

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 3

-----X
HARCH INTERNATIONAL LIMITED,

Plaintiff,

-against-

Index No.: 601312/2005
Motion Date: 09/30/2010
Motion Seq. No.: 21

HARCH CAPITAL MANAGEMENT, HARCH
CLO I LIMITED, and JPMORGAN CHASE BANK,
N.A. f/k/a/ CHASE BANK OF TEXAS,
NATIONAL ASSOCIATION,

Defendants.

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PRESENT: EILEEN BRANSTEN, J.:

Defendant JPMorgan Chase Bank (“Defendant”) moves for summary judgment dismissing plaintiff Harch International Limited’s (“Plaintiff”) third cause of action for breach of contract and granting Defendant’s counterclaim for indemnification. Plaintiff opposes.

BACKGROUND

Due to heavy motion practice, the court will assume all parties are familiar with the facts of this case. Therefore, the court will only discuss the facts as necessary to the instant motion.

Defendant Harch CLO I Limited and non-party Harch CLO I Corporation (collectively the “Issuer”) were authorized to issue \$425 million in notes secured primarily by collateralized debt obligations, or CDOs.

Defendant entered into a contract dated March 15, 2000 with the Issuer (Affirmation

of Robert Friedman [“Friedman Aff.”], Ex. 1 [the “Indenture”]), pursuant to which Defendant was to serve as indenture trustee for the Issuer. Defendant’s rights and obligations were defined by the Indenture. In general terms, Defendant was to administer the proceeds from the note issuance.

Under the terms of the Indenture, the holders of notes sold by the Issuer, including Plaintiff, are third-party beneficiaries of the Indenture, but are not parties to it.

For reasons not relevant to the instant motion, the business relationship between the Issuer and various noteholders soured in early 2005.

By letter dated March 28, 2005, defendant Harch Capital Management (“HCM”) demanded indemnification from Defendant JPMorgan Chase Bank. HCM based its claim for indemnification on the March 15, 2000 collateral management agreement between it and defendant Harch CLO I Limited.

Plaintiff commenced this action on April 13, 2005.

Harch CLO I Limited then demanded indemnification from Defendant on behalf of itself and HCM by invoice dated June 21, 2005.

On June 22, 2005, Defendant sent a notice to the holders of certain notes stating that, in light of the demands for indemnification and the pending lawsuit, Defendant had transferred the interest proceeds from the note issuance then in trust, totaling \$1,455,376.94, into a separate account (the “Account”). Defendant has since refused to disburse any of the funds in the Account.

Plaintiff contends that Defendant's establishing the Account and refusal to disburse the funds therein constitutes a breach of the indenture. Defendant argues that its actions were consistent with the indenture and seeks indemnification from the funds in the Account for its legal fees incurred in connection with this action

ANALYSIS

1. Standard of Law

The moving party bears the initial burden of demonstrating entitlement to summary judgment as a matter of law. *See Bray v. Rosas, et al.*, 29 A.D.3d 422, 424 (1st Dep't 2006). Defendant will only prevail if its "cause of action [and] defense shall be established sufficiently to warrant the court as a matter of law in directing judgment" in Defendant's favor and Plaintiff is unable to "show facts sufficient to require a trial on any issue of fact." CPLR 3212.

If Defendant is unable to sustain its burden, its motion will be denied without regard to the sufficiency of Plaintiff's opposition papers. *Alvarez v. Prospect Hosp.*, 68 N.Y.2d 320, 324 (1986); *see also Dauman Displays, Inc. v. Masturzo, et al.*, 168 A.D.2d 204, 205 (1st Dep't 1990).

In deciding the motion, the court will view the evidence in a light most favorable to the opposing party. *Marine Midland Bank, N.A. v. Dino & Artie's Automatic Transmission Co.*, 168 A.D.2d 610, 610 (2d Dep't 1990). However, "mere expressions of hope or

unsubstantiated allegations are insufficient” to defeat a motion for summary judgment. *Zuckerman v. City of New York*, 49 N.Y.2d 557, 562 (1980). Plaintiff “must produce evidentiary proof in admissible form sufficient to require a trial of material questions of fact on which he rests his claim” or an acceptable reason for his failure to do so. *Id.*

2. Defendant Has Not Shown That it Had Authority to Establish the Account and Withhold the Funds Therein

Defendant moves for summary judgment dismissing Plaintiff’s third cause of action against it for breach of contract. Defendant argues that the “decision to preserve the funds was made in good faith and was prudent under the circumstances,” referring to section 6.3 (h) of the Indenture. Memorandum of Law of Defendant JPMorgan Chase Bank, N.A. in Support of its Motion for Summary Judgment on its Second Counterclaim and Plaintiff’s Third Cause of Action (“Defendant’s Memo”), p. 13. Defendant contends that if it had distributed the funds in the Account, it would have “potentially risked its own funds or incurred liability to the other parties. Further, neither [Plaintiff], [Harch Capital Management] nor Harsh CLO offered to indemnify JPMC.” Defendant’s Memo, p. 13.

Defendants’ argument that it acted properly under the Indenture because its actions were prudent and made in good faith does not present the proper issue to be decided at this juncture. Section 6.3 (h) of the Indenture states that “the Trustee shall not be liable for any action it takes or omits to take in good faith that it reasonably and prudently believes to be authorized or within its rights or powers hereunder.” Section 6.3 (h) therefore presents a

threefold inquiry: whether Defendant's action was taken in good faith, whether Defendant believed its action to be authorized or within its powers under the Indenture and, if so, whether Defendant's belief that its action was authorized was reasonable and prudent.

Defendant contends that it was authorized to establish the Account by sections 6.1 (c) and 6.3 (e) of the Indenture. Pursuant to 6.3 (h), Defendant's belief that its actions were authorized based on those sections must be reasonable. Whether or not a party's actions were reasonable will "necessarily depend on all the relevant circumstances" and is thus, generally, a question of fact precluding summary judgment. *Lazzarino v. Warner Bros. Entertainment, Inc.*, 13 Misc.3d 1230(A), 9 (Sup. Ct. NY County 2006); *see also* CPLR 3212; *Bossert v. Fratalone*, 28 A.D.3d 852, 853 (3d Dep't 2006); *Wilner v. Allstate Ins. Co.*, 71 A.D.3d 155, 166 (2d Dep't 2010).

Section 6.1 (c) (iv) states:

[N]o provision of this Indenture shall require [Defendant] to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, if it has reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured to it unless such risk or liability relates to its ordinary services, including under Article V, under this Indenture.

Section 6.3 (e) states that:

[Defendant] shall be under no obligation to exercise or to honor any of the rights or powers vested in it by this Indenture at the request or direction of any of the Noteholders pursuant to this

Indenture, unless such Noteholders shall have offered to the Trustee reasonable security or indemnity against the costs, expenses and liabilities which might reasonably be incurred by it in compliance with such request or direction.

Defendant has not shown “reasonable grounds for believing that repayment of such funds . . . is not reasonably assured to it.” Indenture, Section 6.1 (c) (iv). Further, pursuant to Section 6.7 (a), the Issuer agreed not only to reimburse Defendant for “all reasonable expenses, disbursements and advances incurred or made by the [Defendant] in accordance with any provision of the indenture,” but also to:

indemnify [Defendant] . . . [for] any loss, liability, or expense incurred without negligence, willful misconduct or bad faith on [Defendant’s] part, arising out of or in connection with the acceptance or administration of this trust, including the costs and expenses of defending themselves against any claim or liability in connection with the exercise or performance of any of its powers or duties hereunder[.]

Even if Defendant had made the showing required to complete its argument pursuant to section 6.1 (c) (iv) and 6.3 (e), neither section explicitly authorizes Defendant to establish a reserve account to address potential future liabilities and to refuse disbursement of the contents therein. Therefore, a material issue of fact requiring consideration of all relevant circumstances exists as to whether Defendant’s belief that its actions were authorized under those sections was reasonable, as the Indenture requires. *See* Indenture, § 6.3 (h).

For the sake of clarity, the court has not found that Defendant breached the contract,

but, rather, that Defendant has not affirmatively shown that it did not breach the contract.

Defendant has not demonstrated its entitlement to judgment as a matter of law dismissing Plaintiff's third cause of action against it for breach of contract. Defendant's motion for summary judgment dismissing Plaintiff's claim is denied.

3. Defendant's Right to Indemnification

Defendant seeks summary judgment granting its second counterclaim.

As an initial matter, Defendant argues that its second counterclaim "seeks a declaration that it is entitled to payment of its costs and expenses and that [Defendant] has priority on the remaining funds and is entitled to payment before any other parties." Defendant's Memo, p. 9. Defendant's second counterclaim seeks only a "declaration that the [Defendant's] right to receive payment under the Indenture and the CMA is superior to any of the parties to this litigation." Friedman Aff., Ex. 10 (Defendant JPMorgan Chase Bank, N.A.'s Answer to the Amended Complaint with Counterclaims). Defendant's claim for indemnification is a component of its first, not its second, counterclaim. *Id.*, ¶ 39. However, both Plaintiff and Defendant have treated Defendant's second counterclaim as including a claim for indemnification. The court will address the issue in the same manner.

Defendant contends that it is entitled to indemnification for costs and expenses from the Issuer pursuant to the Indenture. Defendant bases its claim on the Indenture's indemnification clause, Section 6.7 (a), stating that the clause is "broad, applies to suits by third parties and [because Defendant's] duties are limited under the Indenture." Reply

Memorandum of Law of Defendant JPMorgan Chase Bank, N.A. in Further Support of its Motion for Summary Judgment on its Second Counterclaim and Plaintiff's Third Cause of Action ("Reply Memo"), p. 2.

Defendant also asserts that, pursuant to the Indenture's "waterfall" provision, section 11.1, Plaintiff has priority to the funds in the Account to satisfy its claim for indemnification.

Plaintiff opposes. Plaintiff argues that New York law disfavors the use of indemnification clauses for claiming fees in a dispute between contracting parties. Relying on *Gotham Partners v. High River Limited Partnership*, 76 A.D.3d 203 (1st Dep't 2010), Plaintiff contends that it is not unmistakably clear that section 6.7 (a) applies to suits between contracting parties and that summary judgment is therefore unwarranted.

The decision in *Gotham* was based predominately on *Hooper Associates, Ltd. v. AGS Computers*, 74 N.Y.2d 487, 491 (1989). In *Hooper*, the plaintiff, Hooper, contractually agreed to purchase computer equipment and services from the defendant, AGS. Hooper later sued AGS for breach of contract, breach of warranty and fraud. Hooper also sought indemnification for its attorneys' fees pursuant to an indemnification clause in the contract. That indemnification clause stated, in pertinent part, that AGS shall "indemnify and hold harmless [Hooper] . . . from any and all claims, damages, liabilities, costs and expenses, including reasonable counsel fees." *Hooper*, 74 N.Y.2d at n 1. The parties agreed to sever the indemnification claim and Hooper prevailed at trial. AGS then moved for summary judgment dismissing Hooper's indemnification claim. The court searched the record and

granted summary judgment in favor of Hooper. The court found the contract at issue to be clear in “providing for indemnification of all claims, including reasonable attorneys’ fees.” *Id.* at 490.

The appellate division affirmed the trial court but granted leave to appeal. The Court of Appeals reversed. The Court of Appeals stated

When a party is under no legal duty to indemnify, a contract assuming that obligation must be strictly construed to avoid reading into it a duty which the parties did not intend to be assumed.

* * *

Inasmuch as a promise by one party to a contract to indemnify the other for attorneys’ fees incurred in litigation between them is contrary to the well-understood rule that parties to are responsible for their own attorneys’ fees, the court should not infer a party’s intention to waive the benefit of the rule unless the intention to do so is *unmistakably clear* from the language of the promise. *Id.* at 491-92, (emphasis added).

The Court proceeded to find that the indemnification clause did not clearly permit Hooper to recover attorneys’ fees from AGS in a suit between the two. “On the contrary, [the indemnification clause] is typical of those which contemplate reimbursement when the indemnitee is required to pay damages on a third-party claim.” *Id.* at 492.

Hooper and its progeny have come to stand for the proposition that “for an indemnification clause to serve as an attorneys’ fees provision with respect to disputes between the parties to the contract, the provision must unequivocally be meant to cover claims

between the contracting parties rather than third-party claims.” *Gotham Partners, L.P. v. High River Ltd. Partnership*, 76 A.D.3d 203, 207 (1st Dep’t 2010).

Relying on *Gotham*, Plaintiff argues that it is not unequivocally clear that Section 6.7 (a) is meant to cover claims between the contracting parties rather than third-party claims.

Plaintiff mischaracterizes the underlying case. This action is not between parties to the relevant contract. Plaintiff asserted two causes of action against Defendant, both arising from breach of the Indenture. The Indenture is an agreement between the Defendant as indenture trustee and co-issuers Harch CLO I Limited and non-party Harch CLO I Corporation. *See* Indenture, p. 5. Plaintiff is a third-party beneficiary of the Indenture, not a party to it. First Amended Complaint, ¶ 19. Plaintiff’s claims as they relate to Defendant are thus third-party claims, not disputes between contracting parties.

The instant case is more analogous to *Perchinsky v. State*, 232 A.D.2d 34 (3d Dep’t 1997). There, as in the instant case, a third party brought a claim against both indemnitor and indemnitee. The court noted that the action was not one between the indemnitor and indemnitee, and permitted the indemnitee to recover attorneys’ fees for defending against the plaintiff’s claims and pursuing defensive third-party claims, but not for the costs of pursuing its indemnification claim. Importantly, the court stated that “to hold otherwise would deprive the indemnitee of the full benefit of the bargain it struck with indemnitor.” *Id.* at 40; *see also Di Perna v. American Broadcasting Companies, Inc.*, 200 A.D.2d 267, 270 n 3 (1st Dep’t

1994).

A) Defendant JPMC Has Not Shown Entitlement to Indemnification from the Account

Defendant bases its claim for indemnification on section 6.7 (a) of the Indenture. That section reads:

The Issuer agrees: . . . (iii) to indemnify [Defendant] . . . and to hold [it] harmless against any loss, liability or expense incurred without negligence, willful misconduct or bad faith on their part, arising out of or in connection with the administration of this trust, including the costs or expenses of defending themselves against any claim or liability in connection with the exercise or performance of any of its powers or duties hereunder.

Defendant states that “it is undisputed that JPMC incurred costs and expenses regarding the administration of Harch CLO including, but not limited to, the legal fees and expenses incurred in defending this action.” Defendant’s Memo, p. 10. Defendant’s contractual right to payment for services rendered as indenture trustee and reimbursement of costs associated therewith is grounded in sections 6.7 (a) (i) and (ii) of the Indenture. Those sections state, in pertinent part, that the Issuer agrees:

- (i) to pay [Defendant] . . . reasonable compensation for all services rendered by it hereunder . . . ;
- (ii) except as otherwise provided herein, to reimburse [Defendant] . . . for all reasonable expenses, disbursements and advances incurred or made by [Defendant] in accordance with any provision of this Indenture [.]

Thus, Defendant’s costs and expenses outside of its attorneys’ fees are not properly the

subject of its indemnification claim under 6.7 (a) (iii).

Turning to Defendant's claim for indemnity for attorneys' fees: in New York, there is a "long, uninterrupted line of decisions which have interpreted broadly worded indemnification clauses as embracing the right to reimbursement for counsel fees." *Breed, Abbott & Morgan v. Hulko*, 139 A.D.2d 71, 74 (1st Dep't 1988). With that in mind, it is hard to conceive how the Issuer's agreement to indemnify Defendant against any "loss, liability or expense incurred without negligence, willful misconduct or bad faith on [its] part, arising out . . . the administration of this trust, including the costs or expenses of defending themselves against any claim . . . in connection with the exercise or performance of any of its powers or duties" under the Indenture could be construed as not including Defendant's right to attorneys' fees. Indenture, § 6.7 (a) (iii).

Plaintiff even concedes that Defendant is entitled to reimbursement of its attorneys' fees in third-party claims, noting in its counter-statement of material facts that "Indenture Section 6.7 (a) (iii), *indemnifying JPMC against any loss, liability or expense . . . is susceptible to third-party claims.*" Plaintiff Harch International Limited's Response to Defendant JPMorgan Chase Bank, N.A.'s Statement of Material Facts in Support of its Motion for Summary Judgment, ¶ 38 (emphasis added).

Thus, the broad language of that section entitles Defendant to reimbursement by the Issuer for attorneys' fees in third-party claims.

However, the parties stipulated to discontinue this action against co-issuer and indemnitor Harch CLO I Limited in October of 2006¹, one year after Defendant asserted its counterclaim for indemnification and interpled the funds in the Account. Friedman Aff, Ex. 9 (Stipulation of Discontinuance). It is one thing to seek indemnification from the indemnitor, but quite another to seek indemnification from the interpled funds. Although the Indenture permits Defendant to “deduct payment from moneys on deposit in the Payment Account for the Notes,” that is not what has occurred. Indenture, § 6.7 (b). Instead, Defendant transferred the full balance of the Collection Account, which, pursuant to the Indenture, is separate from the Payment Account, into the Account forming the basis of Plaintiff’s third cause of action for breach of contract. *See* Indenture, §§ 10.2, 10.3; Friedman Aff, Ex. 5 (Notice to Certain Holders of Securities of Harch CLO Limited & Harch CLO I Corp.), p. 2.

Defendant has shown entitlement under the Indenture to indemnification for its attorneys’ fees arising from third party claims. However, the Indenture is a contract between Defendant and the co-issuers and indemnitors Harch CLO I Limited and non-party Harch CLO I Corporation, neither of whom are parties to this action. To the extent that Defendant’s claim for indemnification is asserted against the interpled funds, Defendant has not shown its entitlement to indemnification as a matter of law.

¹The Stipulation of Discontinuance is dated October 18, 2005. However, it refers to events in 2006 in the past tense and was e-filed on October 19, 2006, so the court will assume that the parties intended for the Stipulation of Discontinuance to be dated October 18, 2006.

B) Defendant Has Not Shown its Entitlement To Priority to the Funds in the Account

Defendant next argues that it has priority to the funds in the Account for the satisfaction of its claim for indemnification. Defendant bases its claim on section 11.1 of the Indenture. That section establishes that Defendant has priority in payment from the Payment Account of its fees and expenses accrued under section 6.7 over payment of all interest to the various classes of noteholders. However, the funds in the Account are from the Collection Account, not the Payment Account. Friedman Aff, Ex. 5 (Notice to Certain Holders of Securities of Harch CLO Limited & Harch CLO I Corp.). Furthermore, it is still open for determination whether Defendant's actions in establishing the Account and refusing to disburse the funds therein constitute a breach of the Indenture. *See* § 2, *supra*. Therefore, the court does not find that section 11.1 of the Indenture dispenses with all questions of fact with respect to priority of payment.

Accordingly, it is

ORDERED that defendant JPMorgan Chase Bank, N.A.'s Motion for Summary Judgment dismissing Plaintiff's third cause of action for breach of contract against JPMorgan Chase Bank, N.A. is DENIED; and it is further

ORDERED that defendant's JPMorgan Chase Bank, N.A.'s Motion for Summary

