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

CULLIGAN SOFT WATER CO., et al.,

Plaintiffs,

v.

CLAYTON, DUBILIER & RICE, LLC, et al.,

Defendants.

Index No. 651863/2012

IAS Part 48 (Justice Andrea Masley)

Oral Argument Requested

MEMORANDUM OF LAW IN SUPPORT OF THE MOTION OF NOMINAL DEFENDANT CULLIGAN LTD. TO SUBSTITUTE MICHAEL W. MORRISON AND CHARLES THRESH, LIQUIDATORS OF CULLIGAN LTD., AS PLAINTIFFS IN PLACE OF THE SHAREHOLDER PLAINTIFFS AND TO DISMISS

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Nominal defendant Culligan Ltd. in Members' Voluntary Liquidation[1] ("Culligan Ltd.") respectfully submits this Memorandum of Law in support of its motion to substitute Michael W. Morrison and Charles Thresh, liquidators of Culligan Ltd., as plaintiffs in place of the shareholder Plaintiffs, and to dismiss for Plaintiffs' failure to make demand on the liquidators.

PRELIMINARY STATEMENT

Plaintiffs were told more than five years ago that Culligan Ltd. entered voluntary liquidation under Bermuda law in April 2013, and that as a result, "the claims in this action could only be pursued by the Liquidators." (Affirmation of Michael W. Morrison, May 8, 2015, NYSCEF Doc. No. 146 ["Morrison Aff."], ¶ 5.) Plaintiffs, who purport to represent the shareholders' interests, ignored that legal consequence of the voluntary liquidation, and proceeded to file a series of flawed – and failed – amended complaints. Each time, until now, Plaintiffs would amend or seek to amend their complaint and each time this Court and the First Department would strike the complaint. Indeed, to date, there has not yet been a complaint validly in litigation in this action – *i.e.*, one not subject to dismissal.

Plaintiffs obviously and simply will not accept that they lack the power to prosecute this action. Nonetheless, under settled New York law, the appointment of the liquidators (akin under New York and Bermuda law to the appointment of a receiver) divested

[1] As of April 2013, Culligan Ltd. entered a members' voluntary liquidation. As a matter of Bermuda law, this proceeding allows for the dissolution of this solvent, but no longer active, holding company and Culligan Ltd.'s formal legal name is now "Culligan Ltd., in Members' Voluntary Liquidation." (Morrison Aff. at ¶ 1.)

the shareholders of any standing they might have had (and no court has recognized any such standing) to pursue the claims in the Verified Shareholder Fourth Amended Derivative Complaint ("Fourth Amended Complaint"; NYSCEF Doc. No. 332; Affirmation of David A. Berger dated March 15, 2019 submitted herewith, Exhibit 1). Further, under New York law, in these circumstances, the liquidators are entitled to be substituted in Plaintiffs' stead. *See* Points I-II, below.

Plaintiffs' refusal to acknowledge the liquidators' standing with regard to Culligan Ltd. perhaps explains their failure to make a demand upon the liquidators before filing of the Fourth Amended Complaint or to allege any particularized facts about the futility of doing so. That failure is fatal to Plaintiffs' claim under settled New York law. *See* Point III, below.

FACTS

This derivative action was commenced on May 30, 2012 by shareholders of Culligan Ltd. seeking to assert claims on behalf of Culligan Ltd. On April 29, 2013 Culligan Ltd. entered voluntary liquidation under the law of Bermuda, where it is incorporated. (Morrison Aff. ¶ 1). On that date, Culligan Ltd.'s shareholders appointed two individuals – Michael W. Morrison and Charles Thresh – to serve as Culligan Ltd.'s joint and several liquidators in order to wind up its affairs. (*Id.* ¶ 2.) Their appointment took effect immediately. (*Id.*)

Culligan Ltd. and its liquidators Messrs. Morrison and Thresh now move, pursuant to CPLR 1017 and 1021, to substitute as plaintiffs Messrs. Morrison and Thresh, as liquidators, in place of the current Plaintiffs. The ground for the motion is that – under both New York and Bermuda law – the liquidators now have the sole authority to represent Culligan Ltd. in Members' Voluntary Liquidation, displacing both the corporation's board of directors and any shareholders seeking to sue derivatively. Moreover, dismissal is required because Plaintiffs failed to make demand on the liquidators.

ARGUMENT

I. MICHAEL W. MORRISON AND CHARLES THRESH, AS LIQUIDATORS OF CULLIGAN LTD., ARE THE SOLE PROPER PLAINTIFFS.

CPLR 1017 provides: "If a receiver is appointed for a party, or a corporate party is dissolved, the court shall order substitution of the proper parties." In the specific context of shareholder derivative litigation, when a receiver is appointed, the substitution of the proper parties involves the removal of the original shareholder derivative plaintiffs, who are replaced by the receiver. *See O'Keefe v. Corless*, 231 A.D. 58, 58-59 (1st Dep't 1930) (foreign receiver of the foreign defendant corporation "has power to take over this litigation and continue the same"); *see also Esther Sadowsky Testamentary Trust v. Syron*, No. 08-5221, 2009 WL 10697000, at *2 (S.D.N.Y. Jan. 28, 2009), *report adopted,* 639 F. Supp. 2d 347 (S.D.N.Y. 2009), *aff'd,* 412 F. Appx. 361 (2d Cir. 2011) (under federal law) (motion for substitution granted as transfer of interests previously possessed by shareholders deprived the shareholders of standing to maintain the derivative action); *FDIC v. Wrapwell Corp.*, 922 F. Supp. 913, 917 (S.D.N.Y. 1996) (same).

Under New York law, where a receiver is appointed for a non-New York corporation, the appropriate party to represent the corporation is the receiver appointed in the corporation's jurisdiction of incorporation. *O'Keefe*, 231 A.D. at 58-59 (Delaware receiver, not New York ancillary receiver, is proper party). The term "receiver," as used in CPLR 1017, is not limited to court-appointed receivers in a narrow sense but also includes liquidators, conservators, bankruptcy trustees and other similar fiduciaries appointed to manage or wind up a corporation's affairs pursuant to law. *See, e.g., SNR Holdings, Inc. v. Ataka Am., Inc.*, 54 A.D.2d 406, 409 (1st Dep't 1976) (substituting Canadian trustee in bankruptcy for a party under CPLR 1017; for purposes of that provision, "no difference exists between a receiver and a trustee in bankruptcy"); *Downey Sav. & Loan Ass'n, F.A. v. Francis*, Index No. 107118/08, 2013 N.Y. Slip

Op. 30699(U) (Sup. Ct. N.Y. County, Apr. 2, 2013) (substituting FDIC as statutory receiver for a financial institution under CPLR 1017, though FDIC is not judicially appointed or supervised).

In 2013, Messrs. Morrison and Thresh were appointed as liquidators for Culligan Ltd. by authority of the Bermuda Companies Act 1981. As such, they "act as trustees of the assets of the Company for the benefit of the creditors and the shareholders." (Morrison Affirm. ¶ 2.) Under the Bermuda Companies Act 1981, the liquidators have exclusive powers to manage and wind up the affairs of Culligan Ltd., including the powers "to bring or defend any action or other legal proceeding in the name and on behalf of the company," "to carry on the business of the company so far as may be necessary for the beneficial winding up thereof," "to appoint an attorney to assist him in the performance of his duties," "to sell the real and personal property" of the company," "to do all acts . . . in the name and on behalf of the company," and "to do all such other things as may be necessary for winding up the affairs of the company and distributing its assets." (Affirmation of Rhys Williams dated March 15, 2019 submitted herewith, Exhibit A (Bermuda Companies Act of 1981, §§ 175(1)(a)–(c), (2)(a)-(b), (h), 207-08(1), 224, 226(1)(b).)) New York courts recognize the statutory title of an alien trustee in bankruptcy. *SNR Holdings, Inc. v. Ataka Am., Inc.*, 54 A.D.2d at 409 (recognizing the trustee appointed by Canadian court); *Bertisch v. Drory*, 4 Misc. 3d 1023(A) (N.Y. County Sup. Ct. 2004) ("courts in New York have generally deferred to foreign bankruptcy proceedings unless the foreign court lacks jurisdiction over the bankrupt").

Thus, the liquidators are now the parties who have the authority to represent Culligan Ltd., and they should be substituted in Plaintiffs' place. CPLR 1017.

II. PLAINTIFFS DO NOT CHALLENGE THE LIQUIDATORS' INDEPENDENCE.

Plaintiffs have offered no reason to doubt that Messrs. Morrison and Thresh are independent, able to, and obligated to represent Culligan Ltd.'s interests in this action. The Complaint names KPMG Advisory Limited as a defendant, incorrectly claiming that it is the liquidator (Complaint ¶ 105); but it is Messrs. Morrison and Thresh individually who are the liquidators. (Morrison Affirm. ¶ 2). Although Morrison and Thresh are employees of KPMG Advisory Limited, in their capacity as liquidators they serve as individual fiduciaries for Culligan Ltd. and not on any KPMG entity's behalf (Morrison Affirm. ¶ 1-2).

Plaintiffs also do not allege a lack of independence of the liquidators. Plaintiffs' only allegation is that KPMG Advisory Limited, as the putative liquidator, has not brought an action against the defendants. (Complaint ¶¶ 208-13.)[2] But, as a matter of law, a fiduciary's

[2] The Court permitted the addition of these allegations to the Fourth Amended Complaint (comprising the Sixth Cause of Action) only because KPMG Advisory Services Limited was not a party to the action at the time of the amendment, and the motion to include the Sixth Cause of Action was thus not specifically opposed. *Culligan Soft Water Co. v. Clayton Dubilier & Rice, LLC*, No. 651863/2012, 2019 WL 78923, at *5 (N.Y. County Sup. Ct. Jan. 2, 2019). Moreover, the alleged factual underpinning for this cause of action is demonstrably wrong. Plaintiffs allege that by "sworn Affirmation in this case (Doc. No. 146) KPMG Bermuda has stated that, at the time Plaintiffs sought commencement of action against the above-listed Defendants, it controlled Culligan Ltd. and was the sole authority to speak on behalf of the company." (Complaint ¶ 211). Plaintiffs sought commencement of this action on May 31, 2012. The sworn Affirmation in this

independence is not undermined merely because a derivative plaintiff has alleged that it should have initiated a derivative action. *See Hildene Capital Mgmt., LLC v. Friedman, Billings, Ramey Grp., Inc.*, No. 11-5832, 2012 WL 3542196, at *3 (S.D.N.Y. Aug. 15, 2012) (holding that Wells Fargo's independence as trustee was not undermined merely by the institution of proceedings naming it as a defendant for not bringing the requested action). Otherwise, any derivative plaintiff could defeat a liquidator's powers, and create standing for itself, simply by criticizing the liquidator's failure to sue.

Plaintiffs allege that they "are informed and believe that KPMG [Advisory Services Limited] has received millions of dollars in fees from CDR and companies CDR controls." (Complaint ¶ 105.) KPMG, however, is a huge global accounting firm that receives fees from many clients and whose reputation for independence is paramount to its abilities to act as an independent auditing firm. Plaintiffs do not allege that any of KPMG's fees were anything other the customary fees KMPG received for serving as any company's "auditors, accountants and advisers." (*Id.*) Moreover, neither KPMG Advisory Services Limited nor any other KPMG entity is Culligan Ltd.'s liquidator; rather, the fiduciary duties are owed by Messrs. Morrison and Thresh individually. Accordingly, none of Plaintiffs' allegations – as to fees or otherwise – raise any doubt regarding the liquidators' independence. *Cf. Alpert v. Nat'l Ass'n of Secs. Dealers, LLC*, 7 Misc. 3d 1010(A), at *9 (Sup. Ct. N.Y. County 2004) (in the context of directors of a corporation, allegations of the receipt of "fees is not sufficient to show self-interest" unless the fees were "substantially in excess of normal … fees").

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case on which Plaintiffs rely, states however unequivocally that the liquidators were appointed some *eleven months later* on April 29, 2013. (Morrison Aff. ¶ 2).

III. DISMISSAL IS REQUIRED BECAUSE PLAINTIFFS FAILED TO MAKE DEMAND ON THE LIQUIDATORS.

Where, as here, there was no complaint validly in litigation when the Fourth Amended Complaint was filed, Plaintiffs should have made a demand on the liquidators before filing it, or plead with particularity their reasons why demand on the liquidators would have been futile. *Korinsky v. Winkelreid*, 143 A.D.3d 427 (1st Dep't 2016) ("The second amended pleading does not relate back to 2009 for demand futility purposes, because the original pleading was not 'validly in litigation' – that is, it would not have survived a motion to dismiss" (*citing Braddock v. Zimmerman*, 906 A.2d 776, 779, 786 (Del. 2006)); *Lerner v. Prince*, 36 Misc.3d 297, 312 (Sup. Ct. NY County May 15, 2012) ("Because these claims were never validly in litigation, plaintiff was required to plead demand futility regarding the new Board as of June 2010") (*citing Braddock*)); *see also M+J Savitt, Inc. v. Savitt*, No. 08 Civ. 8535, 2009 WL 691278, at *6 (S.D.N.Y. Mar. 17, 2009); *Blumenfeld v. Stable 49, Ltd.*, No. 157117/2017, 2018 WL 7051062, at *27–28 (Sup. Ct. N.Y. County Dec. 17, 2018) (under New York law, assessing demand futility "at the time the amended 2017 complaint was filed").

The record of this action certainly establishes that there has not yet been a complaint validly in litigation in this action – *i.e.*, one not subject to dismissal. The complaints before the Fourth Amended Complaint have repeatedly been dismissed, and each dismissal was upheld by the First Department. *Culligan Soft Water Co. v. Clayton Dubilier & Rice LLC*, 118 A.D.3d 422, 422 (1st Dep't 2014); *Culligan Soft Water Co. v. Clayton Dubilier & Rice, LLC*, 139 A.D.3d 621 (1st Dep't 2016). Indeed, the First Department, in overturning a partial settlement of this action with certain defendants expressly noted (after the dismissal of the Verified Shareholder Third Amended Derivative Complaint) that the Plaintiffs "after four attempts, have yet to plead properly that they have standing to sue derivatively," that "plaintiffs .

. . had not established – and may never establish – their standing to bring the action." *Culligan Soft Dep't. v. Clayton Dubilier & Rice, LLC*, 144 A.D.3d 611 (1st Dep't 2016). Since Plaintiffs had not established their standing to sue in each of their four previous attempts, and each of the complaints in which they sought to so do was dismissed, there was no complaint validly in litigation at the time of the Fourth Amended Complaint, and Plaintiffs should have made a demand on the relevant governing corporate authority, or plead its futility, before filing the Fourth Amended Complaint.

As explained above, when the Fourth Amended Complaint was filed, the company's liquidators had already been appointed (and had notified Plaintiffs of such), vesting them with sole authority to manage and direct the corporation, including pursuing the claims in this action. Plaintiffs thus were required to make demand on them but have made no allegation in the Fourth Amended Complaint that they did so, or that to do so would have been futile. That lapse alone warrants dismissal. *Brody v. Chem. Bank*, 517 F.2d 932, 934 (2d Cir. 1975).[3] The action should be dismissed because of Plaintiffs' failure to make adequate demand on the liquidators.

[3] As noted above, the Fourth Amended Complaint misidentifies the liquidator as KPMG Advisory Limited, and wrongly alleges that the liquidator ignored Plaintiffs' original demand – before the liquidator was even appointed. (*See* fn. 2 above). These allegations, even if they were not flatly wrong, are insufficient to challenge the liquidators' independence or their business judgment in declining to bring suit. *See, e.g., Hildene Capital Mgmt., LLC v. Friedman, Billings, Ramey Grp., Inc.*, No. 11-5832, 2012 WL 3542196, at *3 (S.D.N.Y. Aug. 15, 2012).

CONCLUSION

The current Plaintiffs – who seek to be representatives of Culligan Ltd. – are no longer proper parties to this action in light of the appointment of Michael W. Morrison and Charles Thresh as Culligan Ltd.'s liquidators. Messrs. Morrison and Thresh should therefore be substituted as plaintiffs in place of the current Plaintiffs, and in the alternative, the Fourth Amended Complaint should be dismissed for Plaintiffs' failure to make or plead any excuse for not making demand on the liquidators.

Dated: New York, New York
March 15, 2019

Respectfully submitted,

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