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Wyle Inc. v ITT Corp.
2013 NY Slip Op 51707(U)
Decided on October 21, 2013
Supreme Court, New York County
Ramos, J.
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Decided on October 21, 2013

Supreme Court, New York County

Wyle Inc. and WYLE SERVICES CORPORATION, Plaintiffs,

against

ITT Corp., ITT EXELIS INC., and XYLEM INC., Defendants.

653465/2011

PETITIONERS

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Charles E. Ramos, J.

In motion sequence 004, defendants ITT Corp., ITT Exelis Inc., and Xylem Inc. (together, "ITT") move, pursuant to CPLR 3211(a)(1) and (7), to dismiss plaintiffs Wyle Inc. ("Wyle") and Wyle Services Corporation's ("Wyle Services") (together, "Plaintiffs") amended complaint ("Complaint").

Background

This action arises out of plaintiff Wyle Services' purchase of non-party CAS, Inc. ("CAS"), a corporation specializing in the provision of engineering, scientific, and technical services to the Federal government.

Founded in 1979, CAS expanded its business by bidding on contracts to supply the Federal government with system engineering and analysis support for theater missile defense, air defense, aviation, and land-combat missile systems. In 2006, CAS's annual revenue exceeded $184 million, a majority of which was derived from work performed under Professional Engineering Services schedules ("PES Schedules"), a type of Government Services [*2]Administration (the "GSA") schedule. The labor rates contained in CAS's PES Schedules formed the basis for the rates that CAS could charge under its largest contract, known as the AMCOM Express Blanket Purchase Agreement (the "AMCOM Agreement"), under which CAS provided advisory and assistance services to the United States Army Aviation and Missile Command. In 2010, work performed pursuant to the AMCOM Agreement accounted for $110.5 million, or 47.6 percent, of CAS's revenue and 50.1 percent of CAS's total profits.

In 2006, CAS's founders sold the business to EDO Corporation ("EDO"). In 2007, ITT acquired EDO. In 2010, after a few years of CAS contributing only a small percentage to ITT's overall revenue, ITT decided to sell CAS. The timing of this sale coincided with the end of the period of performance for CAS's PES Schedules. However, the PES Schedules gave the GSA the option to extend the period of performance and, in early 2010, the GSA notified CAS of its intent to exercise that option. After notification of the extension, CAS elected to submit new proposed rates, which they were permitted to do.

On March 1, 2010, the Office of the Inspector General ("OIG") sent a letter to CAS notifying it that the government had chosen CAS's PES Schedules to be one of 75 schedules subject to a "pre-award audit" that fiscal year. During this audit process, ITT continued its efforts to sell CAS. On August 7, 2010, Wyle Services and its parent company, Wyle, entered into a stock purchase agreement with CAS and EDO (the "Agreement").

Under the Agreement, Wyle agreed to pay EDO approximately $235 million for all capital stock of CAS. As part of the Agreement, Wyle insisted that EDO make certain representations designed to ensure that any potential risks associated with CAS's government contracts were disclosed. In Section 3.15(c)(v) of the Agreement, EDO represented that it listed any government audits of CAS's contracts, including the PES Schedules:

"Section 3.15(c)(v) of the Company Disclosure Schedule lists each Government Contract or Government Bid to which [CAS] is a party which, to [CAS's] knowledge, is as of the date hereof under audit by any Governmental Authority or any other Person that is a party to such Government Contract or Government Bid" (Compl., ¶¶ 26-27; Agreement § 3.15(c)(v)).

Under Section 4.10 of the Agreement, Plaintiffs represented and warranted that:

"[t]he Company has provided Parent with such access to the facilities, books, records and personnel of the Company as Parent has deemed necessary and appropriate in order for Parent to investigate to its satisfaction the business, assets, condition, operations and prospects of the Company sufficiently to make an informed investment decision to purchase the Shares and to enter into this Agreement and Parent has conducted its own independent review and analysis of, and, based thereon, has formed an independent judgment

concerning, the business, assets, condition, operations and prospects of the Company. Parent (either alone or together with its advisors) has such knowledge and experience in financial and business matters so as to be capable of evaluating the merits and risks of its purchase of the Shares and is capable of bearing the economic risks of such purchase. Parent agrees to accept the Shares on the Closing Date based upon its own investigation, examination and determination with respect thereto as to all matters and without reliance upon any express or implied representations or warranties of any nature made by or on behalf of or imputed to the Company or Seller, except as expressly set forth in this Agreement" (Schatzow Aff., Ex. 2; Agreement § 4.10). [*3]

The final article of the Agreement included an express merger clause (the "Merger Clause"). Section 9.1 provides, in pertinent part:

"This Agreement, together with the Transaction Documents, contains the entire agreement of the parties with respect to the subject matter hereof and supersedes all other prior agreements, understandings, representations and warranties, oral or written, express or implied, between the parties..." (*Id.* at § 9.1).

On September 8, 2010, Wyle's acquisition of CAS closed without disclosure of the ongoing OIG audit. On March 4, 2011, the GSA announced the results of the OIG audit and decided to reduce the rates that CAS could charge for many of its employees performing work for the government under the PES Schedules. On March 23, 2011, CAS signed the new PES schedule. On April 15, 2011, Wyle's general counsel notified ITT that they were enforcing their right under Section 8.2 of the Agreement and sought indemnification from ITT for their losses as a result of EDO's breach of Section 3.15 of the Agreement. Section 8.2 of the Agreements provides, in relevant part:

"[EDO] and ITT Corp. (the "Seller Parties"), on a joint and several basis, agree to indemnify and hold [Wyle], [Wyle Services], [CAS], and/or their respective officers, directors, employees, Affiliates, representatives, successors, assigns and/or agents (each such Person, a "Parent Indemnified Party") harmless from and against any and all Losses based upon or arising from...(a) any breach of any representation or warranty made by [CAS] pursuant to Article III..." (Compl., ¶ 34; Agreement § 8.2).

Wyle memorialized its demand for indemnification in two letters dated June 22, 2011 and September 16, 2011.

On December 14, 2011, Plaintiffs filed their original action alleging breach of contract. On February 17, 2012, ITT moved to dismiss that action on the ground that Plaintiffs" claim for breach of contract was barred as a result of their failure to comply with the express notice conditions of the Agreement. The parties briefed the issues and the Court held argument on the motion on May 10, 2012. There was no dispute that Wyle gave late written notice to ITT, as Wyle did not memorialize its demand for indemnification until June 22, 2011.

In a decision and order dated October 31, 2012, this Court granted ITT's motion to dismiss the complaint, holding that Plaintiffs' request for indemnification constituted a "Third Party Claim" as defined in Section 8.5(b) of the Agreement and that Plaintiffs' failure to comply with the express notice conditions barred Plaintiffs from asserting a claim for indemnification.

On December 17, 2012, ITT moved to reargue the motion to dismiss the breach of contract action and to amend their complaint to add a count for fraud. In a decision and order dated March 21, 2013, this Court denied Plaintiffs' motion to reargue the breach of contract action, but granted Plaintiffs' motion to amend the complaint to the extent that Plaintiffs sought to plead an action for fraud. ITT now moves to dismiss the Complaint.

Standard

In determining whether a complaint is sufficient to withstand a motion to dismiss pursuant to CPLR 3211(a)(7), the court accepts as true the facts as alleged in the complaint and submissions in opposition to the motion, accords the plaintiff the benefit of every possible favorable inference, and determines only whether the facts as alleged fit within any cognizable [*4]legal theory (*Sokoloff v Harriman Estates Dev. Corp.*, 96 NY2d 409, 414 [2001]). "Dismissal pursuant to CPLR 3211(a)(1) is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law" (*Ladenburg Thalmann & Co. v Tim's Amusements, Inc.*, 275 AD2d 243, 246 [1st Dept 2000]). "In assessing a motion under CPLR 3211(a)(7)...the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one"

(*Leon v Martinez*, 84 NY2d 83, 88 [1994][internal quotations

omitted]).

"A claim rooted in fraud must be pleaded with the requisite particularity under CPLR 3016(b)" (*Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]). CPLR 3016(b) requires that claims for fraud set forth "the circumstances constituting the wrong...in detail". Thus, "[a]lthough there is certainly no requirement of unassailable proof at the pleading stage, the complaint must allege basic facts to establish the elements of the cause of action" (*Eurycleia* at 559).

Discussion

ITT argues that Plaintiffs' fraud claim must be dismissed as duplicative of Plaintiffs' breach of contract claim. ITT also contends that Plaintiffs cannot allege reasonable reliance on the alleged misrepresentation or omission of the pre-award review as an inducement to purchase CAS because Plaintiffs were aware that the PES Schedules' rates were subject to change, the underlying government contract specifically precluded expectation of future work, and Plaintiffs expressly disclaimed reliance on any outside representations or warranties in the Merger Clause. ITT also argues that Plaintiffs' claim is untenable because Plaintiffs fail to allege that any fraudulent misrepresentation was made collateral to the Agreement. Further, ITT argues that Plaintiffs have not adequately pled damages.

In their opposition, Plaintiffs respond that Wyle relied on ITT's specific written representations regarding CAS contracts under audit and would have altered its valuation analysis of CAS if it was aware of the OIG pre-award review of the AMCOM Agreement. Plaintiffs also contend that the Merger Clause does not bar a fraudulent inducement claim. In addition, Plaintiffs counter that they seek damages based on the difference between CAS's purchase price and CAS's true value at the time of purchase, which was reduced by the undisclosed material fact of the OIG pre-award review.

To state a cause of action for fraud, a plaintiff must allege "a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on

the misrepresentation or material omission, and injury" (*Lama Holding Co. v Smith Barney*, 88 NY2d 413, 421 [1996]). "[R]eliance must be found to be justifiable under all the circumstances before a complaint can be found to state a cause of action in fraud" (*Danann Realty Corp. v Harris*, 5 NY2d 317, 322 [1959]).

As an initial matter, generally "a cause of action for fraud does not arise when the only fraud charged relates to a breach of contract" (*Krantz v Chateau Stores of Canada Ltd.*, 256 AD2d 186, 187 [1st Dept 1998]).

However, "if a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, the plaintiff has stated a claim for fraud even though the [*5]same circumstances give rise to the plaintiff's breach of contract claim" (*First Bank of Am. v Motor Car Funding, Inc.*, 257 AD2d 287, 291-292 [1st Dept 1999]).

"Unlike a misrepresentation of future intent to perform, a misrepresentation of present facts is collateral to the contract...and therefore involves a separate breach of duty"

(*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 293 [1st Dept 2011]).

Here, Plaintiffs' fraud claim is premised on allegations that ITT misrepresented by omission the ongoing audit of the AMCOM Agreement. The purported false statement is that ITT specifically represented and warranted in the Agreement that it had disclosed in the schedules attached to the Agreement all ongoing audits of any of CAS's government contracts.

This clearly is a misrepresentation of present fact and "cannot be characterized merely as an insincere promise to perform" (*First Bank* at 292). "A warranty is not a promise of performance, but a statement of present fact" and "a fraud claim can be based on a breach of contractual warranties notwithstanding the existence of a breach of contract claim" (*id.*). The First Department has held that "the claims are not duplicative merely because some of the allegedly false representations are also contained in the agreements as warranties and form a basis of the breach of contract claims" (*Ambac Assur. Corp. v DLJ Mortg. Capital, Inc.*, 33 Misc 3d 1208(A) [Sup Ct 2011] *revd on other grounds*, 102 AD3d 487, 956 NYS2d 891 [1st Dept 2013][fraudulent inducement claim premised on alleged representations "addressed by

express contractual representations and warranties" not duplicative of breach of contract claim].

In addition, Plaintiffs have adequately pled justifiable reliance. Plaintiffs allege that the Agreement contains specific representations from EDO that it disclosed all ongoing audits of the CAS contracts and they were therefore justified in relying on those terms.

The Court of Appeals has held that in contract negotiations between sophisticated entities, the justifiable reliance prong of a fraud claim can be sufficiently alleged where the plaintiff "has gone to the trouble to insist on a written representation that certain facts are true, it will often be justified in accepting that representation rather than making its own inquiry" (*DDJ Mgt., LLC v Rhone Group LLC*, 15 NY3d 147, 155 [2010]).

Plaintiffs having "made a significant effort to protect themselves against the possibility of" misrepresentations by obtaining a specific representation in the Agreement (*Id.* at 156), were not required, as a matter of law, to conduct their own investigation" (*CIFG Assur. N. Am., Inc. v Goldman, Sachs & Co.*, 106 AD3d 437, 438 [1st Dept 2013]). Whether their reliance was justified, particularly in light of the indemnification provision, is a question of fact that must be resolved at trial or upon a motion for summary judgment (*id.*).

Moreover, it is well established that a merger clause does not preclude a claim of fraudulent inducement (*Sabo v Delman*, 3 NY2d 155, 162 [1957]["In short, a contractual promise made with the undisclosed intention not to perform it constitutes fraud and, despite the so-called merger clause, the plaintiff is free to prove that he was induced by false and fraudulent misrepresentations"]).

Lastly, Plaintiffs' allegations that its damages are the difference between CAS's purchase price and CAS's actual value considering the ongoing audit are sufficiently pled to survive the motion to dismiss. "Damages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained" (*Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413, 421 [1996]). [*6]

It is undisputed that "[t]he measure of damages in a fraud action is the difference between the value of what was given up and what was received in exchange, all elements of profit to be excluded" (*Mihalakis v Cabrini Med. Ctr. (CMC)*, 151 AD2d 345, 346 [1st Dept 1989]).

Therefore, Plaintiffs' allegations are sufficient to form the basis of a cognizable claim for fraudulent inducement of contract.

Accordingly it is

ORDERED that defendants ITT Corp., ITT Exelis Inc., and Xylem Inc.'s motion to dismiss is denied, and it is further

ORDERED that the parties are to contact the Clerk of Part 53 to schedule a status conference within thirty (30) days of the entry of this decision.

This constitutes the decision and order of the Court.

Date: October 21, 2013

ENTER:

_____J.S.C.

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