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United States District Court
For the Northern District of California

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

No. C 06-7339 CW

THOMAS FERNANDEZ; LORA SMITH; and
TOSHA THOMAS, individually and on
behalf of a class of all other
persons similarly situated,

Plaintiffs,

v.

K-M INDUSTRIES HOLDING CO., INC.; K-M
INDUSTRIES HOLDING CO., INC. ESOP
PLAN COMMITTEE; WILLIAM E. AND
DESIREE B. MOORE REVOCABLE TRUST;
TRUSTEES OF THE WILLIAM E. AND
DESIREE B. MOORE REVOCABLE TRUST; CIG
ESOP PLAN COMMITTEE; NORTH STAR TRUST
COMPANY; DESIREE B. MOORE REVOCABLE
TRUST; WILLIAM E. MOORE MARITAL
TRUST; WILLIAM E. MOORE GENERATION-
SKIPPING TRUST; and DESIREE MOORE,
both in her individual capacity and
as trustee of the William E. and
Desiree B. Moore Revocable Trust's
successor trusts named above,

Defendants.

ORDER DENYING NORTH
STAR'S MOTION FOR
JUDGMENT ON THE
PLEADINGS AND GRANTING
THE SETTling PARTIES'
CROSS-MOTION FOR
JUDGMENT ON THE
PLEADINGS

_____ /

Plaintiffs Thomas Fernandez, Lora Smith and Tosha Thomas
brought this action under the Employee Retirement Income Security
Act (ERISA). They allege, among other things, that Defendant North
Star Trust Company breached its fiduciary duties as the trustee of

1 an employee stock ownership plan (ESOP) in which they participate.
2 North Star now moves for judgment on the pleadings on its cross-
3 claims for contractual indemnity against Defendant K-M Industries
4 Holding Co., Inc. (KMH) and against Defendants William E. and
5 Desiree B. Moore Revocable Trust, Trustees of the William E. and
6 Desiree B. Moore Revocable Trust, Desiree B. Moore Revocable Trust,
7 William E. Moore Marital Trust, William E. Moore Generation-
8 Skipping Trust and Desiree Moore (collectively, the Moore Trust
9 Defendants). These Defendants oppose the motion jointly with
10 Plaintiffs (together, the Settling Parties) and cross-move for
11 judgment on the pleadings on North Star's cross-claims. The matter
12 was heard on August 6, 2009. Having considered oral argument and
13 all of the papers submitted by the parties, the Court denies North
14 Star's motion and grants the Settling Parties' cross-motion.

15 BACKGROUND

16 I. Plaintiffs' Claims Against North Star

17 Plaintiffs are former employees of either Kelly-Moore Paint
18 Company or Capital Insurance Group (CIG). Kelly-Moore was founded
19 in 1946 by William Moore, who served as the company's president
20 until 1984 and effectively exercised control over the company until
21 shortly before his death in 2004. Kelly-Moore acquired CIG in
22 1985. Kelly-Moore and CIG continued to be wholly owned by Mr.
23 Moore and his family through a trust, the successor trusts of which
24 are the Moore Trust Defendants, until 1998.

25 This lawsuit arises from Mr. Moore's establishment of an ESOP
26 for Kelly-Moore and CIG employees in 1998. In connection with the
27 establishment of the ESOP, Kelly-Moore was restructured. KMH was

1 created as a holding company, all of whose shares were owned by the
2 Moore Trust. Kelly-Moore and CIG became wholly-owned subsidiaries
3 of KMH. KMH's shares were organized into two groups of "tracking
4 stock," each intended to track the performance of its associated
5 subsidiary: the "series P" stock tracked Kelly-Moore and the
6 "series I" stock tracked CIG.

7 In October, 1998, Mr. Moore sold forty-two percent of the
8 Moore Trust's interest in KMH's series P stock to the ESOP for \$232
9 million. In October, 1999, Mr. Moore sold forty-two percent of the
10 Moore Trust's interest in KMH's series I stock to the ESOP for \$55
11 million. Mr. Moore was the sole trustee for the ESOP in connection
12 with both of these transactions. He was therefore both the buyer
13 and the seller in the transactions. The gist of the complaint is
14 that the ESOP purchased KMH shares from the Moore Trust for more
15 than they were worth because Mr. Moore failed to provide valuation
16 experts with complete and accurate information about Kelly-Moore's
17 exposure to liability from asbestos litigation.

18 In 2003, Mr. Moore's deteriorating health necessitated his
19 resignation as the ESOP trustee. North Star was appointed to
20 replace him in April of that year. As North Star began
21 familiarizing itself with KMH's potential asbestos liability, it
22 realized that the initial stock valuation raised some concerns.
23 However, North Star ultimately decided not to take any action to
24 challenge the price for which the ESOP purchased the KMH shares.

25 Plaintiffs assert a claim against North Star for breach of
26 fiduciary duty in violation of ERISA. See 29 U.S.C. §§ 1104(a)(1),
27 1109, 1132(a)(2), 1132(a)(3). Specifically, Plaintiffs charge

28

1 North Star with liability under 29 U.S.C. § 1105(a)(3), which
2 provides that a fiduciary "shall be liable for a breach of
3 fiduciary responsibility of another fiduciary with respect to the
4 same plan . . . if he has knowledge of a breach by such other
5 fiduciary, unless he makes reasonable efforts under the
6 circumstances to remedy the breach." Plaintiffs claim that,
7 despite clear warning signs, North Star did not take adequate steps
8 to investigate whether the ESOP paid more than fair market value
9 for the KMH shares it purchased from the Moore Trust and to remedy
10 the overpayment. As discussed in more detail below, North Star has
11 asserted cross-claims for contractual indemnification against the
12 Settling Defendants.

13 On May 8, 2009, the Court granted final approval of a
14 settlement of Plaintiffs' claims against KMH and the Moore Trust
15 Defendants. The settlement agreement provides that, if Plaintiffs
16 prevail against North Star but North Star prevails against the
17 Settling Defendants on its claim for indemnification, Plaintiffs
18 will accept a reduction in the judgment against North Star in the
19 amount by which the Settling Defendants are required to indemnify
20 North Star. Accordingly, if North Star prevails against either KMH
21 or the Moore Trust Defendants on its claim for total
22 indemnification, Plaintiffs will not recover any funds beyond the
23 amount for which they have already settled.

24 II. North Star's Claims for Indemnity

25 North Star bases its claim for indemnity against the Moore
26 Trust Defendants on the agreements that governed the ESOP's initial
27 stock purchases in 1998 and 1999. It bases its claim for indemnity
28

1 against KMH on the agreement that governed its engagement as the
2 ESOP trustee in 2003.

3 A. The Stock Purchase Agreements

4 The terms of the ESOP's 1998 and 1999 purchases of KMH stock
5 from the Moore Trust are set out in separate stock purchase
6 agreements. The two agreements are identical in all respects
7 relevant to the present motion.

8 North Star asserts that its indemnification rights are spelled
9 out in sections 2(b) and 7 of the agreements. Section 2(b)
10 provides:

11 The purchase price in Section 2(a) hereof is not more
12 than the fair market valuation established as of the date
13 of this Agreement. In the event that there is a final
14 determination by the Internal Revenue Service, a court of
15 competent jurisdiction or otherwise that the fair market
16 value of the Shares as of this date is less than the
17 Purchase Price paid by the Trustee, then Selling
18 Shareholder shall transfer to the Trustee an amount of
19 cash, or transfer to the Trustee shares of [KMH's] Class
20 P-B Stock, or any combination thereof, equal in value to
21 the difference between the Purchase Price and said fair
22 market value for all such Shares.

23 Diller Dec. Ex. 1 at 2-3; Ex. 2 at 2-3.¹ Section 7 provides:

24 Selling Shareholder agrees to indemnify and hold harmless
25 Trustee, and Trustee agrees to hold Selling Shareholder
26 harmless, from any and all claims, actions and suits,
27 whether groundless or otherwise, and from and against any
28 and all liabilities, losses, damages, costs, charges,
counsel fees and other expenses of every nature and
character resulting or arising therefrom or resulting
from or arising out of the breach of any representation,
agreement or warranty made under or pursuant to this
Agreement.

29 Id. Ex. 1 at 6; Ex. 2 at 6.

30 ¹The contents of the agreements on which North Star relies are
31 alleged in the pleadings and are not disputed. They are therefore
32 appropriately considered on this motion.

1 North Star also relies on section 11 of the agreements, which
2 provides that the agreements "shall inure to the benefit of and be
3 binding upon the parties named herein and their successors and
4 assigns." Id. Ex. 1 at 8; Ex. 2 at 8.

5 B. The Trustee Engagement Agreement

6 North Star's appointment as the ESOP trustee is governed by a
7 Trustee Engagement Agreement between North Star and KMH. The
8 agreement contains an indemnification provision that states:

9 Indemnification. For purposes of this Section 14, the
10 term "Indemnitees" shall mean North Star and its
11 officers, directors, employees, and agents. Subject to
12 the applicable provisions of ERISA, the Company [(KMH)]
13 shall indemnify the Indemnitees for any loss, cost,
14 expense, or other damage, including reasonable attorney's
15 fees, suffered by any of the Indemnitees resulting from
16 or incurred with respect to any legal proceedings related
17 in any way to the performance of services by any one or
18 more of the Indemnitees pursuant to this Agreement. The
19 indemnification provided for in this Section 14 shall
20 extend to: (a) any action taken or not taken by any of
21 the Indemnitees at the direction or request of the Plan
22 Administrator or of any agent of the Plan Administrator;
23 (b) any action taken or not taken by the prior trustee or
24 trustees; and (c) all reasonable costs and expenses
25 incurred by the Indemnitees in enforcing the
26 indemnification provisions of this Section 14, including
27 reasonable attorney's fees and court costs. However,
28 these indemnification provisions shall not apply to the
extent that any loss, cost, expense or damage with
respect to which any of the Indemnitees shall seek
indemnification is held by a court of competent
jurisdiction, in a final judgment from which no appeal
can be taken, to have resulted either from the gross
negligence of one or more of the Indemnitees or from the
willful misconduct of one or more of the Indemnitees.

Diller Dec. Ex. 3 at 4.

LEGAL STANDARD

Rule 12(c) of the Federal Rules of Civil Procedure provides,
"After the pleadings are closed but within such time as not to
delay the trial, any party may move for judgment on the pleadings."

1 Judgment on the pleadings is proper when the moving party clearly
2 establishes on the face of the pleadings that no material issue of
3 fact remains to be resolved and that it is entitled to judgment as
4 a matter of law. Hal Roach Studios, Inc. v. Richard Feiner & Co.,
5 Inc., 896 F.2d 1542, 1550 (9th Cir. 1990).

6 DISCUSSION

7 I. North Star's Claim for Indemnification against KMH

8 Section 410(a) of ERISA provides that "any provision in an
9 agreement or instrument which purports to relieve a fiduciary from
10 responsibility or liability for any responsibility, obligation, or
11 duty under this part shall be void as against public policy." 29
12 U.S.C. § 1110(a). The Settling Parties argue that, even assuming
13 the scope of the Trustee Engagement Agreement's indemnification
14 provision extends to the claims asserted against North Star in this
15 action,² the provision is invalid under section 410(a).

16 Section 410(b) states that nothing in section 410(a)
17 precludes:

18 (1) a plan from purchasing insurance for its fiduciaries
19 or for itself to cover liability or losses occurring by
20 reason of the act or omission of a fiduciary, if such
21 insurance permits recourse by the insurer against the
22 fiduciary in the case of a breach of a fiduciary
23 obligation by such fiduciary;

24 (2) a fiduciary from purchasing insurance to cover
25 liability under this part from and for his own account;
26 or

27 (3) an employer or an employee organization from
28 purchasing insurance to cover potential liability of one

25
26 ²The Settling Parties argue that the claims asserted against
27 North Star do not fall within the categories of claims covered by
28 the indemnification provision. Because the Court concludes that
the provision is invalid, it need not reach this issue.

1 or more persons who serve in a fiduciary capacity with
2 regard to an employee benefit plan.

3 29 U.S.C. § 1110(b).

4 The Department of Labor (DOL) has issued a regulation
5 interpreting section 410(a)'s application to indemnification
6 agreements. The regulation provides in relevant part:

7 The Department of Labor interprets this section to permit
8 indemnification agreements which do not relieve a
9 fiduciary of responsibility or liability under Part 4 of
10 Title I. Indemnification provisions which leave the
11 fiduciary fully responsible and liable, but merely permit
12 another party to satisfy any liability incurred by the
13 fiduciary in the same manner as insurance purchased under
14 section 410(b)(3), are therefore not void under section
15 410(a).

16 Examples of such indemnification provisions are:

17 (1) Indemnification of a plan fiduciary by (a) an
18 employer, any of whose employees are covered by the
19 plan, or an affiliate (as defined in section
20 407(d)(7) of the Act) of such employer, or (b) an
21 employee organization, any of whose members are
22 covered by the plan; and

23 (2) Indemnification by a plan fiduciary of the
24 fiduciary's employees who actually perform the
25 fiduciary services.

26 The Department of Labor interprets section 410(a) as
27 rendering void any arrangement for indemnification of a
28 fiduciary of an employee benefit plan by the plan. Such
an arrangement would have the same result as an
exculpatory clause, in that it would, in effect, relieve
the fiduciary of responsibility and liability to the plan
by abrogating the plan's right to recovery from the
fiduciary for breaches of fiduciary obligations.

29 C.F.R. § 2509.75-4.

30 Although the indemnification provision in the Trustee
31 Engagement Agreement does not require the ESOP itself to indemnify
32 North Star -- an arrangement that would clearly be void under
33 section 410(a) -- it would impose liability on the company whose

1 shares constitute the ESOP's sole asset. The price of those shares
2 is determined annually by a valuation of KMH. If KMH were forced
3 to indemnify North Star against a sizeable judgment for breach of
4 fiduciary duty, it would almost certainly decrease the value of KMH
5 and, by extension, the ESOP shares.³ The ESOP, which owns forty-
6 two percent of KMH, would thus shoulder a large part of the burden
7 of indemnification. While the DOL's regulation provides, as an
8 example, that indemnification of a plan fiduciary by the employer
9 may be permissible, ESOP plans differ from other plans governed by
10 ERISA in that a judgment against the employer will negatively
11 affect the plan itself. Because the Trustee Engagement Agreement's
12 indemnification provision would indirectly impose on the ESOP the
13 cost of any breach of fiduciary duty by North Star, the provision
14 is invalid under section 410(a).

15 This conclusion is supported by a recent Ninth Circuit case,
16 Johnson v. Couturier, ___ F.3d ___, 2008 WL 4443085 (9th Cir.
17 2009). In Johnson, the district court had granted a preliminary
18 injunction prohibiting the company in which an ESOP plan held
19 shares from advancing individual defendants, who were trustees of
20 the ESOP, the cost of defending against claims for breach of
21 fiduciary duty. Advancement of such costs was required by an
22 indemnification provision between the company and the defendants.
23 The district court agreed with "a number of federal courts" that
24 "have held that under ERISA § 410, where an ESOP owns a substantial

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26 ³KMH considers its value to be confidential. The Court notes,
27 however, that the amount Plaintiffs seek for North Star's alleged
28 breach of fiduciary duty is significant in relation to KMH's total
value.

1 portion of the sponsoring company's stock, it would be inconsistent
2 with the intentions of ERISA to allow a trustee who has breached
3 his fiduciary duties to the ESOP to be indemnified by the
4 sponsoring company where the ESOP would indirectly bear the
5 financial burden." Johnson v. Couturier, 2008 WL 4443085, at *5
6 (E.D. Cal.) (internal quotation marks omitted).

7 The Ninth Circuit affirmed. In doing so, it rejected the
8 defendants' argument -- an argument that North Star advances here
9 -- that section 410(a) did not apply "because advancement would be
10 made from corporate, not plan, assets." 2009 WL 2216805 at *9.
11 The court recognized that any proceeds taken from the corporation
12 to pay for the defendants' defense costs would reduce the funds
13 available for distribution to ESOP participants. "In other words,"
14 the court stated, advancement was "tantamount to asking ESOP
15 participants to pay for Defendants' defense costs," an arrangement
16 that was impermissible under section 410(a). 2009 WL 2216805 at
17 *9.

18 North Star attempts to distinguish Johnson on the basis that
19 the ESOP in that case owned 100 percent of the company against
20 which indemnification was sought, and that the company was in the
21 process of liquidating its assets, such that any funds used to pay
22 the costs of the individual defendants would be unavailable for
23 distribution to plan participants. However, while the financial
24 damage to the ESOP participants in Johnson may have been more
25 closely linked to the challenged indemnification than in the
26 present case, the court's decision did not turn on this point. The
27 rationale underlying the court's holding supports the conclusion

28

1 that indemnification agreements are invalid any time an ESOP would
2 bear the financial burden of indemnification, whether directly or
3 indirectly.

4 Even if Johnson did not govern this case, the lower court
5 decisions on which North Star relies do not support the conclusion
6 that the Trustee Engagement Agreement's indemnification provision
7 is valid. The first of these cases is Wells Fargo Bank v. Bourns,
8 Inc., 860 F. Supp. 709 (N.D. Cal. 1994). In Bourns, the court
9 addressed the validity of an indemnification agreement between the
10 trustee of an employee profit-sharing plan and the employer, which
11 was also a fiduciary of the plan. The DOL had previously found
12 that the company had breached its fiduciary duty when it directed
13 the trustee to invest plan assets in a real estate venture that
14 later failed. The trustee incurred significant expenses in
15 successfully defending against the DOL's investigation into whether
16 it had also breached its fiduciary duty by following the company's
17 direction and, subsequently, against a lawsuit brought against it
18 by the company for breach of fiduciary duty. The trustee then sued
19 the company for indemnification, seeking reimbursement for the
20 costs of its defense. The court held that the indemnification
21 provision was valid under section 410(a) of ERISA and the DOL's
22 interpretive regulation. In reaching this conclusion, the court
23 noted that "ERISA § 410 seeks to avoid provisions which circumvent
24 express statutory requirements to the detriment of Plan
25 beneficiaries." Id. at 716. Such an effect was not the case in
26 Bourns, however, because -- as the parties agreed -- there was "no
27 possibility that the beneficiaries themselves would suffer as a

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1 result of enforcement of the Agreement." Id. Here, in contrast,
2 enforcement of the indemnification clause would cause Plaintiffs to
3 suffer. Thus, Bourns does not support North Star's position.

4 North Star also cites Pudela v. Swanson, 1995 WL 77137 (N.D.
5 Ill.), in which the court addressed the validity of a corporate
6 bylaw that, under certain circumstances, provided indemnification
7 for corporate officers and directors sued in connection with the
8 performance of their duties. The plaintiffs argued that the
9 provision was invalid because it would permit ESOP assets to be
10 used for the indemnification. The provision, however, only applied
11 to officers and directors who had acted in good faith and in a
12 manner they reasonably believed was not opposed to the best
13 interests of the company. Id. at *3. Because the bylaw "could be
14 interpreted as leaving plan fiduciaries fully responsible and
15 liable for any breach of fiduciary duties," the court could not
16 determine that the provision was invalid as a matter of law. Id.
17 at *5.⁴ Here, in contrast, the Trustee Engagement Agreement would
18 leave KMH responsible and liable for North Star's breach of
19 fiduciary duty unless the breach involved gross negligence or
20 willful misconduct.

21 Other district courts, in cases more similar to this one than
22 Bourns and Pudela, have held that indemnification of an ESOP

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24 ⁴At the same time, the defendants had not established that any
25 of the corporate directors had provided the corporation with an
26 undertaking to repay legal expenses if their defense was
27 unsuccessful. The court therefore found that the potential existed
28 that the directors would not bear the financial burden of a finding
that they breached their fiduciary duties. For this reason, the
court deferred ruling on the validity of the indemnification
clause. Id.

1 trustee by the company whose shares the ESOP owns is invalid under
2 section 410(a). In Donovan v. Cunningham, 541 F. Supp. 276 (S.D.
3 Tex. 1982), rev'd in part on other grounds, 716 F.2d 1455 (5th Cir.
4 1983), for example, the court stated:

5 In the instant case, of course, the ESOP owns a
6 substantial portion of MCS stock. It is inconsonant with
7 the intentions of section 410 of ERISA, 29 U.S.C. 1110,
8 and the regulations quoted above [(29 C.F.R.
9 § 2509.75-4)], to permit indemnification by MCS where the
10 ESOP would indirectly bear the financial burden. Such
11 situation is not a mere shifting of liability incurred by
12 a fiduciary in the same manner as insurance. Further
13 that there is no adjudication of Allied's status as
14 fiduciary does not affect the court's ruling on this
15 question. The goal is to protect the ESOP from suffering
16 any expense of this suit -- that goal cannot be met by
17 requiring MCS to indemnify any part [sic] to this suit.

18 Id. at 289. The only basis North Star identifies for
19 distinguishing Donovan is the fact that the indemnification
20 agreement in that case was set forth in the ESOP plan documents,
21 not a separate agreement between the fiduciary and the company.
22 But the document in which the indemnification agreement is
23 contained does not bear on the question of its validity. The
24 question is whether the nature of the agreement renders it invalid.
25 In addition, neither section 410(a) nor the DOL's implementing
26 regulation contains any reference to the location of the
27 indemnification agreement.

28 Delta Star, Inc. v. Patton, 76 F. Supp. 2d 617 (W.D. Pa.
1999), also dealt with the validity of an indemnification agreement
under section 410(a) when an ESOP trustee is alleged to have
committed a breach of fiduciary duty. The agreement in Delta Star
provided that the sponsoring company would indemnify any member of
the ESOP board of trustees "against any personal liability or

1 expense resulting from his service on the ESOP Board . . . , except
2 such liability or expense as may result from his own willful
3 misconduct." Id. at 640. The court stated that indemnification
4 was "prohibited by law in this case" because "ERISA prohibits, as
5 being against public policy, any agreement that purports to relieve
6 a fiduciary of responsibility or liability under ERISA for either
7 breach of fiduciary duty or self-dealing." Id. (citing Moore v.
8 Williams, 902 F. Supp. 957, 966 (N.D. Iowa 1995); Donovan, 541 F.
9 Supp. at 289). As North Star points out, this conclusion could be
10 considered dictum because the court found that the trustee
11 defendant had engaged in willful misconduct, and thus his actions
12 did not fall within the scope of the indemnification provision.
13 Nonetheless, the court in Delta Star was clearly of the view that
14 the indemnification provision was invalid on its face.

15 North Star also notes that, because of the settlement
16 agreement between Plaintiffs and the Settling Defendants, KMH will
17 not actually be forced to pay any additional sums if North Star
18 prevails on its claim for indemnification against KMH.
19 Accordingly, there is no possibility that the value of the ESOP
20 shares will actually decrease if KMH is held liable for
21 indemnification. While this is true, the validity of an
22 indemnification agreement under ERISA must be determined from the
23 face of the agreement. Moreover, the Settling Parties correctly
24 point out that, even though the value of the ESOP shares would not
25 actually decrease if North Star succeeded on its indemnification
26 against KMH, Plaintiffs nonetheless would suffer a financial
27 detriment; Plaintiffs would be forced to forego a potentially

1 significant recovery against North Star.

2 In sum, the Court agrees with Plaintiffs that the Ninth
3 Circuit's decision in Johnson compels the conclusion that the
4 indemnification provision in the Trustee Engagement Agreement is
5 invalid. Even if Johnson were distinguishable, the Court agrees
6 with the other district courts that have concluded that any
7 indemnification provision, such as the one here, that imposes the
8 burden of an ESOP trustee's breach of fiduciary duty on the company
9 that sponsors the ESOP is invalid under section 410(a) of ERISA.
10 Accordingly, North Star cannot recover against KMH.

11 II. North Star's Claim for Indemnification against the Moore Trust
12 Defendants

13 A. Section 2(a) of the Stock Purchase Agreements

14 As noted above, section 2(a) of the stock purchase agreements
15 provided that the Moore Trust would transfer to Mr. Moore, as
16 trustee for the ESOP, any amounts that the ESOP was found by a
17 court to have overpaid for the stock. North Star argues that,
18 because Plaintiffs' claim against it is based on its alleged
19 failure to investigate and rectify the original overpayment for the
20 ESOP shares, and because it succeeded to Mr. Moore's rights under
21 the stock purchase agreements when assumed the role of trustee, if
22 Plaintiffs were to prevail, this provision would be triggered and
23 North Star would be entitled to recover the amount of overpayment
24 from the Moore Trust.

25 North Star's interpretation of section 2(a) stretches reason.
26 A straightforward reading of the text indicates that the provision
27 exists for the benefit of ESOP participants. It requires the Moore

1 Trust Defendants to return to the ESOP any amounts they are found
2 to have wrongfully received as a result of the plan's overpayment.
3 The fact that the provision requires the Moore Trust Defendants to
4 transfer funds to the trustee does not suggest that the trustee may
5 keep the funds for itself; the trustee must hold the funds in trust
6 for the plan beneficiaries. It is inconceivable that the parties
7 to the agreements would have intended the trustee itself to benefit
8 financially from an overpayment. To the extent North Star argues
9 that section 2(a) provides that the Moore Trust, and no one else,
10 can be called upon to compensate the ESOP for an overpayment,
11 nothing in the text suggests as much. Moreover, North Star is not
12 being charged with liability for the overpayment but for breaching
13 its fiduciary duty by failing to investigate and take appropriate
14 action to remedy the overpayment. Section 2(a) does not require
15 the Moore Trust Defendants to indemnify North Star for this breach.

16 B. Section 7 of the Stock Purchase Agreements

17 Pursuant to section 7 of the stock purchase agreements, the
18 Moore Trust agreed "to indemnify and hold harmless" Mr. Moore, who
19 at the time was the trustee of the ESOP, and Mr. Moore agreed to
20 hold the Moore Trust harmless (but not to indemnify it) "from any
21 and all claims, actions and suits . . . and from and against any
22 and all liabilities, losses, damages, costs, charges, counsel fees
23 and other expenses . . . resulting from or arising out of the
24 breach of any representation, agreement or warranty made under or

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1 pursuant to this Agreement.”⁵

2 The fact that section 7 imposes reciprocal obligations on the
3 parties makes it difficult to assign the provision a meaning.

4 There are three possible interpretations: 1) Mr. Moore and the
5 Moore Trust each agreed not to sue the other for breach of
6 representations he or it made in connection with the agreements;
7 2) Mr. Moore and the Moore Trust agreed not to seek indemnity from
8 each other if either was sued by a third party for breach of
9 representations he or it made in connection with the agreements; or
10 3) Mr. Moore and the Moore Trust each agreed to indemnify the other
11 in the event that one was sued for the other’s breach of
12 representations made in connection with the agreements. None of
13 these interpretations is entirely satisfactory but, as explained
14 below, the Court concludes that the second interpretation is the
15 most reasonable.

16 Plaintiffs advance the first interpretation: that section 7
17 imposes a mutual promise not to sue for breach of representations

18
19 ⁵The Court will assume for the purpose of this discussion that
20 Plaintiffs’ claim against North Star arises out of the breach of a
21 representation made under the stock purchase agreements. This
22 matter, however, is disputed. As Plaintiffs point out, North Star
23 is being charged with liability for its own breach of fiduciary
24 duty, which took place after it assumed its position as the ESOP
25 trustee in 2003. Even though its alleged breach relates to the
26 stock purchase agreements in that it is being charged with
27 liability for failing to investigate and rectify Mr. Moore’s
28 earlier breach, it does not appear that the claims against North
Star “arise out of” the earlier breach. Moreover, section 7
extends only to liability arising out of the breach of a
“representation, agreement or warranty” made pursuant to the stock
purchase agreements. North Star has pointed to no representation,
agreement or warranty in the stock purchase agreements that it is
alleged to have breached. Because the Court concludes that North
Star may not recover under section 7 of the stock purchase
agreements in any event, it need not decide these issues.

1 made in connection with the stock purchase agreements. Such an
2 interpretation would convert the provision from one requiring
3 indemnification, which contemplates a lawsuit by a third party,
4 into a two-party exculpatory clause. See Queen Villas Homeowners
5 Ass'n v. TCB Prop. Mgmt., 149 Cal. App. 4th 1, 5 (2007). If
6 section 7 were interpreted this way, it would prevent the ESOP
7 trustee from attempting to recover any overpayment from the Moore
8 Trust. Because such a provision would relieve the trustee from its
9 fiduciary duties -- and, in fact, would prohibit the trustee from
10 discharging those duties -- it would be void under section 410(a)
11 of ERISA. Because an interpretation that gives effect to a
12 contractual provision is preferred to one that makes the provision
13 void, see Cal. Civ. Code § 3541, the Court will not interpret the
14 contract as prohibiting the parties to the stock purchase
15 agreements from suing each other for breaches of representations
16 made in connection with the agreements. In addition, to be
17 effective, an exculpatory clause must contain "clear, unambiguous
18 and explicit language" releasing one side from liability to the
19 other. Queen Villa, 149 Cal. App. 4th at 5 (citation omitted).
20 Section 7 contains no such language.

21 North Star favors the third interpretation: that Mr. Moore
22 agreed, as the ESOP trustee, to indemnify the Moore Trust for any
23 third-party liability it incurred as a result of Mr. Moore's
24 conduct, and that the Moore Trust agreed to indemnify Mr. Moore
25 against any third-party liability he incurred as a result of the
26 Moore Trust's conduct. North Star's interpretation overlooks the
27 fact that section 7 contains no promise on Mr. Moore's part to

1 indemnify the Moore Trust. In addition, this interpretation makes
2 little sense given that Mr. Moore was, in reality, both the buyer
3 and the seller in the ESOP transaction. Moreover, to the extent
4 certain representations could be attributed to Mr. Moore as trustee
5 of the Moore Trust and other representations could be attributed to
6 Mr. Moore as trustee of the ESOP, North Star's claim for indemnity
7 under the stock purchase agreements is premised on its succession
8 to Mr. Moore's rights as trustee of the ESOP. Under North Star's
9 own interpretation of section 7, it would therefore only be
10 entitled to indemnity from the Moore Trust if it incurred third-
11 party liability as a result of the Moore Trust's conduct. North
12 Star is not even arguably being charged with liability for a
13 "representation, agreement or warranty" made by the Moore Trust.
14 It is being charged with liability for breaching its fiduciary duty
15 by failing to investigate and remedy Mr. Moore's previous breach as
16 trustee of the ESOP. Thus, even under North Star's interpretation
17 of the reciprocal nature of section 7, its indemnity claim fails.

18 The second interpretation of the reciprocal indemnification
19 provision is the most reasonable: the provision prevents the
20 parties from seeking indemnity from each other where, as here, a
21 third party charges one or both of them with a breach. This
22 interpretation finds support in Queen Villas, which addresses the
23 meaning of the term "hold harmless":

24 Are the words "indemnify" and "hold harmless" synonymous?
25 No. One is offensive and the other is defensive -- even
26 though both contemplate third-party liability situations.
27 "Indemnify" is an offensive right -- a sword -- allowing
28 an indemnitee to seek indemnification. "Hold harmless"
is defensive: The right not to be bothered by the other
party itself seeking indemnification.

1 Let us illustrate: As every veteran of construction
2 defect litigation and every judge who ever picked up a
3 hefty construction defect file knows, in third-party
4 situations there is usually a blizzard of cross-
5 complaints seeking indemnity for the cross-complainant's
6 possible liability for indemnity. Consider this
7 hypothetical: Homeowner sues general contractor. General
8 contractor sues Subs 1 and 2 for indemnity, that is, to
9 make both subcontractors cover the general's prospective
10 liability to the homeowner. Now suppose Sub 1 has an
11 agreement with Sub 2 which requires Sub 2 to "indemnify
12 and hold harmless" Sub 1. Sub 1 can use the word
13 "indemnify" in the agreement as a basis to sue Sub 2 for
14 indemnity for the possible liability Sub 1 may incur to
15 the general. And Sub 1 can use the phrase "hold
16 harmless" as a basis to prevent Sub 2 from suing it for
17 the liability that Sub 2 might incur to the general.

18 149 Cal. App. 4th at 9.

19 The fact that Mr. Moore, as the ESOP trustee, agreed to hold
20 the Moore Trust harmless for breach of any representations
21 indicates a promise not to seek indemnification in the event of a
22 lawsuit against him arising from the breach. North Star takes the
23 position that it succeeded to all of the ESOP trustee's rights and
24 obligations contained in the section 7. Accordingly, under this
25 interpretation of the provision, North Star may not seek
26 indemnification from the Moore Trust if North Star is held liable
27 for a breach arising out of the agreement.⁶ Nor may the Moore
28 Trust seek indemnification from North Star if the Moore Trust is
29 held liable for a breach arising out of the agreement.

30 North Star argues that the reciprocal agreement between Mr.

31 ⁶Under the second interpretation, section 7 is not a
32 prohibited exculpatory clause. The provision would be exculpatory
33 only if it excused North Star from discharging its fiduciary
34 duties. Under the second interpretation, North Star is not
35 prohibited from suing the Moore Trust to assert the ESOP's
36 interest. It is merely prohibited from seeking indemnification
37 from the Moore Trust if it is held personally liable for breach of
38 its fiduciary duties.

1 Moore and the Moore Trust to hold each other harmless should not be
2 interpreted as cancelling out the Moore Trust's promise to
3 indemnify Mr. Moore. North Star notes that, under California law,
4 "repugnant" contractual terms -- in other words, contradictory or
5 inconsistent terms -- should be "reconciled, if possible, by such
6 an interpretation as will give some effect to the repugnant
7 clauses, subordinate to the general intent and purpose of the whole
8 contract." Cal. Civ. Code § 1652.

9 It is true that Mr. Moore's promise to hold the Moore Trust
10 harmless renders the Moore Trust's promise to indemnify Mr. Moore
11 illusory. However, the two promises cannot be reconciled in any
12 meaningful way. Moreover, North Star's interpretation would not
13 only cancel out the reciprocal obligation to hold harmless, it
14 would also impose a mutual promise to indemnify where none exists.
15 The most reasonable interpretation of the reciprocal
16 indemnification agreement is that each party agreed not to seek
17 indemnification from the other in the event of a lawsuit by a third
18 party arising from representations made in connection with the
19 stock purchase agreements. Because North Star is prohibited by
20 section 7 from pursuing its claim for indemnification against the
21 Moore Trust, Plaintiffs' motion must be granted and North Star's
22 denied.⁷

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24

25 ⁷The Court need not reach Plaintiffs' argument that the stock
26 purchase agreements do not provide any personal rights, such as the
27 right to indemnification, to North Star. Nor need the Court reach
28 Plaintiffs' argument that North Star may not rely on any promises
in the stock purchase agreements because the later Trustee
Engagement Agreement is a fully integrated writing.

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CONCLUSION

For the foregoing reasons, the Court DENIES North Star's motion for judgment on the pleadings (Docket No. 274) and GRANTS the Settling Parties' cross-motion for judgment on the pleadings (Docket No. 304).

IT IS SO ORDERED.

Dated: 8/21/09



CLAUDIA WILKEN
United States District Judge