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

PRESENT: BARBARA R. KAPNICK J.S.C. Justice PART 39

LPL Holdings, et. al.

- v -

Pacific Life Ins.

INDEX NO. 603562/09

MOTION DATE

MOTION SEQ. NO. 001

MOTION CAL. NO.

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	
Answering Affidavits — Exhibits	
Replying Affidavits	

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING [illegible]

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE FOR THE FOLLOWING REASON(S):

Dated: 3/3/11

BARBARA R. KAPNICK J.S.C.

Check one: ☒ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☒ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IA PART 39

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LPL HOLDINGS, INC., ASSOCIATED SECURITIES CORP., MUTUAL SERVICE CORPORATION, and WATERSTONE FINANCIAL GROUP, INC.,

Plaintiffs,

-against-

PACIFIC LIFE INSURANCE COMPANY,

Defendant.

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DECISION/ORDER
Index No. 603652/09
Motion Seq. No. 001

BARBARA R. KAPNICK, J.:

This action for breach of contract and a declaratory judgment arises out of a Purchase and Sale Agreement (the "PSA"), dated as of March 2, 2007, between plaintiff LPL Holdings, Inc. ("LPL"), a holding company for the nation's largest independent broker/dealer network, and defendant Pacific Life Insurance Company ("Pacific Life") and other entities, pursuant to which LPL acquired Associated Securities Corp. ("ASC"), Mutual Service Corporation ("MSC"), and Waterstone Financial Group, Inc. ("WFG") (collectively, the "Transferred Subsidiaries")[1] from Pacific Life, for approximately $100 million in cash and stock.

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[1] ASC, MSC, and WFG are all registered broker-dealers and investment advisors. They are now indirect subsidiaries of LPL, although plaintiffs acknowledge that certain parts of their operations were recently consolidated with the operations of LPL.

[* 3]

Background

Section 6.2 of the PSA provides, in relevant part that:

> (a) From and after the Closing Date, subject to the provisions of Sections 6.4 through 6.8, Seller shall indemnify and save and hold harmless Purchaser Parent, Purchaser, the Transferred Subsidiaries and their Representatives (collectively, the "Purchaser Indemnified Parties") from and against any Covered Losses suffered by any such Purchaser Indemnified Parties, directly or indirectly, resulting from or arising out of:
>
> * * *
>
> (iv) a Third Party Claim relating to any action, omission or course of conduct by any of the Transferred Subsidiaries (x) during any period prior to the Closing Date (including any such matters disclosed in the Seller Disclosure Letter) or (y) at any time during the period of nine (9) months after the Closing Date, provided that, with respect to clause (y), Purchaser has operated the Transferred Subsidiaries with reasonable care and supervision; . . . .

"Covered Loss," is defined in Section 8.1 of the PSA, in relevant part as:

> any and all Losses, liabilities, claims, fines, deficiencies, damages, obligations, payments (including, without limitation, those arising out of any settlement, judgment or compromise relating to any Legal Proceeding[2]),

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[2] The term "Legal Proceeding" is defined in Section 8.1 as "any judicial, administrative or arbitration actions, suits, proceedings (public, private, civil or criminal), complaints, disputes, investigations, reviews, requests for information, actions or proceedings before any arbitrator, mediator or Government Entity."

> reasonable costs and expenses (including, without limitation, interest and penalties due and payable with respect thereto and reasonable attorneys' and accountants' fees and any other reasonable out-of-pocket expenses incurred in investigating, preparing, defending, avoiding or settling any Legal Proceeding), whether or not involving a third party claim; . . . .[3]

According to the Complaint, Section 6.2(a)(iv) requires Pacific Life to indemnify LPL and the Transferred Subsidiaries for Covered Losses resulting from or arising out of, *inter alia*, third party claims.

The indemnification obligation is expressly limited by Section 6.5 of the PSA, which provides, in relevant part:

> (g) Subject to Section 6.7, each indemnified party shall use its commercially reasonable efforts to mitigate any Covered Losses. In the event an indemnified party fails to so mitigate any Covered Loss, the indemnifying party shall have no liability for any portion of such Covered Loss that reasonably could have been avoided had the indemnified person made such efforts.

There is no dispute that since the PSA was executed in 2007, Pacific Life has indemnified plaintiffs for approximately $32 million worth of settlement and defense costs related to third

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[3] The PSA provides that Pacific Life would indemnify LPL for these "Covered Losses" when they arise out of the situations enumerated in the PSA, Sections 6.2(a)(i) through (iv).

party claims, including claims asserted by investors against ASC in a FINRA arbitration proceeding (the "Brezden Claims").[4]

In Spring 2009, LPL filed a Continuing Membership Application ("CMA") with FINRA on behalf of the Transferred Subsidiaries, seeking FINRA's approval of a transaction in which customer accounts and financial advisors, associated with the Transferred Subsidiaries, would be transferred to LPL Financial Corp. ("LPL Financial"), a subsidiary of LPL.

Subsequent to LPL's announcement that the Transferred Subsidiaries would be transferred to LPL Financial, FINRA received letters raising concerns from various third party claimants who had previously commenced actions against the Transferred Subsidiaries. As a result, FINRA sought assurances from plaintiffs that following the transfer of customer accounts and financial advisors, the Transferred Subsidiaries would retain sufficient funds to pay any potential judgments or settlements arising out of the pending litigation.

FINRA ultimately required plaintiffs, as a condition of approving the CMA, to establish escrow accounts with sufficient

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[4] The Brezden Claims were settled for approximately $8.4 million in July 2009, after the arbitration panel rendered an award of approximately $8.9 million against ASC in March 2009.

funds to cover any pending claims against them.[5] Since the Transferred Subsidiaries lacked sufficient excess capital to fund the escrow accounts in the amounts requested by FINRA, LPL voluntarily agreed to fund the shortfall.[6] FINRA approved plaintiffs' proposed transaction in September 2009.

On October 1, 2009, counsel for Pacific Life sent a letter to David J. Freniere, Deputy General Counsel of LPL Financial,[7] stating that "rather than using its commercially reasonable efforts to mitigate Pacific Life's indemnity obligation, LPL's actions are intentionally calculated to do quite the opposite. LPL is actually doing what it can to *maximize* Pacific Life's exposure." Pacific Life also indicated that it would "refuse any future indemnity requests made on ASC's behalf, and will similarly refuse future

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[5] FINRA's role in LPL's decision to infuse capital into the Transferred Subsidiaries is disputed by the defendant. *See infra* p. 13.

[6] According to Pacific Life, the Transferred Subsidiaries, with the exception of the funded escrow accounts, are today nothing more than shell entities in terms of ongoing operations.

[7] Pacific Life argues that the letters exchanged between the parties are inadmissible and cannot be considered by this Court because they are part of settlement discussions. This Court, however, finds this argument unavailing. Under CPLR 4547, evidence of compromise and offers to compromise are excluded if offered to show liability. Here, these letters are not offered to show liability; rather, they are merely offered to show the nature of the parties' interactions leading up to the instant litigation. In any event, the positions expressed by counsel in these letters were generally referred to by counsel for both parties during oral argument.

indemnity requests on MSC's behalf that exceed MSC's true excess net capital."[8]

On October 20, 2009, LPL submitted a request to Pacific Life for indemnification in the amount of $57,000.00 to fund ASC's settlement of an arbitration proceeding brought against it (the "Jensen Claim"). Pacific Life responded on October 30, 2009, reiterating that it would not indemnify LPL Financial for the Jensen Claim or "any other indemnity requests related to ASC." As a result, plaintiffs commenced the instant action for breach of contract and for a declaratory judgment on November 20, 2009.

In the first cause of action, plaintiffs claim that by failing to indemnify ASC for the settlement of the Jensen Claim, Pacific Life has breached Section 6.2(a)of the PSA, and seek to recover damages in the amount of $57,000.00, plus interest and related costs.

In the second cause of action, plaintiffs seek a declaratory judgment declaring and adjudging that, with respect to third party claims, including customer claims, Pacific Life is obligated under

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[8] According to Mr. Freniere, as of October 1, 2009, outstanding third party claims against the Transferred Subsidiaries totaled approximately $25 million. (Freniere Aff., sworn to on February 22, 2010, at ¶ 14.)

the PSA to fully indemnify plaintiffs for "Covered Losses" without regard to the "value" of ASC, MSC, or WFG, and that the indemnity obligation is not subject to any monetary limitation.

Defendant served and filed an Answer, dated February 1, 2010, asserting three counterclaims seeking:

(i) injunctive relief, pursuant to Section 9.17 of the PSA, directing the counterclaim defendants to cease making indemnity demands on Pacific Life for all pending and future third party claims against the Transferred Subsidiaries, (a) based on their alleged breach of Section 6.5(g) of the PSA (i.e., plaintiffs' failure to use commercially reasonable efforts to mitigate Pacific Life's exposure)(Count I); and (b) based on plaintiffs' alleged breach of an implied covenant of good faith and fair dealing, by taking actions that intentionally and unnecessarily increased Pacific Life's potential indemnity exposure to third party claims, without consulting Pacific Life (Count II); and

(ii) a declaratory judgment declaring and adjudging that plaintiffs have failed to use commercially reasonable efforts to mitigate Covered Losses as required by the PSA, and that Pacific Life's indemnity obligation under the PSA has, therefore, been fully satisfied and is hereafter extinguished (Count III).

Plaintiffs now move for an order pursuant to CPLR 3212,

(1) granting them summary judgment on both of their causes of action;

(2) dismissing defendant's counterclaims; and

(3) awarding plaintiffs the costs and expenses incurred herein, including reasonable attorneys' fees.

Discussion

I. Interpreting Section 8.1 of the PSA

Plaintiffs' breach of contract and declaratory judgment causes of action turn on the meaning of Section 8.1, which defines "Covered Loss," and which defendant argues is ambiguous.

Plaintiffs argue that Pacific Life is obligated by Section 6.2(a)(iv) of the PSA to indemnify LPL for any "Covered Losses," as defined by Section 8.1, "directly or indirectly, . . . arising out of: . . . a Third Party Claim relating to any action, omission or course of conduct by any of the Transferred Subsidiaries" without any "ability to pay" limitation. Plaintiffs maintain that the defendant breached the PSA when it failed to indemnify LPL for the Jensen Claim. Therefore, LPL asserts that it is entitled to summary judgment.

Defendant argues that this motion should be denied, in the first instance, as premature, because it should be entitled to take

discovery, *inter alia*, to examine the parties' negotiations leading up to the execution of the PSA.

Defendant next argues that the motion should be denied because Section 8.1 of the PSA, which defines a "Covered Loss" is ambiguous. It is defendant's position that it is unclear whether it agreed to indemnify only against payments or also against liabilities. Defendant further contends that the parenthetical that follows the word "payments" renders Section 8.1 susceptible to the interpretation that if legal proceedings are involved, then the PSA only requires indemnity against "payments." In light of this, defendant argues that the there is a question of fact as to the meaning of the indemnity provision and summary judgment must be denied.

In reply, plaintiffs argue that the definition of a "Covered Loss" is clear and unambiguous and that Section 8.1 shows that broad indemnity coverage was intended. Plaintiffs also contend that defendant's interpretation of Section 8.1 would limit the indemnity obligation to such an extent that, out of all the enumerated "Covered Loss[es]," only "payments" would be indemnified against, when the claims arise in the context of legal proceedings. Plaintiffs urge that this interpretation would yield an absurd

result, because "claims" and "damages" almost invariably arise in the context of legal proceedings.

Under New York law, a contract is ambiguous if "on its face [it] is reasonably susceptible of more than one interpretation." *Telerep, LLC v. U.S. Intl Media, LLC*, 74 AD3d 401, 402 (1st Dep't 2010)(internal citation omitted). "A contractual provision is not ambiguous merely because the parties urge different interpretations of it." *Pfizer, Inc. v. Stryker Corp.*, 348 FSupp2d 131, 142 (SDNY 2004) (applying New York law). If a court concludes that a contract is ambiguous, "it cannot be construed as a matter of law." *Telerep, LLC v. U.S. Intl Media, LLC, supra* at 402.

On the other hand, "[a] contract is unambiguous if the language it uses has a definite and precise meaning, unattended by danger of misconception in the purport of the [agreement] itself, and concerning which there is no reasonable basis for a difference of opinion (citation omitted)." *Telerep, LLC v. U.S. Int'l Media, LLC, supra* at 402 (internal quotations omitted). If the contract is unambiguous, summary judgment is appropriate. *Pfizer, Inc. v. Stryker Corp., supra* at 142.

This Court does not find that the indemnification provision is ambiguous merely because Pacific Life has urged an interpretation

of the definition of "Covered Loss" that would limit its indemnity obligation. Since it is clear that any limitations on indemnification, which were intended by the parties, were expressly set forth in Section 6.5, and the meaning of the terms in Section 8.1 are clearly discernible, this Court does not find that there is any "danger of misconception" imposed by Section 8.1 and it may interpret the provision as a matter of law.

> New York recognizes agreements that indemnify against loss and those that indemnify against liability. Under an agreement to indemnify against loss, a claim does not accrue until the indemnified party has made a payment, or actually suffered a loss. A right to indemnification against liability, however, arises when the party faces a fixed liability, even though it has not paid the claim and thus suffered no damage . . . . Although loss indemnification is more common, courts have construed an indemnification agreement to be one against liability where there is some express indication that the parties so intended.

Pfizer, Inc. v. Stryker Corp., *supra* at 150-51.

In this case, it is clear from the language of Section 8.1 that the parties intended not only for Pacific Life to indemnify plaintiffs against losses or payments, but also to indemnify them against liabilities.

II. Breach of Contract

Plaintiffs claim that defendant breached Section 6.2(a) of the PSA when it failed to indemnify ASC for the settlement of the Jensen arbitration, which plaintiffs contend undeniably constitutes a "Covered Loss" under the PSA.

Both during oral argument held on the record on May 27, 2010, and in its March 9, 2009 letter from defendant's counsel to Mr. Freniere, defendant contended that an indemnitor cannot be required to indemnify for an amount that exceeds the "value" of the indemnitee.[9] Defendant argues that by infusing capital into the Transferred Subsidiaries, plaintiffs enhanced the Transferred Subsidiaries' "value," which in turn made more money available to fund "payments" to third party claimants and triggered defendant's indemnification obligation.

Plaintiffs contend, on the other hand, that LPL's infusion of capital into the Transferred Subsidiaries has no bearing on the defendant's indemnity obligation, because, as discussed *supra*, defendant agreed to indemnify against "liabilities," not just "payments" or "losses."

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[9] According to Mr. Freniere, in July 2009, Pacific Life indemnified LPL for the Brezden Claim settlement in an amount that was far in excess of ASC's supposed "value" (Freniere Aff., sworn to on February 22, 2010, at ¶ 9).

According to plaintiffs, there is no basis in the PSA to imply an "ability to pay" or "value" limitation on defendant's indemnity obligation.

Finally, defendant argues that plaintiffs' decision to execute the CMA transaction and infuse capital into the Transferred Subsidiaries was a breach of LPL's duty, under Section 6.5(g), to make commercially reasonable efforts to mitigate "Covered Losses." Defendant claims that LPL's decision was not commercially reasonable under the circumstances because it had the effect of making funds available to third-party claimants that would not otherwise have been available to them.[10]

Plaintiffs deny that their decision was commercially unreasonable because it was necessary to pay the Transferred Subsidiaries for the assets it acquired, not only to comply with FINRA's requests, but also to avoid liability under New York's fraudulent conveyance laws.

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[10] *See* Affidavit of Lani M. Sen Woltmann ("Woltmann"), executed on March 4, 2010, who was employed by FINRA (previously NASD) from 1982 until 2006, where she served as Regional Counsel. Woltmann states in her affidavit that "[t]here were alternatives to infusing funds," and lists several different ways that plaintiffs could have proceeded.

Defendant maintains that there is at least an issue of fact as to whether plaintiffs abandoned their contractual duty to mitigate their damages by infusing additional capital to fund the escrow accounts, and that it should be entitled to take discovery with respect to the time period between the Spring of 2009, when plaintiffs filed their CMA with FINRA, and September 2009, when FINRA approved the transaction.

"The elements of a breach of contract claim are formation of a contract between the parties, performance by the plaintiff, the defendant's failure to perform, and resulting damage (citation omitted)." *Flomenbaum v. New York Univ.*, 71 AD3d 80, 91 (1st Dep't 2009).

There is no dispute that here, a contract was formed between the parties (the PSA) and that plaintiffs performed by purchasing the Transferred Subsidiaries. What is disputed, however, is whether the defendant had an obligation to perform and failed to meet it by refusing to indemnify plaintiffs for the Jensen Claim.

This Court has already found that Section 8.1 unambiguously defines "Covered Loss," and includes, *inter alia*, "payments" and "liabilities," meaning that the Jensen Claim falls within the indemnity provision.

The only issue that remains is whether Section 6.5 of the PSA (the mitigation clause) shields defendant from any portion of its indemnity obligation.

As discussed above, defendant argues that plaintiffs abandoned their contractual duty to mitigate "Covered Losses," when they completed the CMA transaction and infused additional capital to fund the escrow accounts. This argument, however, assumes that defendant's indemnification obligation is contingent upon the Transferred Subsidiaries' "value" or "ability to pay" judgments or settlements. While this argument may make sense with respect to indemnification against payment or loss, here, the defendant explicitly agreed to indemnify against liabilities, which as this Court has already determined, creates an obligation that is triggered once the party faces a fixed liability, even though it has not paid the claim or suffered a loss. *See Pfizer, Inc. v. Stryker Corp.*, *supra* at 150-51. "A contract to indemnify against liability is breached the moment the liability is imposed and a cause of action arises because of the fact of the breach." *755 Seventh Ave Corp. v. Carroll*, 266 NY 157, 161 (1935). Therefore, because there has been no showing that, as a matter of law, the infusion of funds to the Transferred Subsidiaries could impact defendant's obligation to indemnify against ***liability***, there is no

need to reach the issue of whether the CMA Transaction was a breach of the plaintiffs' duty to mitigate "Covered Losses."

Based on the foregoing, plaintiffs' motion for summary judgment with respect to the first cause of action is granted.

III. Declaratory Judgment

Pursuant to CPLR 3001, a declaratory judgment may be granted ". . . as to the rights and other legal relations of the parties to a justiciable controversy whether or not further relief is or could be claimed." "To constitute a 'justiciable controversy,' there must be a real dispute between adverse parties, involving substantial legal interests for which a declaration of rights will have some practical effect (citations omitted)." *Chanos v. MADAC, LLC*, 74 AD3d 1007, 1008 (2d Dep't 2010).

The Court of Appeals has held that "[a] declaratory judgment action may be an appropriate vehicle for settling justiciable disputes as to contract rights and obligations (citations omitted)." *Kalisch-Jarcho, Inc. v. City of New York*, 72 NY2d 727, 731-32 (1988).

Plaintiffs assert in Count II of their Complaint for a declaratory judgment that "[r]esolution of the parties' dispute

will have important practical consequences because it will determine the extent of Pacific Life's indemnity obligations to plaintiffs with respect to pending and future Third Party Claims for millions of dollars." (Compl. ¶ 33)[11]

Accordingly, based on the analysis herein, plaintiffs' motion for summary judgment on their second cause of action is granted and it is HEREBY DECLARED and ADJUDGED that with respect to Third Party Claims against ASC, MSC and WFG, including customer claims, Pacific Life is obligated under the PSA to indemnify plaintiffs for Covered Losses without regard to the "value" of ASC, MSC or WFG, and that the indemnity obligation is not subject to any monetary limitation.

Consequently, defendant's first and second counterclaims seeking injunctive relief directing the plaintiffs to cease making indemnity demands on Pacific Life for all pending and future third party claims against the Transferred Subsidiaries, and third counterclaim for a judgment declaring that Pacific Life's indemnity obligation under the PSA has been fully satisfied and is hereafter extinguished must be dismissed.

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[11] In its opposition papers, defendant does not specifically address plaintiffs' request for declaratory relief.

IV. Costs and Attorney's Fees

Finally, plaintiffs argue that they are entitled under the PSA to recover their costs and expenses, including reasonable attorneys' fees, pursuant to Sections 6.2 and 8.1 of the PSA.

"[I]t is a well-settled rule in New York that attorneys' fees are considered an incident of litigation and, unless authorized by statute, court rule or written agreement of the parties, are not recoverable." *Campbell v. Citibank, N.A.*, 302 AD2d 150, 154 (1st Dep't 2003) (internal citation omitted); *see also TAG 380, LLC v. ConMet 380, Inc.*, 10 NY3d 507, 515-16 (2008).

Here, Section 6.2(a) of the PSA explicitly provides that Pacific Life shall indemnify plaintiffs "from and against any Covered Losses suffered by [the plaintiffs] directly or indirectly, resulting from or arising out of: . . . (ii) any nonfulfillment or breach of any covenant or agreement made by Seller . . . in or pursuant to this Agreement," and "(iv) a Third Party Claim . . . ." A "Covered Loss" is defined to include all "reasonable costs and expenses (including . . . reasonable attorneys' . . . fees . . . incurred in investigating, preparing, defending, avoiding or settling any Legal Proceeding . . . ."

Thus, plaintiffs' costs and expenses associated with this dispute, including their reasonable attorneys' fees, constitute "Covered Losses" and may be recovered.

The issue of the amount of reasonable attorneys' fees plaintiffs may recover against the defendant is referred to a Special Referee to hear and report with recommendations, or upon stipulation of the parties, to hear and determine.

Counsel for the plaintiffs shall, within 30 days from the date of this order, serve a copy of this order with notice of entry, together with a completed Information Sheet,[12] upon the Special Referee Clerk in the Motion Support Office (Room 119M), who is directed to place this matter on the calendar of the Special Referee's Part for the earliest convenient date.

This constitutes the Decision, Order and Judgment of this Court.

Dated: 3/3, 2011

BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK
J.S.C.

[12] Copies are available in Rm. 119M at 60 Centre Street and on the Court's website at www.nycourts.gov/supctmanh under "References" section of the "Courthouse Procedures" link.