

New York Court of Appeals Upholds Purchase Agreement's Broad Release in Affirming Dismissal of \$900 Million Fraud Claim

By: **Michael C. Hefter, Laurence A. Silverman and Seth M. Cohen**

June 14, 2011

On June 7, 2011, the New York Court of Appeals affirmed the dismissal of a \$900 million lawsuit brought by former shareholders against America Movil SAB ("Movil"), Latin America's largest mobile phone carrier, on the grounds that a general release entered into by the parties in 2003 barred Plaintiffs' claims. *Centro Empresarial Cempresa SA et al. v. America Movil SAB de CV et al.*, -- N.E. 2d --, 2011 WL 2183293, slip op. at 1, 14 (June 7, 2011). The unanimous decision by New York's highest court underscores the extent to which sophisticated parties to arms-length transactions can contract away future claims, even "fraud claims . . . unknown at the time of contract." *Id* at 9.

Factual Background

The facts underlying the litigation date back to 1999 when Plaintiffs Centro Empresarial Cempresa SA ("Centro") and Conecel Holding Ltd. -- two British Virgin Island entities holding a combined majority interest in the Ecuadorian telecom company Consorcio Ecuatoriano de Telecomunicaciones S.A. Conecel (the "Company") -- sought financing from Mexican billionaire Carlos Slim Helu ("Slim").

Slim's company, Telmex Mexico ("Telmex") injected \$150 million into the Company in 2000, taking a majority interest. Following the transaction, Plaintiffs and Telmex held their interests in the Company through a new entity, Telmex Wireless Ecuador LLC ("TWE"). The parties agreed that in the event Slim consolidated his Latin American telecommunications interests into one entity, Plaintiffs would have the right to exchange their units in TWE for equity shares of the new entity.

That consolidation occurred in late 2000, when Movil was spun off from Telmex Mexico, triggering Plaintiffs' right to negotiate an exchange of their units in TWE for shares of Movil. This exchange never happened. Rather, pursuant to a Purchase Agreement entered into in 2003, Plaintiffs sold their units in TWE to Defendants for cash.

The Purchase Agreement released Telmex and its affiliates, shareholders, and agents from:

"all manner of actions, causes of action, suits, debts, dues, sums of money, accounts, reckonings, bonds, bills, specialties, covenants, contracts, controversies, agreements, promises, variances, trespasses, damages, judgments, extents, executions, claims and demands, liability, whatsoever, in law or equity, whether past, present or **future, actual or contingent**, arising under or in connection with the Agreement Among Members and/or arising out of, based upon, attributable to or resulting from the ownership of membership interests in [TWE] or having taken or failed to take any action in any capacity on behalf of [TWE] or in connection with the business of [TWE]." (Emphasis added.)

In 2008, Plaintiffs filed suit, accusing Movil and the Defendants of fraudulently inducing them to sell their interest in TWE. According to the Complaint, in connection with a possible exchange of their TWE units for shares in Movil, Plaintiffs allegedly were provided inaccurate financial information about the Company, and never received other information, despite

repeated requests. The Complaint alleges that if Plaintiffs had exchanged their TWE units for shares in Movil rather than selling them outright for cash, they would have been entitled to receive approximately \$900 million in Movil stock. The allegations included breach of contract, fraud, fraudulent inducement, unjust enrichment, and a claim for accounting.

Last year, a divided panel in the Appellate Division, First Department, held that the Plaintiffs' suit was "barred by the general release they granted defendants in connection with the sale of their interest." *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B. de C.V.*, 76 A.D.3d 310 (1st Dep't 2010). Last week, the Court of Appeals affirmed.

The Holding

In a unanimous opinion, Judge Carmen Beauchamp Ciparick held that "[a]s sophisticated entities, [the plaintiffs] negotiated and executed an extraordinarily broad release with their eyes wide open. They cannot now invalidate that release by claiming ignorance of the depth of their fiduciary's misconduct." As detailed below, the Court's opinion centered around the broad nature of the release and Plaintiffs' failure to conduct thorough due diligence in the face of red flags:

1. **Plaintiffs Released "Unknown Fraud Claims."** The Court relied on the broad language of the release; specifically, that the phrase "all manner of actions," in conjunction with the reference to "future" and "contingent" actions "indicate[d] an intent to release defendants from fraud claims, like this one, unknown at the time of contract." *America Movil*, 2011 WL 2183293, slip op. at 9. The Court stated that, to circumvent such a broad release, Plaintiffs would have had to plead facts from which the court could infer that "the release itself was induced by a separate fraud" (which they did not.) *Id.*
2. **Fiduciary Relationship Irrelevant.** The Court noted that Telmex, as TWE's majority shareholder, owed a fiduciary duty to Plaintiffs, which required Defendants to "disclose any information that could reasonably bear on plaintiffs' consideration of [its purchase] offer." *Id.* at 11. However, the Court also held that a sophisticated principal is able to release its fiduciary from claims, "at least where, as here, the fiduciary relationship is no longer one of unquestioning trust -- so long as the principal understands that the fiduciary is acting in its own interest and the release is knowingly entered into." *Id.* The Court noted that: (1) Plaintiffs were large corporations engaged in complex transactions in which they were advised by counsel; and (2) as sophisticated entities, they negotiated and executed an extraordinarily broad release "with their eyes wide open." *Id.* at 12.
3. **Plaintiffs Failed to Allege Justifiable Reliance On Defendants' Fraudulent Statements In Executing The Release.** Citing its recent decision in *DDJ Mgt., LLC v. Rhone Group LLC*, 15 NY3d 147, 153-43 (2010), the Court held that Plaintiffs failed to allege justifiable reliance because "plaintiffs knew that defendants had not supplied them with the financial information necessary to properly value the TWE units, and that they were entitled to that information." *America Movil*, 2011 WL 2183293, slip op. at 12-13. The fact that Plaintiffs cashed out their interests and released defendants from fraud claims without demanding either access to the information or assurances in the form of representations and warranties was fatal to Plaintiffs' case. Plaintiffs "have been so lax in protecting themselves that they cannot fairly ask for the law's protection." *Id.* at 13.

Implications

The *America Movil* decision is instructive for parties seeking to foreclose future litigation in connection with Asset Sales and Purchases. A broad release, even one that waives future, unknown and contingent claims, will be enforced by New York courts, as long as the release itself is not procured by fraud. It is imperative that parties conduct thorough due diligence, and that in the

face of uncertainty, purported inaccuracies or other red flags, parties demand further warranties and access to information prior to agreeing to any release in connection with an asset purchase or sale.