

STATE OF MICHIGAN
IN THE 17th CIRCUIT COURT FOR KENT COUNTY

OLIVER HOLDINGS, INC.,

Plaintiff,

vs.

MASON WELLS BUYOUT FUND II, LP,

Defendant.

Case No. 13-07763-CKB

HON. CHRISTOPHER P. YATES

OPINION AND ORDER GRANTING SUMMARY DISPOSITION TO PLAINTIFF
OLIVER HOLDINGS UNDER MCR 2.116(C)(10) ON COUNTS TWO AND THREE

This dispute traces its origin to a transaction in which Plaintiff Oliver Holdings, Inc. (“Oliver Holdings”) purchased all of the issued and outstanding stock of Oliver Products Company (“Oliver Products”) so that Oliver Products could merge with a wholly owned subsidiary of Oliver Holdings. Defendant Mason Wells Buyout Fund II, LP (“Mason Wells”) served as the designated agent for the stockholders and option holders of Oliver Products who sold their interests to Oliver Holdings. In the wake of the merger, Oliver Holdings sought money from a \$17.5 million escrow fund to cover the tax consequences of a qualified subchapter S subsidiary election (“QSub election”) that resulted in recognition of a last-in, first-out (“LIFO”) recapture amount of \$3,577,349, which in turn created a federal tax expense of \$1,216,299, an obligation of \$95,225 for a late filing, and a host of state and local tax expenses and late filing fees. When Mason Wells refused to accede to the demand from Oliver Holdings for a disbursement of \$1,313,983 from the escrow account, this suit resulted. Now, the Court concludes that Plaintiff Oliver Holdings is entitled to draw from the escrow fund to cover the tax expenses associated with its QSub election.

I. Factual Background

Both sides have moved for summary disposition under MCR 2.116(C)(10). “A motion under MCR 2.116(C)(10) tests the factual sufficiency of the complaint” and requires the Court to consider the complete record, “including affidavits, pleadings, depositions, admissions, and other evidence submitted by the parties.” Corley v Detroit Board of Education, 470 Mich 274, 278 (2004). Thus, the Court shall limn the facts from the parties’ supporting documents.

On March 20, 2012, Plaintiff Oliver Holdings, Defendant Mason Wells, and Oliver Products executed an “Agreement and Plan of Merger By and Between Oliver Products Company and Oliver Holdings, Inc.” See Complaint, Exhibit A. That merger agreement not only contemplated a QSub election by Oliver Holdings “with respect to Oliver [Products] pursuant to Section 1361(b)(3)(B) of the Tax Code . . . effective as of the date immediately following the Closing Date[.]” see id. (Merger Agreement, § 10.6(e)), but also obligated the former stockholders of Oliver Products to indemnify Oliver Holdings *via* the escrow account for any losses in the form of “Taxes incurred by the Oliver Companies with respect to any Pre-Closing Tax Period or the portion of a Straddle Period ending on and including the Closing Date” of the merger. See id. (Merger Agreement, § 11.2(a)(iv)).

On April 10, 2012, the parties completed the merger, resulting in Oliver Products becoming a wholly owned subsidiary of Plaintiff Oliver Holdings and divesting all of the former stockholders of ownership and control of Oliver Products. Then, on May 17, 2012, Oliver Holdings made a QSub election for its subsidiaries,¹ causing a LIFO recapture event comprising an increase in the tax basis

¹ The form filed by Plaintiff Oliver Holdings identified the effective date as April 10, 2012, see Brief in Support of Defendant’s Motion for Summary Disposition Under MCR 2.116(C)(10), Exhibit E, but that effective date was later changed to April 11, 2012, to comport with the language of section 10.6(e) of the merger agreement. See, e.g., Complaint, Exhibit B (Dispute Resolution Agreement at 1) (stating that QSub election was “effective as of April 11, 2012”).

for its inventory coupled with a corporate-tax obligation for that increase in the basis.² See Brief in Support of Defendant’s Motion for Summary Disposition Under MCR 2.116(C)(10), Exhibit E. As the IRS Form 8869 explains, Oliver Holdings made the QSub election as “Parent S Corporation” for its subsidiary, Oliver Products. See id.

In the summer of 2012, Defendant Mason Wells informed Plaintiff Oliver Holdings that the corporate tax returns for the period before the merger would not include the LIFO recapture amount. But Oliver Holdings “disagree[d] concerning the reporting of the LIFO recapture amount where the Buyer is an S corporation and has elected qualified subchapter S subsidiary treatment for one or more of the acquired subsidiaries effective as of April 11, 2012[,]” see Complaint, Exhibit B, so the parties entered into a written agreement on December 21, 2012, to submit their dispute to an arbitrator. See id. On May 21, 2013, the arbitrator rendered a 36-page opinion and award, see Complaint, Exhibit C, concluding that the LIFO recapture amount arising from the QSub election need not be included in the Oliver Products federal tax return “for the period ending on April 10, 2012[,]” see id. (Opinion and Award at 36), but the LIFO recapture amount must be “included in a Pre-Closing Tax Period (as defined in Section 10.6(b)(i) of the Merger Agreement) tax return[.]” Id.

The merger agreement set up an escrow fund, see Complaint, Exhibit A (Merger Agreement, § 4.2(c)), which would “be used to satisfy amounts due” to Plaintiff Oliver Holdings for, *inter alia*, “indemnification or reimbursement in accordance with Article XI” of the merger agreement. See id. (Merger Agreement, § 4.5). After the arbitrator rendered the award, Oliver Holdings presented a demand on June 5, 2013, for reimbursement from the escrow fund for LIFO recapture tax expenses

² That tax obligation is immediate, but the obligation is offset by a reduction in taxes as the company draws from its inventory at a stepped-up basis, and therefore realizes a much smaller gain for tax purposes on the sale of that inventory.

flowing from the QSub election. See Complaint, Exhibit D. On June 10, 2013, Defendant Mason Wells responded with an objection to the indemnification demand. See Complaint, Exhibit E. On August 16, 2013, Oliver Holdings filed suit against Mason Wells, asserting claims for breach of the merger agreement, breach of the dispute-resolution agreement executed on December 21, 2012, and a declaratory judgment “that the assessment of any taxes, additions to taxes, penalties, interest, fees, and expenses, related to the LIFO Recapture Amount are Buyer Indemnifiable Losses.” Both sides have moved for summary disposition on all counts pursuant to MCR 2.116(C)(10), so the Court must determine whether either side is entitled to such relief.

II. Legal Analysis

A motion for summary disposition pursuant to MCR 2.116(C)(10) should be granted “if there is no genuine issue regarding any material fact and the moving party is entitled to judgment as a matter of law.” See West v General Motors Corp, 469 Mich 177, 183 (2003). Such a genuine issue of material fact “exists when the record, giving the benefit of reasonable doubt to the opposing party, leaves open an issue upon which reasonable minds might differ.” Id. Applying these standards, the Court must determine whether either side should prevail at this juncture. In doing so, the Court shall first consider the merger agreement cited by Plaintiff Oliver Holdings in Count One of its complaint, then turn to the dispute-resolution agreement cited in Count Two of the complaint to decide whether its language alters the outcome dictated by the merger agreement, and finally consider Count Three, which sets forth a demand for declaratory relief, to ascertain whether Oliver Holdings is entitled to a declaratory judgment with respect to future tax obligations flowing from its QSub election and the resulting LIFO recapture event.

A. Count One – Breach of Merger Agreement.

Both sides insist that the merger agreement that they signed on March 20, 2012, provides the primary justification for an award of summary disposition in their favor. Under Michigan law,³ an unambiguous contract is “not open to judicial construction and must be *enforced as written.*” Rory v Continental Ins Co, 473 Mich 457, 468 (2005). In contrast, “the meaning of an ambiguous contract is a question of fact that must be decided by the jury.” Klapp v United Ins Group Agency, Inc, 468 Mich 459, 469 (2003). In deciding whether the parties’ merger agreement contains ambiguities, the Court “cannot simply ignore portions of [the] contract in order to avoid a finding of ambiguity or in order to declare an ambiguity.” Id. at 467. Instead, the merger agreement “must be ‘construed so as to give effect to every word or phrase as far as practicable.’” Id.

The merger agreement clearly authorizes Plaintiff Oliver Holdings to dip into the escrow fund “to satisfy Buyer Indemnifiable Losses” for which Oliver Holdings “is entitled to indemnification or reimbursement in accordance with Article XI.” See Complaint, Exhibit A (Merger Agreement, § 4.5). Section 11.2(a)(iv) of the merger agreement, in turn, states that Oliver Holdings may obtain indemnification from the escrow fund for any losses suffered by Oliver Holdings “arising out of, in connection with or resulting from” taxes “incurred by the Oliver Companies with respect to any Pre-Closing Tax Period or the portion of a Straddle Period ending on and including the Closing Date[.]” Id. (Merger Agreement, § 11.2(a)(iv)). Section 10.6(e) of the merger agreement provides not only that “Oliver’s tax year shall end at the end of the Closing Date[.]” but also that any QSub election regarding Oliver Products “shall be made effective as of the date immediately following the Closing Date.” Id. (Merger Agreement, § 10.6(e)). Oliver Holdings made a QSub election on May 17, 2012,

³ The Court notes in passing that the merger agreement stipulates that Michigan law governs the interpretation of that agreement. See Complaint, Exhibit A (Merger Agreement, § 12.9). Thus, the Court shall apply Michigan law in analyzing Plaintiff Oliver Holdings’s claims.

with an effective date of April 10, 2012, see Brief in Support of Defendant’s Motion for Summary Disposition Under MCR 2.116(C)(10), Exhibit E, but that effective date was subsequently changed to April 11, 2012, to comply with the language of section 10.6(e) of the merger agreement. See, e.g., Complaint, Exhibit B (Dispute Resolution Agreement at 1).

By all accounts, the QSub election contemplated in the merger agreement and made after the closing date by Plaintiff Oliver Holdings resulted in a seven-figure tax obligation flowing from that LIFO recapture event. Oliver Holdings characterizes that tax expense as a buyer-indemnifiable loss for which it should receive reimbursement from the escrow fund pursuant to section 11.2(a)(iv) of the merger agreement, whereas Defendant Mason Wells describes that tax expense as a voluntary, post-closing undertaking that must be borne by Oliver Holdings. Mason Wells clearly has the better argument. Section 10.6(e) of the merger agreement decreed that the QSub election “shall be made effective as of the date immediately following the Closing Date[.]” and the QSub election occurred after the merger, effective April 11, 2012. According to section 11.2(a)(iv) of the merger agreement, Oliver Holdings can obtain reimbursement or indemnification from the escrow fund only for taxes “incurred by the Oliver Companies with respect to any Pre-Closing Tax period or the portion of a Straddle Period ending on and including the Closing Date[.]” The tax expenses resulting from the LIFO recapture event, which was triggered by Oliver Holdings’s post-closing QSub election, cannot be characterized as “Buyer Indemnifiable Losses . . . arising out of, in connection with or resulting from . . . Taxes incurred by the Oliver Companies with respect to any Pre-Closing Tax Period or the portion of a Straddle Period ending on and including the Closing Date[.]” See Complaint, Exhibit A (Merger Agreement, § 11.2(a)(iv)). Therefore, Defendant Mason Wells is entitled to an award of summary disposition under MCR 2.116(C)(10) on Count One, which sets forth Oliver Holdings’s demand for reimbursement or indemnification under the merger agreement.

B. Count Two – Breach of Dispute-Resolution Agreement.

Had the parties simply presented their dispute to the Court, as opposed to an arbitrator, in the first instance, Oliver Holdings would have no basis to seek reimbursement or indemnification from the escrow fund for the tax expenses flowing from the QSub election that caused the LIFO recapture event. But on December 21, 2012, the parties entered into a dispute-resolution agreement that not only presented their disagreement to an arbitrator, but also defined the consequences flowing from the arbitrator's ultimate decision. See Complaint, Exhibit B (Dispute Resolution Agreement). That is, the parties submitted two questions to the arbitrator and defined consequences of the arbitrator's answer to each question. The first question posed by the parties asked:

(a) Is the LIFO recapture amount, as defined in Internal Revenue Code Section 1363(d)(3), that arises from the Qualified Subchapter S Subsidiary elections for Oliver Products Company and Oliver Packaging and Equipment Company required to be included in the Oliver Products Company's U.S. consolidated federal income tax return for the period ending on April 10, 2012 pursuant to applicable Legal Requirements (as defined in the Merger Agreement)?

See Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 2). In a written opinion and award, the arbitrator answered this question: "No." See Complaint, Exhibit C (Opinion and Award at 36). The second question posed by the parties asked:

(b) If the LIFO recapture amount is not required to be included in Oliver Products Company's U.S. consolidated federal income tax return for the period ending on April 10, 2012, is the LIFO recapture amount required to be included in a Pre-Closing Tax Period (as defined in Section 10.6(b)(i) of the Merger Agreement) tax return pursuant to applicable Legal Requirements (as defined in the Merger Agreement)?

See Complaint, Exhibit C (Dispute Resolution Agreement, ¶ 2). In the written opinion and award, the arbitrator answered this question: "Yes." See Complaint, Exhibit C (Opinion and Award at 36). Although the arbitrator did not consider the "availability under the Merger Agreement of remedies relating to indemnities or other remedies for breaches of contract or other obligations of the Parties,"

id. (Opinion and Award at 10), Plaintiff Oliver Holdings contends that the parties' dispute-resolution agreement dictates that the arbitrator's answer to the second question translates into a right to obtain reimbursement or indemnification from the escrow fund for the tax expenses occasioned by the LIFO recapture event.⁴ This argument forms the basis for Count Two of the complaint.

Paragraph 11 of the dispute-resolution agreement sets forth the consequences "in the event the Arbitrator's answer to the Second Question is 'yes'," but offers no guidance about reimbursement or indemnification from the escrow fund. See Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 11). Instead, paragraph 12 of the dispute-resolution agreement speaks to the propriety of Plaintiff Oliver Holdings's claim for escrow funds to cover its tax expenses in the following language:

If the Arbitrator determines that the LIFO recapture amount is reported on a tax return related to a Pre-Closing Tax Period other than the Disputed Return, (i) Buyer [*i.e.*, Oliver Holdings] must file any and all Tax Returns in accordance with the Arbitrator's decision, (ii) Stockholders Agent [*i.e.*, Mason Wells] shall cause the Escrow Agent (as defined in the Merger Agreement) to disburse to Buyer an amount sufficient to indemnify Buyer for all federal, state, and local taxes that are incurred by the Oliver Companies related to the LIFO recapture with respect to a Pre-Closing Tax Period in accordance with Section 11.2(a)(iv) of the Merger Agreement within fourteen (14) days of the Arbitrator's decision, and (iii) Buyer shall further remit this amount to the United States Treasury and the appropriate state and local tax authorities to satisfy the tax related to the LIFO recapture amount.

See Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 12). Under this provision, the claim by Oliver Holdings for reimbursement or indemnification for tax expenses turns upon whether "the Arbitrator determin[e]d that the LIFO recapture amount is reported on a tax return related to a Pre-Closing Tax Period other than the Disputed Return[.]" See id. Accordingly, the Court must answer that question in order to resolve the claim in Count Two of the complaint.

⁴ The dispute-resolution agreement includes a list of consequences flowing from the answer to the first question as well, see Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 9), but the parties have not focused on those consequences in light of the arbitrator's answer of "no" to that first question. The Court notes in passing, however, that the arbitrator's answer to the first question led to the filing of a disputed federal income tax return.

The starting point of the Court’s analysis is “the Arbitrator’s determination that, pursuant to section 1363(d)(4)(D) of the Code, the LIFO recapture amount included in the Target Parent’s gross income is reported on a Single Transaction Return.”⁵ See Complaint, Exhibit C (Opinion and Award at 29). However, that determination does not indicate whether the single-transaction return “relate[s] to a Pre-Closing Tax Period” as contemplated by paragraph 12 of the dispute-resolution agreement. Fortunately, the arbitrator devoted substantial attention to the parties’ conflicting views as to whether that single-transaction return related to a period before or after the closing. See Complaint, Exhibit C (Opinion and Award at 30-35). Ultimately, the arbitrator ruled: “Target Parent’s LIFO recapture amount is included in gross income reported on a Single Transaction Return for a Pre-Closing Period that began and ended on the Closing Date” of April 10, 2012,⁶ see id. (Opinion and Award at 35). so paragraph 12 of the dispute-resolution agreement dictates that “Stockholders Agent [*i.e.*, Mason Wells] shall cause the Escrow Agent (as defined in the Merger Agreement) to disburse to Buyer [*i.e.*, Oliver Holdings] an amount sufficient to indemnify Buyer for all federal, state, and local taxes that are incurred by the Oliver Companies related to the LIFO recapture with respect to the Pre-Closing Tax Period in accordance with Section 11.2(a)(iv) of the Merger Agreement” See Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 12(ii)). Consequently, the Court must award summary disposition under MCR 2.116(C)(10) to Plaintiff Oliver Holdings on Count Two of its complaint, and thereby establish that Oliver Holdings is entitled to recover its tax expenses (and quite likely its attorney fees as well) from the escrow fund.

⁵ The arbitrator’s opinion and award makes clear that the “Target Parent” is Oliver Products. See Complaint, Exhibit C (Opinion and Award at 1).

⁶ The Court has no authority to revisit the arbitrator’s decision and conclude that that decision is incorrect as a matter of law. The dispute-resolution agreement expressly states that the arbitrator’s “conclusions shall be binding on the Parties and both Parties hereby waive their respective rights to appeal those conclusions.” See Complaint, Exhibit B (Dispute Resolution Agreement, ¶ 9).

C. Count Three – Declaratory Relief.

Count Three of Plaintiff Oliver Holdings’s complaint seeks declaratory relief to complement its established right to reimbursement or indemnification for the tax expenses it has already incurred. Specifically, Count Three simply requests a declaration that Oliver Holdings may access the escrow fund to cover tax expenses that “have not yet been paid.” See Complaint, ¶ 98. Declaratory relief is available under MCR 2.605 in cases of “actual controversy” whenever “a declaratory judgment is necessary to guide a plaintiff’s future conduct in order to preserve legal rights.” UAW v Central Michigan University Trustees, 295 Mich App 486, 495 (2012). Because the Court is “not precluded from reaching issues before actual injuries or losses have occurred[,]” id., and Oliver Holdings has the same right under the parties’ dispute-resolution agreement to draw from the escrow fund to pay for future tax expenses as the Court has ruled it does with respect to tax expenses it has already paid, the Court shall grant a declaratory judgment stating that Oliver Holdings may draw from the escrow fund to cover all future tax expenses resulting from the LIFO recapture event triggered by the QSub election. The Court rests its ruling in this regard upon the very same analysis supporting the award of summary disposition to Oliver Holdings on Count Two of its complaint.

III. Conclusion

For all of the reasons stated in this opinion, the Court shall award summary disposition under MCR 2.116(C)(10) to Defendant Mason Wells on Count One because Plaintiff Oliver Holdings has no right to reimbursement or indemnification under the merger agreement for tax expenses incurred as a result of the LIFO recapture event triggered by the QSub election. But the Court shall award summary disposition under MCR 2.116(C)(10) to Oliver Holdings on Count Two because Oliver Holdings has the right to such reimbursement or indemnification from the escrow fund pursuant to

the parties' dispute-resolution agreement in light of the arbitrator's analysis and conclusions. And for the same reasons supporting the Court's award of summary disposition on Count Two, Oliver Holdings is entitled to a declaratory judgment on Count Three establishing Oliver Holdings's right to reimbursement or indemnification for future tax expenses arising from the LIFO recapture event. The Court shall schedule a hearing to determine the amount of money Oliver Holdings may draw from the escrow fund to cover its tax expenses and, if contractually justified, its attorney fees.

IT IS SO ORDERED.

Dated: June 11, 2015



HON. CHRISTOPHER P. YATES (P41017)
Kent County Circuit Court Judge