906 N.Y.S.2d 784, 2009 N.Y. Slip Op. 52565(U)

Unreported Disposition
25 Misc.3d 1243(A), 906 N.Y.S.2d 784 (Table), 2009 WL 4893946 (N.Y.Sup.), 2009 N.Y. Slip Op. 52565(U)



UBS Securities LLC and USB AG, London Branch, Plaintiffs,
v.
Highland Capital Management, L.P., Highland CDO Opportunity Master Fund, L.P., and Highland Special Opportunities Holding Company, Defendants.

650097-2009
Supreme Court, New York County
Decided on October 6, 2009

CITE TITLE AS: UBS Sec. LLC v Highland Capital Mgt., L.P.

**ABSTRACT**

Indemnity
Contractual Indemnification

*UBS Sec. LLC v Highland Capital Mgt., L.P.*, 2009 NY Slip Op 52565(U). Indemnity—Contractual Indemnification. (Sup Ct, NY County, Oct. 6, 2009, Fried, J.)

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**OPINION OF THE COURT**

Bernard J. Fried, J.

This action arises out of losses allegedly incurred by plaintiffs UBS Securities LLC ("UBS Securities") and USB AG, London Branch ("USB AG"), (collectively, "UBS") in connection with a failed proposed collateralized debt obligation transaction to be sponsored by defendant Highland Capital Management, L.P. ("Highland Capital"), a hedge fund. The proposed transaction contemplated that UBS would acquire and warehouse certain securities and assume certain obligations under credit default swaps, with the expectation that "special purpose entities" would acquire those securities and assume those obligations and issue securities secured by those securities and obligations. The special purpose entities were never created, and the contemplated transaction never occurred. The complaint alleges that two off-shore funds affiliated with Highland, defendants Highland CDO Opportunity Master Fund, L.P. ("CDO Fund") and Highland Special Opportunities ***2** Holding Company ("SOHC"), had agreed to provide collateral to UBS to mitigate and offset any losses it suffered in case of adverse economic conditions, but failed to do so. UBS alleges that it consequently suffered losses exceeding $745 million.

The rights and duties of the parties are governed by three agreements dated March 14, 2008: (a) an engagement letter between UBS Securities and Highland Capital, (b) a cash warehouse agreement between UBS Securities and all three defendants, and (c) a synthetic warehouse agreement between USB AG and all three defendants. UBS's complaint alleges two causes of action against CDO Fund and SOHC for breach of contract, and a third cause of action against Highland Capital for indemnification under the terms of the engagement letter. CDO Fund and SOHC will collectively be called "the Funds."

Before me is defendants' motion to dismiss the third cause of action for indemnification against Highland Capital, pursuant to C.P.L.R. § 3211(a)(1), and to dismiss the first and second causes of action, insofar as they allege a breach of the engagement letter, as against the Funds. As plaintiffs have withdrawn the claim that the Funds breached the engagement letter, the only question before me is whether to grant

defendants' motion to dismiss the third cause of action for indemnification against Highland Capital. For the reasons that follow, that motion is denied.

Dismissal of any part of a complaint pursuant to C.P.L.R. § 3211(a)(1) is warranted only "where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v. Mutual Life Ins. Co. of NY*, 98 NY2d 314, 326 (2002); *accord 150 Broadway NY Assocs., L.P. v. Bodner*, 14 AD3d 1, 5 (1st Dept. 2004). For a defendant to succeed on a motion to dismiss based on a defense founded upon documentary evidence, requiring the court to interpret a contract, "the documentary evidence must be such that it resolves all factual issues as a matter of law, and conclusively disposes of plaintiff's claim." *Quantum Maint. Corp. v. Mercy Coll.*, 8 Misc 3d 885, 889 (Sup. Ct. 2005). A contract term cannot be interpreted as a matter of law if it "is susceptible to varying reasonable interpretations and intent must be gleaned from disputed evidence or from inferences outside the written words. *Time Warner Entertainment Co., L.P. v. Brustowsky*, 221 AD2d 268, 268 (1st Dept. 1995). Indemnity agreements are strictly construed; "a promise to indemnify should not be found unless clearly implied in the language of the Agreement." *Taussig v. Clipper Group, L.P.*, 13 AD3d 166, 167 (1st Dept. 2004).

In the third cause of action, plaintiffs allege that Highland Capital has a duty to indemnify UBS for losses exceeding $700 million that it incurred when the contemplated transaction failed to occur before the termination of the agreements.

At the heart of this dispute is the proper application of section 3(c) of the engagement letter, which provides: "UBS Securities and [Highland Capital] agree that the CDO Fund and SOHC will in aggregate bear 100% of the risk of the Warehouse Facility in accordance with their respective Allocation Percentages (as defined in the Warehouse Documents) and otherwise in accordance with the terms of the Warehouse Documents...."

Section 6 of the engagement letter incorporates a provision, which appears in full in Schedule I, states:

In connection with the engagement of UBS Securities, [Highland Capital] hereby agrees to indemnify and hold harmless UBS Securities, [and] its affiliates,... from and against any and all losses, costs, claims, damages, liabilities expenses,... or threats thereof, based upon, relating to, arising out of or in connection with (i) any breach or ***3** alleged breach by [Highland Capital] (or any of its affiliates) of any agreement, representation, covenant or warranty in the [engagement letter] or the Servicing Agreement....

(Engagement Ltr., Schedule I-1; *see also id.* § 6.)

According to the complaint, Highland Capital's duty to indemnify UBS in Schedule I was triggered when the Funds failed to bear 100% of the risk of the warehouse facility, as section 3(c) contemplated that they would do. As UBS reads section 3(c), Highland Capital agreed to do what was necessary to ensure that the Funds, which UBS alleges are affiliated with and controlled by Highland Capital, would bear 100% of the risk.

Defendants maintain that this claim is conclusively precluded by the plain language of these two provisions, as well as related provisions in the warehouse agreements. Defendants make a variety of arguments, but the following are the weightiest.

First, defendants argue that Schedule I cannot refer to indemnification for a breach of section 3(c) by Highland Capital, because section 3(c) does not contain any promise by Highland Capital. Defendants argue that it would be unreasonable to infer that this provision imposes an affirmative obligation on Highland Capital that UBS Securities did not also undertake, since they agreed upon the very same language. According to defendants, section 3(c) is just an acknowledgment by the signatories that the Funds will bear certain risks.

Second, the warehouse agreements contain the following language specifically delimiting the liability of Highland Capital:

[Highland Capital] will not be liable to UBS or any other Person for any acts or omissions by [Highland Capital] or any Affiliate of [Highland Capital]..., or for any decrease in the value of the Collateral Portfolio [or CDS Portfolio], except [for bad faith].... [T]he provisions of this [section] are not intended to and shall not affect any liability that [Highland

Capital] may otherwise have under and pursuant to any other agreement.

(Cash Warehouse Agt, § 13(B), at 10; *see also* Synthetic Warehouse Agt., § 11(B), at 11.) Defendants maintain that these provisions conclusively preclude any argument by UBS that Highland Capital could be liable to UBS for a decrease in the portfolio, and that this argument is supported by the merger clauses in both warehouse agreements, which state that those agreements "set forth the entire understanding of the parties herein relating to the subject matter hereof,"(Cash Warehouse Agt. § 18, at 11; Synthetic Warehouse Agt., § 18, at 15).

Third, defendants contend that Schedule I's indemnification provision relates narrowly to losses incurred "[i]n connection with the engagement of UBS Securities" to market the securities, and that it does not cover portfolio losses of the warehouse facility, based on the use of the quoted language at the beginning of the indemnification provision. (Engagement Ltr., Schedule I-1.) According to defendants, the engagement letter describes Highland Capital's obligations related only to assisting UBS Securities in marketing the securities; the warehouse agreements were the only documents that concerned the performance of the assets which they were held in the warehouse facility and who would bear the risk of loss.

I cannot reach the conclusion defendants would like me to draw as a matter of law, however, ***4** for several reasons.

The first and chief reason is that section 3(b) of the engagement letter does *not* in fact contain the word "acknowledge"; it states that UBS Securities and Highland Capital "*agree* that the CDO Fund and SOHC will in aggregate bear 100% of the risk of the Warehouse Facility." (Engagement Ltr. § 3(c) (emphasis added).) Since the agreement is between UBS Securities and Highland Capital, but the undertaking to bear this risk is--in the first instance, at least--by the Funds, there is some question as to what UBS and Highland Capital "agree [d] " to do, if anything, in this provision. Plaintiffs argue that the parties understood and intended by this provision that Highland Capital would ensure that the Funds would bear 100% of the risk of the warehouse facility, because of its close relationship with those entities. In support of their argument, plaintiffs have submitted some evidence that Highland Capital acted on behalf of the Funds at other times during the course of this transaction. (*See* Opp'n Br. at 11 n.8.) I find that plaintiffs' reading of section 3(c) is not unreasonable based on the documents before me.

Plaintiffs' interpretation of section 3(c) is also not inconsistent with section 13(B) of the cash warehouse agreement and section 11(B) of the synthetic warehouse agreement, because the final sentences in those sections specifically provide that they do not "affect any liability that [Highland Capital] may otherwise have," such as under the engagement letter.

Furthermore, I am not convinced by defendants' argument that I must construe the indemnification provision in Schedule I to apply narrowly to the post-warehousing period of time, as a matter of law, based on the "in connection with the engagement of UBS Securities" language. The use of this phrase at the beginning of Schedule I is susceptible of more than one reasonable interpretation.

Defendants rightly argue that the parties' intent does not matter if the meaning of the contracts is clear. Here, however, section 3(c) is not unambiguous, and plaintiffs' reading of it is not unreasonable. I am not prepared to dismiss the complaint as a matter of law, without giving the parties the benefit of discovery.

I have considered the parties' other arguments based on other provisions in the three agreements, and they do not compel a different result.

Since plaintiffs have withdrawn any claim that the Funds breached the engagement letter, the first and second causes of action are dismissed in part, insofar as they allege those claims. In all other respects, the motion to dismiss is denied.

Dated: October 6, 2009

ENTER:

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J.S.C.

**UBS Sec. LLC v Highland Capital Mgt., L.P., 25 Misc.3d 1243(A) (2009)**

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