Blue Sage Capital, LP v Alfa Laval U.S.Holding, Inc.
2016 NY Slip Op 31285(U)
July 7, 2016
Supreme Court, New York County
Docket Number: 650413/2014
Judge: Marcy Friedman
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy Friedman, J.S.C.

BLUE SAGE CAPITAL, LP, as Sellers' Representative,

Plaintiff,

– against –

ALFA LAVAL U.S. HOLDING, INC.,

Defendant.

DECISION/ORDER

Index No.: 650413/2014

This breach of contract action arises out of the sale of Ashbrook Simon-Hartley, LP and Ashbrook Simon Hartley GP, LLC (Ashbrook or the Ashbrook Companies), a wastewater treatment business, by sellers represented by plaintiff Blue Sage Capital, LP (Blue Sage or Sellers) to defendant Alfa Laval U.S. Holding, Inc. (Alfa Laval or Buyer). Alfa Laval and Blue Sage each move for summary judgment "with respect to the Amended Complaint." (Blue Sage and Alfa Laval Notices of Motion, Opening ¶.) Each motion addresses Blue Sage's entitlement to payment from Alfa Laval of the Earnout component of the purchase price.

The following material facts are undisputed. Alfa Laval purchased Ashbrook from Sellers pursuant to a Purchase Agreement (PA), dated July 31, 2012. (Joint Statement of Facts [Joint Statement], ¶¶ 1-3.) Pursuant to the Purchase Agreement, Alfa Laval provided a cash payment of $31 million to Sellers, and placed $6 million into an "Indemnity Escrow." (Id., ¶¶ 4-5, PA § 2.1 [a], [c].) The Earnout was the final component of the purchase price. Purchase Agreement § 2.1 (d) provided for the contingent payment of up to $8 million under an Earnout structure, "based on the financial performance of the Ashbrook Companies in accordance with

the earnout provisions set forth in Sections 2.3 and 2.4." (See Joint Statement, ¶ 6.) No Earnout Payment has been made. (Id.)

Purchase Agreement § 2.3 (a) set forth the formula for calculation of the Earnout Payment for Earnout Period One (which ended December 31, 2012) as follows:

> (a) Four Million Dollars ($4,000,000), if the Adjusted Earnout EBIT for Earnout Period One is equal to or greater than $6,439,785 ("Earnout Period One Target"). If the Earnout Period One Target is not achieved, but Adjusted Earnout EBIT is greater than $4,400,000 (the "Earnout Period One Threshold"), then the Earnout Payment will be equal to Four Million Dollars ($4,000,000) multiplied by a fraction, the numerator of which is equal to Adjusted Earnout EBIT for Earnout Period One minus the Earnout Period Threshold, and the denominator of which is equal to the Earnout Period One Target minus the Earnout Period One Threshold.

The separate formula for Earnout Period Two (which ended December 31, 2013), set forth in § 2.3 (b), provided as follows:

> (b) Four Million Dollars ($4,000,000), if the Adjusted Earnout EBIT for Earnout Period Two is equal to or greater than $8,000,000 ("Earnout Period Two Target"). If the Earnout Period Two Target is not achieved, but the Adjusted Earnout EBIT for such period is greater than the Adjusted Earnout EBIT for Earnout Period One, then the Earnout Payment will be equal to Four Million Dollars ($4,000,000) multiplied by a fraction, the numerator of which is equal to Adjusted Earnout EBIT for Earnout Period Two minus the Adjusted Earnout EBIT for Earnout Period One, and the denominator of which is equal to the Earnout Period Two Target minus the Adjusted Earnout EBIT for Earnout Period One.

Notably, the second formula differed from the first in that it did not set a threshold for Period Two. Under this formula (subject to a cap), the larger the increase in the Adjusted Earnout EBIT between Period One and Period Two, the larger the Earnout Payment in Period Two.

The Adjusted Earnout EBIT was defined as "the consolidated earnings from operations of the Ashbrook Companies for an Earnout Period before interest and income taxes determined in

utilizing the accounting practices, principles, methodologies and procedures used in the preparation of the Historical Financials." (PA, Annex A, Definitions.) This definition also identified certain expenses, revenues, losses, and profits, and stated whether they were or were not to be included in the calculation. (Id.)

The Purchase Agreement further required Alfa Laval to set forth its calculations for each Earnout Period in an Earnout Statement, to be provided to Blue Sage after the close of the period, but no later than March 31 of the next calendar year. (PA § 2.4 [a].) The Earnout Statement was defined as an "unaudited, consolidated statement of income for the Ashbrook Companies for the Earnout Period . . . which shall be prepared in accordance with GAAP utilizing the accounting practices, principles, methodologies and procedures used in the preparation of the Historical Financials . . . ." (Id.)

The Amended Complaint alleges that Alfa Laval breached the Purchase Agreement by various acts that "depriv[ed]" Blue Sage of Earnout Payments, including the failure to provide Blue Sage with Earnout Statements. (Am. Compl. ¶¶ 85-89.)

Alfa Laval's Motion

In support of its motion for summary judgment, Alfa Laval contends that the only commercially reasonable interpretation of Purchase Agreement § 2.3, the Earnout provision, is that it requires payment of an Earnout only if Alfa Laval realizes a profit or gain. (Alfa Laval Memo. In Support at 18-23.) In support of this contention, Alfa Laval argues that "both the definition of 'earnout' and the universal purpose underlying such arrangements establish that an essential prerequisite to any earnout payment based on financial targets is that the acquired business is making more money than expected, not that it is operating at a loss." (Id. at 22.) According to Alfa Laval, as Ashbrook was operating at a loss during the two Earnout Periods, no

Earnout Payment is due. Blue Sage responds that "the Earnout is specifically structured to provide for an Earnout Payment during Earnout Period Two as long as there is improvement in the financial performance of Ashbrook between Earnout Period One and Earnout Period Two." (Blue Sage Memo. In Opp. at 9.) It further argues that there is no threshold for Earnout Period Two and that the Earnout is due because there was such an improvement. (Id. at 9-10.)

The standards for summary judgment are well settled. The movant must tender evidence, by proof in admissible form, to establish the cause of action "sufficiently to warrant the court as a matter of law in directing judgment." (CPLR 3212[b]; Zuckerman v City of New York, 49 NY2d 557, 562 [1980].) "Failure to make such showing requires denial of the motion, regardless of the sufficiency of the opposing papers." (Winegrad v New York Univ. Med. Ctr., 64 NY2d 851, 853 [1985].) Once such proof has been offered to defeat summary judgment "the opposing party must 'show facts sufficient to require a trial of any issue of fact' (CPLR 3212, subd. [b].)" (Zuckerman, 49 NY2d at 562.)

Under settled principles of contract interpretation, "when parties set down their agreement in a clear, complete document, their writing should as a rule be enforced according to its terms. Evidence outside the four corners of the document as to what was really intended but unstated or misstated is generally inadmissible to add to or vary the writing." (W.W.W. Assocs., Inc. v Giancontieri, 77 NY2d 157, 162 [1990]; accord Vermont Teddy Bear Co. v 538 Madison Realty Co., 1 NY3d 470, 475 [2004].) Where an instrument "was negotiated between sophisticated, counseled business people negotiating at arm's length . . . , courts should be extremely reluctant to interpret an agreement as impliedly stating something which the parties have neglected to specifically include. Hence, courts may not by construction add or excise terms, nor distort the meaning of those used and thereby make a new contract for the parties

under the guise of interpreting the writing." (Vermont Teddy Bear Co., 1 NY3d at 475 [internal quotation marks and citations omitted]; accord ACE Secs. Corp. v DB Structured Prods., 25 NY3d 581, 597 [2015]; see Schron v Troutman Sanders LLP, 20 NY3d 430, 437 [2013].)

The determination of whether a contract is ambiguous is one of law to be resolved by the court. (Matter of Wallace v 600 Partners Co., 86 NY2d 543, 548 [1995]; W.W.W. Assocs., Inc., 77 NY2d at 162.) The court should determine from contractual language, without regard to extrinsic evidence, whether there is any ambiguity. (Chimart Assocs. v Paul, 66 NY2d 570, 573 [1986].) In determining whether a contract is ambiguous the "initial question . . . is whether the agreement on its face is reasonably susceptible of more than one interpretation." (Id.; Nausch v Aon Corp., 283 AD2d 353, 353 [1st Dept 2001].)

The court holds that Purchase Agreement § 2.3 unambiguously set forth a specific basis for calculation of the Earnout Payment. This section required the Earnout Payment to be calculated based on "Adjusted Earnout EBIT" for each of the two Earnout Periods. (PA § 2.3 [a], [b].) As noted above (supra at 3), Purchase Agreement § 2.4 required an Earnout Statement to be provided by Alfa Laval and set forth specific requirements for the preparation of the Earnout Statement. The Purchase Agreement also contained a detailed definition of Adjusted Earnout EBIT.

In the document entitled "Earnout Statement – Earnout Period Two," provided by Alfa Laval to Blue Sage on March 31, 2014, Alfa Laval reported the "Adjusted EBIT" for 2012 (Earnout Period One) as negative $4,227,796, and for 2013 (Earnout Period Two) as negative $977,482. (Simes Aff. in Support of Alfa Laval Motion, Ex. 1.) The document further stated that "[b]ased on our interpretation of the [Purchase Agreement], and the clear intent of the parties, since the Adjusted Earnout EBIT was less than the Earnout Period One Threshold for

both Earnout Period One and Earnout Period Two (in fact, the Adjusted Earnout EBIT was negative for both periods), no Earnout Payment is due for Earnout Period Two." (Id.) Alfa Laval acknowledges that applying the formula set forth in Purchase Agreement § 2.3 to the negative Adjusted Earnout EBIT numbers Alfa Laval itself reported, a payment would be due of $1,063,254 for Earnout Period Two. (Alfa Laval Memo. In Support at 6-7.)

In claiming that the negative Adjusted Earnout EBIT cannot support an Earnout Payment, Alfa Laval argues that "[t]he PA defines 'Adjusted Earnout EBIT' as consolidated earnings from operations of . . . Ashbrook . . . ." (Alfa Laval Memo. In Support at 4, n 3 [emphasis Alfa Laval's].) Alfa Laval then argues that earnings means profits, and not losses. (Id. at 22.) As support for these contentions, Alfa Laval cites treatises or dictionaries and cases that discuss Earnouts based on profits. (See e.g. Highland Capital Management LP v Schneider, 8 NY3d 406, 408 n 1 [2007] [considering an earnout based on acquired company's "profitability, not its sales"]; Black's Law Dictionary [10th ed online 2014], compare "earnout agreement" ["An agreement for the sale of a business whereby the buyer first pays an agreed amount up front, leaving the final purchase price to be determined by the business's future profits"] with "earnout" ["A payment contingent on the occurrence of a future event; esp., a payment by a buyer to a seller contingent on the business being sold meeting or exceeding sales or earnings goals. – An earnout provision in a merger or acquisition reduces the buyer's risk because part of the purchase price is paid in the future based on the earnings or performance of the business"].)

Alfa Laval does not cite any case that an Earnout may not be based on an improvement in EBIT. Moreover, as noted above, Alfa Laval itself reported negative Adjusted Earnout EBIT for the two Earnout Periods.

Alfa Laval in effect contends that the court should ignore the express terms of the formula adopted by the parties for calculating the Earnout Payments. Had these extremely sophisticated entities wished to set a threshold for Earnout Period Two, however, they could have done so, as they did for the first Earnout Period. They could also have provided for Earnout Payments only if Ashbrook earned a profit during the Earnout Periods. The court may not, under the guise of contract interpretation, rewrite the contract. (See Vermont Teddy Bear Co., 1 NY3d at 475.)

Alfa Laval also argues that interpretation of the Purchase Agreement to provide for Earnout Payments based on negative Adjusted Earnout EBIT would produce a commercially unreasonable result. As the Court of Appeals has recently held, "an inquiry into commercial reasonableness is only warranted where a contract is ambiguous." (Fundamental Long Term Care Holdings, LLC v Cammeby's Funding LLC, 20 NY3d 438, 445 [2013].) Here, as held above, the Purchase Agreement is not ambiguous. In any event, the court does not find that a reading of Purchase Agreement § 2.3 to authorize an Earnout Payment based on application of the formula provided in that section is commercially unreasonable. It is not implausible that the parties would have provided for an Earnout Payment where there was an incremental improvement in Ashbrook's financial performance between the two Earnout Periods, even if there were not also profits.

Finally, Alfa Laval argues that after interpreting Purchase Agreement § 2.3, the court should dismiss this action, and that any remaining disputes concerning the Earnout should be resolved by an independent accountant. (Alfa Laval Memo. In Support at 9.) Purchase Agreement § 2.4 establishes a procedure for reference of disputes regarding Earnout Statements to an independent accountant. Significantly, however, Alfa Laval chose to seek a judicial

determination as to the proper interpretation of the Earnout provision. In the arbitration context, it is well settled that a party's "affirmative acceptance of the judicial forum" will result in waiver of the right to arbitrate. (De Sapio v Kohlmeyer, 35 NY2d 402, 405 [1974].) Alfa Laval cites no authority that the same result should not obtain given its affirmative resort to the court. Moreover, this action is properly before this court pursuant to Purchase Agreement § 8.9, which provides for the parties' submission to the jurisdiction of the New York courts for "[a]ny suit, action or proceeding arising with respect to the validity, construction, enforcement or interpretation of this Agreement. . . ."

Alfa Laval's motion will accordingly be denied in its entirety.

Blue Sage's Motion

On its motion for summary judgment, Blue Sage contends that "Alfa Laval never provided [Blue Sage] with a proper Earnout Statement," and thereby "made it impossible for [Blue Sage] to obtain their $8 million Earnout." (Blue Sage Memo. In Support at 6-7.) More particularly, Blue Sage contends that "Alfa Laval never provided Sellers with a proper Earnout Statement . . . an act which Alfa Laval has used to forever prevent Sellers from evaluating the financial performance of Ashbrook . . . , and from obtaining their $8 million Earnout." (Id. at 6-7.) Blue Sage further argues that Alfa Laval "cannot use its own prevention of a condition precedent to a contingent payment as a basis for refusing to make such payment," and that it is therefore entitled to the maximum $8 million Earnout Payment provided for in Purchase Agreement § 2.3. (Id. at 6.)

Even assuming arguendo that the prevention doctrine applies under these circumstances, Blue Sage fails to submit evidence that eliminates triable issues of fact as to whether Alfa Laval provided Earnout Statements that met the requirements of Purchase Agreement § 2.4.

For example, Blue Sage claims that Joseph Lawrence, Alfa Laval's Vice President and Controller, admitted that a document provided by Alfa Laval for Earnout Period Two was not an income statement and therefore was not a proper Earnout Statement. (Lawrence Dep. at 59-60.) Blue Sage also claims that Lawrence admitted that Alfa Laval was unable to provide proper Earnout Statements because it did not know how Alfa Laval had kept its books and records. (Id. at 298-299.) In response, Alfa Laval cites Lawrence's testimony that he relied, for assistance with the preparation of the first Earnout Statement, on Jeffrey Smith, who was an owner of Ashbrook and was an employee of Alfa Laval after the merger until he was terminated. (Id. at 298.) Alfa Laval also cites Lawrence's testimony that he believed that Alfa Laval did provide the required information (id. at 55), although he had concerns about preparation of the Statement after Smith's departure because Smith had knowledge of Ashbrook's books. (Id. at 299.) Lawrence's testimony presents issues of credibility which are not properly determined on a motion for summary judgment. (See Capelin Assoc. v Globe Mfg. Corp., 34 NY2d 338, 341 [1974].)

Blue Sage's claim that Lawrence admitted that an Earnout Statement was not an income statement, and therefore failed to satisfy Purchase Agreement § 2.4, is also not established on this record. Lawrence testified that a document entitled "Calculation of Adjusted EBIT for Earnout Statement" was not an income statement. (Lawrence Dep. at 59-60.) However, this document (Simes Aff. In Support of Alfa Laval Motion, Ex. 1) was transmitted by cover letter dated March 31, 2014. Alfa Laval submits evidence that it was followed by consolidated financial statements for 2012 and 2013. (Id., Ex. 4; see also Ex. 15.)

Smith's affidavit, on which Blue Sage also relies, asserts that Alfa Laval could not account for the performance of the Ashbrook Companies because it had destroyed their structure

and accounting; that the Earnout Statements provided by Alfa Laval were not proper; and that Alfa Laval's counsel and unidentified others at Alfa Laval admitted that their Earnout Statements did not meet the contractual requirements for an Earnout Statement. (Smith Aff., sworn to on Oct. 2, 2015, In Opp. to Alfa Laval Motion ¶¶ 2-11.) Like Lawrence's testimony, this affidavit presents issues of credibility.

In sum, triable issues of fact exist as to the sufficiency of the Earnout Statements (Simes Aff. in Support of Alfa Laval Motion, Exs. 1, 4, 15) that Alfa Laval provided – albeit, after the deadlines set forth in Purchase Agreement § 2.4. Blue Sage's motion for summary judgment will accordingly be denied. The court makes no finding as to the extent of the damages to which Blue Sage will be entitled if it prevails on its claim for an Earnout, as this damages issue was not adequately briefed on the motion. Nor does the court make any finding as to whether Blue Sage's Earnout claim may be based on breaches other than the alleged failure to provide proper Earnout Statements, as this motion was not based on such other breaches.

It is hereby ORDERED that the motion of plaintiff Blue Sage Capital, LP for summary judgment is denied; and it is further

ORDERED that motion of defendant Alfa Laval U.S. Holding, Inc. is denied.

This constitutes the decision and order of the court.

Dated: New York, New York
July 7, 2016

MARCY FRIEDMAN, J.S.C.