

INDEX NO. 106511/2011

MOTION DATE

MOTION SEQ. NO. 001

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 ... Petition + Petition	1, 2
Answering Affidavits — Exhibits	5
Replying Affidavits	6
~~Cross~~-Motion: ☑ Yes ☐ No (to Dismiss)	3, 4

Upon the foregoing papers, it is ordered that this motion petition + motion to dismiss are decided in accordance with the attached memorandum decision. (Denied as moot/petition dismissed).

UNFILED JUDGMENT

This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).

Dated: 5/25/11

HON. DORIS LING-COHAN 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

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 36

PAVONIX, INC. (f/k/a SOFTSCAPE, INC.), PAVONIX (MASSACHUSETTS), Inc. (f/k/a SOFTSCAPE (MASS), INC.), PAVONIX ASIA LIMITED (f/k/a SOFTSCAPE ASIA LTD.), PAVONIX ASIA PACIFIC PTY LTD. (f/k/a SOFTSCAPE ASIA PACIFIC PTY LTD.) and PAVONIX EMEA, LTD. (f/k/a SOFTSCAPE EMEA, LTD.), HENRY WATKINS, DAVID WATKINS, and RICHARD WATKINS,

Petitioners,

-against-

SUMTOTAL SYSTEMS, INC., SOFTSCAPE SOFTWARE LLC, SUMTOTAL SYSTEMS ANZ PTY LTD., SUMTOTAL SYSTEMS LTD. and SUMTOTAL SYSTEMS U.K. LTD.,

Respondents.

INDEX NUMBER 101651/2011
Motion Sequence 001 & 002
DECISION & JUDGMENT

DORIS LING-COHAN, J.:

Motion sequence numbers 001 and 002 are hereby consolidated for disposition.

Petitioners Pavonix, Inc. (f/k/a Softscape, Inc.), Pavonix (Massachusetts), Inc. (f/k/a Softscape (Mass), Inc.), Pavonix Asia Limited (f/k/a Softscape Asia Ltd.), Pavonix Asia Pacific Pty Ltd. (f/k/a Softscape Asia Pacific Pty Ltd.) and Pavonix EMEA, Ltd. (f/k/a Softscape EMEA, Ltd.), Henry Watkins, David Watkins, and Richard Watkins (Sellers) petition this court for a judgment requiring respondents SumTotal Systems, Inc., Softscape Software LLC, SumTotal Systems ANZ Pty Ltd., SumTotal Systems Ltd. and SumTotal Systems U.K. Ltd. (Buyers) to provide certain information pertaining to the parties' Asset Purchase Agreement (the Agreement), and to participate in arbitration procedures concerning the Agreement (Mot. Seq. 001). Buyers have moved to dismiss the petition (Mot. Seq. 002).

The issue before the court is whether the agreement required arbitration.

Factual Background

The parties executed the Agreement as of August 31, 2010. Ex. B attached to Mot. Seq. 002. It provided for the sale of Softscape, Inc. (Softscape) and its affiliates by Sellers to Buyers. The transaction closed on September 17, 2010, and Buyers assumed control and operation of Softscape.

Relevant portions of the Agreement are summarized as follows:

- Section 2.5 (a) – In advance of the closing date, Sellers will provide a "good faith estimate of the estimated Net Working Capital" of Softscape, calculated as of the day before the scheduled closing date, "which shall be reasonably satisfactory to the Buyers." This estimate will be used to calculate the purchase price, subject to final adjustments.

- Section 2.5 (b) – Within 120 days following the closing date, Buyers will provide a statement of the actual Net Working Capital, termed the "Closing Statement."

- Section 2.5 (c) – The purchase price will be recalculated based on the Closing Statement. Any difference between the recalculated purchase price and the amount paid, according to the estimated Net Working Capital, shall result in either an additional payment by Buyers into the escrow account holding the amount paid, or a return to Buyers of the difference from the escrow account. The amount in escrow after any transfers shall be paid to Sellers.

- Section 2.5 (d) – Within 10 days of the determination of the actual purchase price, an adjusting payment of any difference between the estimated purchase price held in escrow shall be made, and then the final payment to Sellers made from escrow.

- Section 2.5 (e) – Unless Sellers object in writing "in reasonable detail," within 20 business days of receipt of the Closing Statement, it "shall be final and binding for all purposes." If Sellers timely object, the parties "shall attempt in good faith to reach an agreement as to the matter in dispute." If the parties are unable to resolve their dispute within 15 days, they will submit it to KPMG LLP (KPMG), an independent accounting firm, for "determination." KPMG "shall be given reasonable access to all of the records of the Sellers." The Closing Statement resulting from KPMG's determination shall be "final, binding and conclusive on all parties hereto."

On January 14, 2011, Buyers sent Sellers a Closing Statement (Ex. O attached to Simes Affirm.), which Sellers allege "was devoid of critical details and explanations" of Buyers'

calculations, leaving Sellers unable to understand whether Buyers' calculations comport with the Agreement's requirements. Petition, ¶ 35. Sellers claim that their efforts to gain clarification have been significantly frustrated by Buyers, and Sellers have, thus, been unable to provide a dispute notice, pursuant to Section 2.5 (e), and proceed in good faith to resolve the dispute. *Id.*, ¶ 39. Buyers' conduct, according to the petition, constitutes a breach of the Agreement. After this proceeding commenced, Sellers provided a "preliminary Dispute Notice" on February 11, 2011, which Sellers' state might lack reasonable detail because of "Buyers' own lack of cooperation." Ex. E, at 2 attached to Mot. Seq. 002.

Buyers request dismissal of the petition pursuant to CPLR 404 (a), 406 and 3211 (a) (7), on the grounds of failing to state a cause of action. On a motion to dismiss for failure to state a cause of action pursuant to CPLR 3211 (a) (7), the pleading is afforded a liberal construction. The court "accept[s] the facts as alleged in the complaint as true, accord[s] plaintiffs the benefit of every possible favorable inference, and determine[s] only whether the facts as alleged fit within any cognizable legal theory." *Leon v Martinez*, 84 NY2d 83, 87-88 (1994). However, "[i]t is well settled that bare legal conclusions and factual claims, which are either inherently incredible or flatly contradicted by documentary evidence, . . . are not presumed to be true on a motion to dismiss for legal insufficiency." *O'Donnell, Fox & Gartner, P.C. v R-2000 Corp.*, 198 AD2d 154, 154 (1st Dept 1993).

Sellers label KPMG's role, as described in Section 2.5 (e) of the Agreement, as "accounting arbitration" throughout their papers. For instance, Sellers state: "By this special proceeding, Petitioners seek to compel Respondents to participate in the accounting arbitration procedures set forth in the Asset Purchase Agreement." *Id.*, ¶ 48. Sellers request this relief pursuant to Article 75 of the CPLR, which deals with arbitration. While not referenced

specifically in the petition, CPLR 7503 provides that "[a] party aggrieved by the failure of another to arbitrate may apply for an order compelling arbitration." However, the word "arbitration" does not appear in the Agreement.

In *Matter of Penn Cent. Corp.* (82 AD2d 208, 212 [1st Dept 1981], *affd* 56 NY2d 120 [1982]), the Appellate Division found that Article 75 of the CPLR applied, although "[t]he agreement does not use the word arbitration. However, it is noted that in the parties' instructions to the escrow agent they use the word 'arbitration' to describe the panel." Subsequently, in *Vitale v Friedman*, (227 AD2d 198 [1st Dept 1996]) the Appellate Division rejected a claim for arbitration, finding that "[t]he pertinent lease provision, which refers throughout only to 'appraisers', never to 'arbitrators', was clearly intended to resolve a typical valuation dispute ." *Vitale v Friedman*, 227 AD2d 198 (1st Dept 1996). In another instance, the Appellate Division found that the parties' agreement prescribed arbitration under a different name. *Chris O'Connell, Inc. v Beacon Looms, Inc.*, 235 AD2d 248, 249 (1st Dept 1997) ("Although the parties' agreement employs the word 'mediate' rather than 'arbitrate', it does provide that '[t]he proceedings shall be conducted as the mediator directs, with written findings', that 'such findings are agreed to be enforceable in any court with jurisdiction over the [losing] party', and that '[c]osts of mediation shall be borne by the [losing] party'").

In re Delmar Box Co. (309 NY 60, 63-64 [1955]), the court discussed the differences between an appraisal and an arbitration as follows:

> "Appraisal proceedings are, moreover, attended by a larger measure of informality . . . and appraisers are not bound to the strict judicial investigation of an arbitration. Arbitrators are required to take a formal oath, and may act only upon proof adduced at a hearing of which due notice has been given to each of the parties. They may not predicate their award upon evidence garnered through an *ex parte* investigation of their own, at least unless so authorized by the parties. . . . Furthermore, in an arbitration, all the arbitrators, if there be more than one, must

meet together and hear all the allegations and proofs of the parties."

Id. at 63-64 (internal quotation marks and citations omitted).

CPLR 7601 provides for a special proceeding to enforce an agreement calling for a valuation, appraisal or other issue to be determined by a named person "as if it were an arbitration agreement," which may then be conducted under Article 75 of the CPLR. When the Court of Appeals decided *Penn Central* on appeal, it reviewed the legislative history of CPLR 7601 and found that it was not intended as an exclusive remedy: "neither was the statute designed to restrict the court's power to enforce appraisal agreements. In fact the drafters noted that it was intended to have the opposite effect of permitting the court to 'choose from a wider range of remedies' than those previously employed in such proceedings." *Matter of Penn Cent. Corp.*, 56 NY2d 120, 129 (1982) (quoting NY Legis Doc, 1960, No. 20, at 62).

The Agreement requires that the "disputed matter shall be submitted to and determined by an independent team of auditors of KPMG LLP." Ex. B attached to Mot. Seq. 002. According to Black's Law Dictionary, an audit is "a formal examination of an individual's or organization's accounting records, financial situation, or compliance with some other set of standards" Black's Law Dictionary (3d pocket ed 2006). This is not a call for arbitration -a quasi-judicial proceeding relying on testimony and argument. Thus, it would be unfair and/or inconsistent with the intent of the parties to overlay Article 75 onto Section 2.5 (e) of the Agreement. The court will examine the Agreement's dispute resolution process on its own terms without resort to Article 75.

It appears that, in the absence of precise instructions in the Agreement on the methods and procedures for the production of the Closing Statement, both sides made reasonable efforts to reach a common understanding. Sellers wrote several letters asking how and why certain

calculations were made in the January 14, 2011 Closing Statement. *See* Exs. E, F, I, L and N attached to Mot. Seq. 002. Buyers timely responded. *See* Exs. C, D, G, H, J, K and M attached to Mot. Seq. 002.

Much of what Sellers offer the court are allegations of Buyers' lack of good faith. The petition describes Buyers' conduct as follows:

> "denying and delaying . . . stonewalled . . . provided incomplete or inadequate information . . . information was incomplete and far less than what the Sellers requested . . . avoided the Sellers' attempts to set up a meeting . . . continue to refuse to provide critical evidentiary support . . . refused to provide other relevant information, permit personnel to answer questions or even allow the Sellers to copy necessary documents . . . continue to refuse to provide other key categories of documents . . . stalling and delaying . . . refusing to engage in good faith to discuss . . . improperly denying the Sellers the necessary information."

Sellers contend that they merely seek information "in order to discharge the Sellers' obligations to (a) provide a 'Dispute Notice' with an appropriate level of detail and (b) discuss the dispute with the Buyers in 'good faith.'" Petition, ¶ 39. While all of the formalities for positing the dispute may not have been met, the parties are now beyond this stage in the process of arriving at a final Closing Statement and, in fact, Sellers have provided a Dispute Notice, dated February 11, 2011. Buyers did "not object[] to the level of detail the Dispute Notice provided" (Fotiades Affirm., ¶ 19), thereby framing the dispute under the terms of Section 2.5 (e) of the Agreement.

It is evident that the dispute between the parties has reached the latter stage of the process identified in Section 2.5 (e), that is, submission to KPMG, an independent accounting firm, which "shall be given reasonable access to all of the records of the Sellers." This is, in fact, one form of the relief asked for in the petition, although mislabeled, that is, "Buyers [shall] participate in the accounting arbitration procedures set forth in Section 2.5 of the Asset Purchase Agreement." Buyers agree that "this dispute must be resolved by KPMG." Respondents'

memorandum of Law, at 11. Under these circumstances, the petition is denied as moot, as is Buyers' motion to dismiss, since both parties agree that the issues raised herein are to be resolved by KPMG ; the parties are encouraged to proceed expeditiously.

Accordingly it is,

ADJUDGED that the petition is denied as moot (Mot. Seq. 001), Buyer's motion is denied as moot (Mot. Seq. 002), and the proceeding is dismissed; and it if further

ORDERED that within 30 days of entry of this order, respondents shall serve a copy upon petitioners with notice of entry.

DATED: **May 25, 2011**

Doris Ling-Cohan, J.S.C.

J:\Arbitration-ADR\Pavonix v Sumtotal.alan gotthelf.wpd

UNFILED JUDGMENT

This judgment has not been entered by the County Clerk and notice of entry cannot be served based hereon. To obtain entry, counsel or authorized representative must appear in person at the Judgment Clerk's Desk (Room 141B).