

BD Capital Partners Ltd. v EBIX, Inc.

2022 NY Slip Op 31951(U)

June 21, 2022

Supreme Court, New York County

Docket Number: Index No. 651362/2021

Judge: Joel M. Cohen

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SUPREME COURT OF THE STATE OF NEW YORK
 COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 03M

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BD CAPITAL PARTNERS LTD.,	INDEX NO. <u>651362/2021</u>
Plaintiff,	MOTION DATE <u>N/A</u>
- v -	MOTION SEQ. NO. <u>001</u>
EBIX, INC., EBIX FINCORP EXCHANGE PTE LTD., CENTRUMDIRECT LIMITED	
Defendants.	DECISION + ORDER ON MOTION
-----X	

HON. JOEL M. COHEN:

The following e-filed documents, listed by NYSCEF document number (Motion 001) 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16
 were read on this motion to DISMISS.

This case arises out of a disputed financial statement used to compute “Earnout Amounts” under a Stock Purchase Agreement (“SPA”). The threshold question raised by this motion is whether, under the terms of the parties’ contract, the dispute is properly before this Court.

BACKGROUND

In 2018, Plaintiff BD Capital Partners Ltd (“BD Capital”) sold all of the shares in a software development company (the “Company”) to Defendants (Compl. ¶ 1 [NYSCEF 1]).¹ As part of the sale, BD Capital negotiated the right to receive “Earnout Amounts,” as defined in the SPA, if the Company hit certain Revenue and EBITDA targets during relevant periods (*id.* ¶¶ 3, 27). To set the Earnout Amounts, Defendants were required to “prepare and deliver . . . a written

¹ “Defendants” refers to, collectively, Defendants Ebix, Inc. and Ebix Fincorp Exchange PTE Ltd. The other Defendant, Centrumdirect Ltd., a company based in India (Compl. ¶ 11), has not appeared in this action

statement setting forth their good faith calculation of the Revenue and EBITDA for the Full Earnout Period, together with a schedule setting forth in reasonable detail the calculations supporting their computation of the Revenue and EBITDA and components thereof” (*id.* ¶ 28; NYSCEF 5 § 2.4 [b] [the SPA]). In the SPA’s parlance, this is an “Earnout Statement.”

If BD Capital “elect[ed] to dispute an Earnout Statement or the calculations set forth thereon,” it had 45 days to submit an “EO Objection Notice” “specify[ing] in reasonable detail the nature of the disagreement and the items and amounts in dispute” (NYSCEF 5 § 2.4 [e]). The parties agreed that absent a timely EO Objection Notice, “the applicable Earnout Statement and the Revenue and EBITDA set forth thereon shall be deemed to be final and binding for all purposes of this Agreement” (*id.* § 2.4 [d]). But “[i]f an EO Objection Notice [were] timely delivered,” the parties then were required to “attempt to resolve the dispute with respect to any such disputed items and to determine the final calculation of the applicable Revenue and EBITDA through good faith negotiations” (*id.* § 2.4 [e]). And after 30 days of “good faith negotiations,” any unresolved “Disputed Items” “shall be referred for resolution to the Neutral Auditor” (*id.*). The Neutral Auditor “shall act as an arbitrator” to resolve the disputed issues, with the aim of issuing a resolution within another 30 days (*id.*).

Defendants delivered an Earnout Statement on September 18, 2020 (the “Earnout Statement”) (Compl. ¶ 32). About a month later, on October 27, BD Capital sent “a demand letter” to Defendants “setting forth its concerns” about the Earnout Statement and “demanding that [Defendants] immediately provide” detailed information to justify the calculations in the Earnout Statement (*id.* ¶¶ 40-41). BD Capital did not refer to the demand letter as an “EO Objection Notice” in the Complaint, but now claims that it was. Regardless, BD Capital contends that the dispute resolution procedures of the SPA have “no effect,” “no relevance,” and

are “premature” (NYSCEF 14 at 12). Instead, in 2021, BD Capital initiated this action to assert claims for breach of contract and specific performance (Compl. ¶¶ 50-63). The premise underlying both claims is the allegation that the Earnout Statement and the calculations therein were “fundamentally flawed” and not “properly calculated” (Compl. ¶¶ 61, 62).

For the reasons described below, Defendants’ motion to dismiss the Complaint is **granted**. BD Capital’s allegations require compliance with the dispute-resolution procedure in section 2.4 [e] of the SPA. Accepting BD Capital’s assertion that its demand letter constituted an “EO Objection Notice,” that means the parties were required to resolve any Disputed Items through a Neutral Auditor. And BD Capital cannot sidestep that contractual requirement by recasting its objections to the Earnout Statement as breaches of covenants in the SPA. As pleaded, those alleged breaches are indistinguishable from objections to the Earnout Statement, which the contract expressly delegates to a Neutral Auditor, not a court, to resolve. Dismissal is without prejudice.

DISCUSSION

To begin with, the parties dispute whether BD Capital’s October 27 demand letter constituted an EO Objection Notice under the SPA. For purposes of this motion, the Court assumes that it did. Although the Complaint did not refer to the demand letter as an EO Objection Notice, “[it] is well settled that affidavits may be used to remedy defects in the complaint and supplement its allegations upon a motion to dismiss” (*Mulder v Donaldson, Lufkin & Jenrette*, 208 AD2d 301, 307 [1st Dept 1995]). Here, in opposition to Defendants’ motion, BD Capital submitted a copy of the demand letter and a supporting affidavit to argue that the demand letter functioned as an EO Objection Notice, “set[ting] forth, in detail[,] BD Capital’s specific objections to” the Earnout Statement (Greenfield Aff. ¶ 5 [NYSCEF 10]; *see* NYSCEF

11 [demand letter]). Indeed, the subject line of the demand letter includes the term “Earnout Objection Notice” (NYSCEF 11). And in substance, too, the demand letter resembles an EO Objection Notice under the SPA: it “specif[ies] in reasonable detail the nature of the disagreement and the items and amounts in dispute” (NYSCEF 5 § 2.4 [e]). The letter identifies numerous “items and amounts in dispute,” including the Company’s stated revenue, “employee expenses . . . as a percentage of revenue,” and various “[o]ther expenses” (NYSCEF 11 at 3-4). Accepting the allegations in the Complaint, as supplemented by the affidavit in opposition, the Court declines to dismiss the case on the ground that BD Capital failed to submit an EO Objection Notice.

Accepting that BD Capital submitted an EO Objection Notice, BD Capital’s claims cannot proceeding in this Court because they circumvent the dispute-resolution procedure mandated by the SPA. Both causes of action in the Complaint ask the Court, or a jury, to settle a dispute about the Earnout Statement, thus supplanting the role contractually assigned to the Neutral Auditor. The First Cause of Action contests the Company’s stated Revenue and EBTIDA figures in the Earnout Statement (Compl. ¶ 54), and seeks as damages “the amount of the full Two-Year Earnout Amount (as defined in the SPA and to be calculated in accordance with the SPA), in an amount to be determined at trial” (*id.* at 11-12). But that is not what the SPA contemplates. Any dispute about the “Earnout Statement or the calculations set forth thereon” – especially a dispute about Revenue and EBITDA, the main drivers of the Earnout Amount – must go through the contractually-ordered process of objection, negotiation, and submission to the Neutral Auditor (NYSCEF §§ 2.4 [d]-[e]). Similarly, the Second Cause of Action seeks “a decree of specific performance requiring [Defendants] to provide an accurate Financial Statement” (Compl. ¶ 63). But again, a dispute over the accuracy of Defendants’

calculations in the Earnout Statement falls squarely within the scope of section 2.4 [e]. And because BD Capital has not alleged compliance with section 2.4 [e], its claims fail as a matter of law.

BD Capital's arguments in opposition are unavailing. *First*, it argues that section 2.4 [e] is inapplicable here because the Earnout Statement it received was "defective under section 2.4 [b]" (NYSCEF 14 at 9-10; Compl. ¶ 32). Section 2.4 [b] requires Defendants to issue an Earnout Statement "setting forth their good faith calculation of the Revenue and EBITDA"; section 2.4 [e] instructs that a dispute about "an Earnout Statement or the calculations set forth thereon" go through the dispute resolution process. BD Capital says the Earnout Statement was "defective" because it contained "deficient support for [Defendants'] calculations" (NYSCEF 14 at 9; *see* Compl. ¶¶ 32-39). But that is just another way of saying BD Capital disputed the "the calculations set forth" in the Earnout Statement. So, section 2.4 [e] applies. Otherwise, if a challenge to the calculations were reason to skip past section 2.4 [e], section 2.4 [e] would mean nothing (*Ronnen v Ajax Elec. Motor Corp.*, 88 NY2d 582, 589 [1996] ["rul[ing] against any construction which would render a contractual provision meaningless or without force or effect"]). Section 2.4 [e] is a dispute-resolution mechanism: it presumes a dispute.

Second, and in a similar vein, BD Capital urges that the dispute-resolution procedure "cannot possibly occur until . . . a court adjudicates whether, and to what degree, [Defendants] have materially breached the Section 2.4(h) Covenants" (Compl. ¶ 47). To be sure, the First Cause of Action alleges breaches of those covenants (*id.* ¶¶ 50-55). But those allegations are not independent of the dispute about the Earnout Statement, which must be resolved in accordance with section 2.4 [e]. They are, essentially, the same dispute clothed in different provisions of the contract. The First Cause of Action alleges (A) that Defendants breached the covenants "by

failing to operate the Company in a manner that maximized BD Capital's opportunity to receive the Earnout Amounts" (Compl. ¶ 53), (B) that "[d]ue to [Defendants'] breaches . . . the Company did not reach Revenue and EBITDA levels it would have otherwise reached" (*id.* ¶ 54), and (C) that BD Capital sustained damages equal to the Earnout Amount "to which it would have been entitled had [Defendants] not breached the Section 2.4(h) Covenants" (*id.* ¶ 55).

Boiled down, those allegations reflect BD Capital's objections to the "Earnout Statement or the calculations set forth thereon." BD Capital believes the numbers in the Earnout Statement, particularly Revenue and EBITDA, should be higher. That basic contention serves a triple role as (A) the cause of the Defendants' breach of the covenants (*id.* ¶ 53), (B) the effect of the Defendants' breach of the covenants (*id.* ¶ 54), and (C) the injury resulting from the Defendants' breach of the covenants (*id.* ¶ 55). Tellingly, the breach of the covenants is pleaded "upon information and belief," with the relevant factual allegations all taking aim at figures in the Earnout Statement:

- "As a result of [Defendants'] combined failures to meet the Section 2.4(h) obligations, the Company's Revenue has been highly variable throughout the Full Earnout Period without explanation or any substantiation" (*id.* ¶ 34).
- "[F]rom the [Earnout Statement], it appears the Company's costs and expenses increased markedly over the last four quarters, during the same period of time that the Company's revenue declined by approximately \$700,000" (*id.* ¶ 35).
- "The increase in costs and expenses raises serious questions considering that the Company substantially reduced costs and expenses over the first three quarters after the acquisition" (*id.* ¶ 36).
- "[E]mployee expenses for the Company as a percentage of revenue had declined to below 40% by Q3 2019 before increasing to 51% by Q1 2020. This seems highly unlikely given the deep pay cuts (of up to 30% of salary),

hiring freezes, and layoffs (including at the senior management level) that were implemented by Ebix after the acquisition” (*id.* ¶ 38).

- “Other expenses also show significant variance, from 25% of revenue (for Q3 2018) to 50% of revenue (for Q1 2020) with a low of 21% of revenue (as of Q1 2019). In dollar terms, the “Other Expenses” line item has increased from approximately \$1,100,000 in Q1 2019 to \$2,500,000 by Q3 2019” (*id.* ¶ 39).

The First Cause of Action is, therefore, indistinguishable from a dispute about the “Earnout Statement or the calculations set forth thereon.”

Moreover, BD Capital’s assertion that the dispute-resolution process is premature, or inapplicable, conflicts with its position in opposition to the instant motion that the dispute letter constituted an EO Objection Notice. The only purpose of an EO Objection Notice, after all, is to advance the dispute-resolution process (*see* NYSCEF 5 § 2.4 [e]). As noted, the October 27 letter identifies numerous “items and amounts in dispute,” including the Company’s stated revenue, “employee expenses . . . as a percentage of revenue,” and various “[o]ther expenses” (NYSCEF 11 at 3-4), in line with the SPA definition of an EO Objection Notice (NYSCEF 5 § 2.4 [e]). It also requested access to books and records:

[W]e hereby demand, *pursuant to Section 2.4(c) of the SPA*, that Parent and Purchaser immediately permit the Sellers’ Representative and its Representatives reasonable access, during normal business hours, to the personnel, books, records and work papers of the Company and Purchaser and their accountants relating to the preparation of the calculations of the Revenue and EBITDA set forth on the Year-Two Earnout Statement

(NYSCEF 11 at 4 [emphasis added]). Section 2.4 [c] entitles BD Capital to access the books and records during the “EO Objection Period,” which precedes the good-faith negotiation period and, later, submission of Disputed Items to the Neutral Auditor (NYSCEF 5 §§ 2.4 [c]-[e]). That BD Capital itself invoked the dispute-resolution procedure further sinks its argument that the procedure has “no effect,” “no relevance,” or is “premature” (NYSCEF 14 at 12).

None of this suggests, of course, that every dispute arising out of the SPA goes to a Neutral Auditor. The SPA does not contain a broad arbitration provision: it contains a narrow dispute-resolution mechanism tailored to disputes about financial reporting and accounting. Many disputes will fall outside that remit. Consider a claim, for example, based on section 2.4 [h] [iv], one of the covenants on which the First Cause of Action is purportedly based (Compl. ¶ 30). Under that provision, Defendants “shall . . . not take or omit to take, directly or indirectly, any action outside the ordinary course of business, which action or omission is intended to eliminate or reduce any Earnout Amount” (*id.*). If BD Capital alleged that Defendants took some specific action intending to sabotage the Earnout Amount, and the legality of that action were at issue, the targeted dispute-resolution procedure likely would not apply. That is because the subject of that (hypothetical) claim is an act independent of the Earnout Statement (a purposeful deferral of revenue, say), raising a legal question about whether the act runs afoul of the covenant. But here, by contrast, BD Capital’s allegations infer a breach of the covenants based on a dispute over the “Earnout Statement or the calculations set forth thereon.”

The proper course here is to follow the steps prescribed in section 2.4 of the SPA *before* bringing suit (if warranted by the facts), not bringing suit to lay the groundwork for a possible claim (*see* Compl. ¶ 63 [seeking “an accurate Financial Statement . . . so that if necessary, a Neutral Auditor can properly perform its duties if called upon by BD Capital pursuant to Section 2.4 [e] of the SPA”]). Among other things, the dispute-resolution process may clarify BD Capital’s objections to the Earnout Statement. If the parties disagree over the accuracy of figures in the Earnout Statement, for example, or the methodology used to derive them, that dispute likely can be resolved by the Neutral Auditor. On the other hand, BD Capital may find that the Earnout Statement is accurate from an accounting perspective but nevertheless contend that it is

skewed to BD Capital’s disadvantage by conduct that breached Defendants’ *substantive* obligations under the SPA. In that case, the dispute likely goes beyond the ambit of the Neutral Auditor and into the province of litigation. In any event, the first step should be to engage in the process envisioned by section 2.4, so that the parties (and, if needed, a neutral fact-finder) can understand the precise nature of the dispute. Filing a lawsuit in the hope of discovering a theory of liability through discovery is unavailing (*Mandarin Trading Ltd. v Wildenstein*, 65 AD3d 448, 451 [1st Dept 2009], *aff’d*, 16 NY3d 173 [2011]).

In light of the foregoing, the Court need not reach Defendants’ arguments concerning compliance with the indemnification provisions set out in sections 6.2 and 6.3 of the SPA.

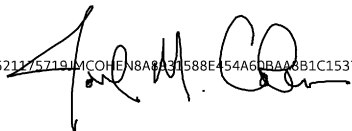
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Accordingly, it is

ORDERED that Defendants’ motion to dismiss is **GRANTED**, the Complaint is dismissed without prejudice, and the Clerk is directed to enter judgment accordingly.

This constitutes the Decision and Order of the Court.

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JOEL M. COHEN, J.S.C.

6/21/2022

DATE

CHECK ONE:

CASE DISPOSED

GRANTED

DENIED

APPLICATION:

SETTLE ORDER

CHECK IF APPROPRIATE:

INCLUDES TRANSFER/REASSIGN

NON-FINAL DISPOSITION

GRANTED IN PART

OTHER

SUBMIT ORDER

FIDUCIARY APPOINTMENT

REFERENCE