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

PRESENT: BERNARD J. FRIED, Justice — PART 60

FICUS INVESTMENTS, INC., and PRIVATE CAPITAL GROUP, LLC,
Plaintiffs,

- v -

PRIVATE CAPITAL MANAGEMENT, LLC, THOMAS B. DONOVAN, et al.,
Defendants,

INDEX NO. 600926/2007

MOTION DATE

MOTION SEQ. NO. 022

MOTION CAL. NO.

FBEM

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 papers submitted, it is

FILED
APR 24 2008
COUNTY CLERK'S OFFICE
NEW YORK

This motion is decided in accordance with the accompanying memorandum decision.

SO ORDERED.

FBEM

Dated: 4/24/08

HON. BERNARD J. FRIED

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☒ REFERENCE

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIV. PART 60
- X

FICUS INVESTMENTS, INC. and
PRIVATE CAPITAL GROUP, LLC,

FBEM

Plaintiffs,

- against - Index No. 600926/2007

PRIVATE CAPITAL MANAGEMENT, LLC,
THOMAS B. DONOVAN, et al.,

Defendants.
- X

APPEARANCES:

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David J. Katz, Esq.

FILED
APR 24 2008
COUNTY CLERK'S OFFICE
NEW YORK

Fried, J.:

Defendants, Thomas B. Donovan ("Donovan"), Christopher Chalavoutis ("Chalavoutis"), and Peter Kamran ("Kamran") (collectively, the "Defendants"), bring this motion seeking reimbursement and advancement of litigation fees and expenses. Defendants assert that, as former officers of Private Capital Group LLC ("PCG" or the "Company"),

their right to such reimbursement and advancement arises under the terms of the Private Capital Group LLC Limited Liability Company Operating Agreement (the "Operating Agreement" or the "Agreement"), and, upon their compliance with certain contractual provisions, is absolute. Plaintiffs, Ficus Investments, Inc. ("Ficus") and PCG, argue, primarily, that the express terms of the Operating Agreement actually bar advancement or indemnification in this case.[1]

This case (the "Main Action") and its several sisters have been the subject of much discussion in recent months,[2] and familiarity with the Decisions and Orders issued in this and the related actions is presumed. Only that background information relevant to the present motion will be addressed.

Ficus is the 80% owner and Managing Member of PCG, a Florida limited liability company dedicated to the business of buying, selling and managing non-performing mortgages. Defendant Donovan, along with former defendant Lawrence A. Cline, together owned Private Capital Management LLC ("PCM"), which is the 20% owner of PCG. There is no dispute that Donovan was the chief executive officer of PCG until April 2007.

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Plaintiffs also brought a cross-motion for sanctions. As I stated during oral argument on the present motion, however, "I see absolutely no basis ... for sanctions in this application." (Hr'g Tr. 13. Feb. 26, 2008.) Plaintiffs' cross-motion is therefore denied without further discussion.

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The related actions currently pending are *Thomas B. Donovan, individually and derivatively on behalf of Private Capital Management, LLC and Private Capital Management Corp. v. Ficus Investments, Inc. a/k/a Ficus (USA), Inc., et al.*, Index No. 602715/2007 (hereafter "*Donovan v. Ficus*"); *Private Capital Group LLC and Ficus Investments, Inc. v. Thomas B. Donovan, et al.*, Index No. 650338/2007; *New York Holding v. PCG REA LLC, Lawrence A. Cline, Susan Cline and Ryan Bloomfield*, Index No. 602795/2007; *422 East 84th Street Holding Corp. v. PCG REA LLC, Lawrence A. Cline, Susan Cline and Ryan Bloomfield*, Index No. 602839/2007; and *Banque Portfolio Corp. and Private Capital Group, LLC v. Daniel S. Torchio, Esq., Peter Kamran, Esq., Thomas B. Donovan, Charles Kosowitz and John Does 1-10*, Index No. 650339/2007.

According to Defendants, but now disputed by Plaintiffs, Chalavoutis and Kamran were, respectively, the Company's former chief financial officer and vice president.

Ficus commenced this action in March 2007, alleging, *inter alia*, that Donovan and other defendants misappropriated millions of dollars of Company funds and assets. Over a year and many rounds of motion practice later, Donovan, Chalavoutis and Kamran bring the present motion, seeking enforcement of their contractual right to advancement and reimbursement of litigation expenses – which expenses total nearly $2.5 million dollars.[3]

Plaintiffs oppose this motion on three separate grounds. First, Plaintiffs argue that the language of the Agreement bars advancement and indemnification because Defendants have been subjected to injunctive relief, and furthermore, that Florida law, which governs the Operating Agreement and is reflected in its language, would bar advancement under the circumstances present here. Next, Plaintiffs assert that the Operating Agreement prohibits advancement or indemnification – or, at the very least, requires reduction of the amount the Company is required to pay out – to the extent that the former officer has already received payment as advancement or indemnification; and because Defendants have allegedly misappropriated monies from the Company and then used them to pay their attorneys, an advancement of any additional funds would represent a duplicate payment, which is

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See Pl. Opp. Mem. 5-6, asserting that the amount initially requested by Defendants was not reflected in the invoices for legal services attached to the moving papers, and that "it strains credibility to consider [that the difference between the amount requested - $3.6 million - and the amount invoiced - just under $2.5 million, are] mere mistakes." (*Id.* at 6.) Although Defendants' moving papers assert that $3.6 million has been accrued in legal fees thus far (Def. Mem. in Supp. of Mot. 2, 8), counsel for Defendants later acknowledged that, "there was a mathematical mistake with respect to the Troutman Sanders invoice," which was "an error by newly retained counsel, not the client." (Def. Reply Mem. 3.) Defendants also assert that the "requested advance was clearly based only on the attached invoices." (*Id.*) Although the exact amount of expenses and their reasonableness will not be determined by this decision, a review of the submitted invoices shows the total amount of fees and expenses requested to be around $2.5 million. (*See* Eilender Affirm. Exs. 4-7.)

prohibited by the Agreement. Finally, Plaintiffs point out that Defendants Kamran and Chalavoutis were never officers of the Company within the meaning of the Operating Agreement, but rather, were merely employees; as such, any advancement or indemnification of their expenses is at the discretion of Ficus, PCG's Manager. After presenting an overview of the contractual provisions, I will address each of these three arguments in turn.

The advancement and indemnification provisions of the Operating Agreement are contained in Section 3.4. Section 3.4.1 contains the definitions of relevant terms, § 3.4.2 establishes the "Obligation to Indemnify; [and its] Limits," and § 3.4.3 is entitled "Advance for Expenses." (Operating Agreement[4] §§ 3.4.1-3.4.3.) Section 3.4.3 provides that:

> The Company must, before final disposition of a Proceeding, advance funds to pay for or reimburse the reasonable Expenses[5] incurred by a Person who is a Party to a Proceeding because he or she is a Member, Manager or Officer[6] if such Person delivers to the Company a written affirmation of his or her good faith belief that his or her conduct does not constitute behavior

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A copy of the Operating Agreement is attached as Exhibit 1 to the Affirmation of Jeffrey M. Eilender in Support of Motion for Advancement of Litigation Fees and Expenses.

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"Expenses" are defined to include

> all reasonable counsel fees, retainers, court costs, transcript costs, fees of experts, witness fees, travel expenses, duplicating costs, printing and billing costs, telephone charges, postage, delivery service fees, and all other disbursements or expenses of the types customarily incurred in connection with prosecuting, defending, preparing to prosecute or defend, investigating, being or preparing to be a witness in, or otherwise participating in, a Proceeding, including any appeals.

(Operating Agreement § 3.4.1(d).)

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"'Member' or 'Manager' or 'Officer'" is defined, in part, to include any person "who is or was a Member, Manager or Officer, respectively, of the Company." (Operating Agreement § 3.4.1(b).) I will hereafter use the shorthand "Officer" to refer to any Member, Manager or Officer under the Agreement.

Plaintiffs do not dispute that Donovan, Chalavoutis and Kamran are parties to this action because of "conduct taken in their capacities as officers or related to those capacities." (Def. Supp. Mem. 3.)

> that would result in Liability[7] for (i) intentional misconduct or a knowing violation of law, or (ii) any transaction for which such Member, Manager or Officer received a personal benefit in violation or breach of any provision of this Agreement; and such Member, Manager or Officer furnishes the Company a written undertaking, executed personally or on his or her behalf, to repay any advances if it is ultimately determined that he or she is not entitled to indemnification under this Section 3.4 or the Florida [Limited Liability Company] Act.

(Operating Agreement § 3.4.3(a).)

According to the Defendants, the obligation to advance under § 3.4.3(a) is absolute, and takes effect immediately upon filing the above described affirmation and undertaking. Indeed, the Operating Agreement goes on to provide that "reimbursement or advances for Expenses under this Section 3.4.3 shall be made not later than thirty (30) days after the later of (i) the Company's receipt of the affirmation and undertaking ... or (ii) the Company's receipt of Supporting Documentation[8] for specific Expenses to be reimbursed or advanced." (*Id.* § 3.4.3(c).)

Defendants submitted demands for reimbursement/advancement by letters dated December 31, 2007 and January 2, 2008, along with the required affirmations and undertakings,[9] and supporting documentation in the form of invoices from the law firms of

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"Liability" is defined to include, "claims, demands and/or the obligation to pay a judgment, settlement, penalty, fine (including an excise tax assessed with respect to an employee benefit plan), or reasonable Expenses actually incurred with respect to a Proceeding." (Operating Agreement § 3.4.1(e).)

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"Supporting Documentation" is defined as, "documents or other evidence of specific Expenses to be reimbursed or advanced, including any relevant invoice, bill, agreement or other documentation." (Operating Agreement § 3.4.1(i).)

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See Affirmation and Undertaking by Thomas B. Donovan in Support of Demand for Advancement of Litigation Fees and Expenses; Affirmation and Undertaking by Peter Kamran in Support of Demand for Advancement of Litigation Fees and Expenses; and Affirmation and Undertaking by Christopher Chalavoutis in Support of Demand for Advancement of Litigation Fees and Expenses (collectively, the "Affirmations and Undertakings").

Troutman Sanders LLP, Curtis, Mallet-Prevost, Colt & Mosle LLP, Nitkewicz & McMahon LLP, and Schlam Stone & Dolan LLP. (*See* Eilender Affirm. Exs. 2 and 3, containing copies of the letters and invoices; *see also* Eilender Affirm. Exs. 4-7, containing copies of invoices from all law firms.) There is no dispute that the Company has failed to comply with the demand letters.

Contemporaneously with serving their demand letters on the Plaintiffs, Defendants also filed the present motion, pursuant to the terms of § 3.4.5 of the Agreement, which provides for "Court-Ordered Indemnification and Advances for Expenses." That subsection provides that the person seeking advancement or indemnification may apply "to the court conducting the Proceeding or to another court of competent jurisdiction." (Operating Agreement § 3.4.5(a).) Notwithstanding any review previously made by the Company, the court is to review the application de novo, and then, after giving any notice it deems necessary:

> the court shall: (i) order indemnification or advance for Expenses if it determines that the Member, Manager or Officer is entitled to indemnification or advance for Expenses; or (ii) order indemnification or advance for Expenses if it determines, in view of all relevant circumstances, that it is fair and reasonable to indemnify the Member, Manger or Officer, or to advance Expenses to the Member, Manager of Officer, even if he or she failed to comply with the requirements for advance of Expenses.

(*Id.*)

Each of these sets forth the respective Defendant's good-faith belief that his conduct did not constitute behavior that would result in Liability (as defined in the Operating Agreement) for intentional misconduct or knowing violation of the law, or for any transaction for which he received "a personal benefit in violation or breach of the PCG Operating Agreement." (Affirmations and Undertakings ¶ 2.) By way of the Affirmation and Undertaking, each Defendant also agreed to "undertake and become bound to repay any funds advanced to pay, or reimburse" him, if it should be "ultimately determined" that he is "not entitled to indemnification under the PCG Operating Agreement or the Florida Limited Liability Act, as amended." (*Id.* ¶ 3.)

Defendants argue that they have complied with the contractual provisions requiring them to submit Affirmations and Undertakings, and that they are therefore entitled to advancement/reimbursement of Expenses in accordance with the express terms of the Operating Agreement.

Not surprisingly, Plaintiffs have a different reading of the relevant contractual provisions. According to Plaintiffs, § 3.4.2, which provides that "[t]he Company must indemnify and hold harmless its Members, Managers and Officers ... from and against any and all Liability whatsoever arising in connection with the Company," goes on to bar indemnification:

> for any Liability incurred in a Proceeding in which such Person is adjudged liable to the Company or is subjected to injunctive relief in favor of the Company (i) for acts or omissions that involve intentional misconduct or a knowing violation of law, or (ii) for any transaction for which such Member, Manager or Officer received a personal benefit not permitted by this Agreement in violation or breach of any provision of this Agreement, or as otherwise prohibited by the Florida [Limited Liability Company] Act.

(Operating Agreement § 3.4.2(a).)

This provision is fatal to Defendants' claims, say the Plaintiffs, because it prevents the indemnification of one who has been "subjected to injunctive relief in favor of the Company" for acts or omissions involving intentional misconduct, or for taking part in a transaction in which one receives a personal benefit not intended by, and in breach or violation of, the Operating Agreement. (*Id.*) Plaintiffs assert that the preliminary injunctions issued so far against Defendants,[10] especially that which "froze" $9.872 million in allegedly

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[10] *See* Order of June 6, 2007, granting preliminary injunction enjoining Defendants from transferring, encumbering, selling, etc. cash in the sum of approximately $9.8 million; *see also* So Ordered Transcript of May 1, 2007, which converted the three previously issued TROs into a single preliminary injunction enjoining

unauthorized loans to the Defendants, were based on acts involving intentional misconduct and transactions for which Defendants received personal benefits in breach or violation of the Operating Agreement. Thus, it is argued that the very face of the Agreement itself bars indemnification in this case. Furthermore, because § 3.4.2 "is the lead part of the provision ... [and the rest of the Agreement] flows from 3.4.2," a party who is not entitled to indemnification because injunctive relief has been issued, is also not entitled to advancement. (Mot. Hr'g Tr. 41, Feb. 26, 2008.) In other words, Plaintiffs argue, where the question of entitlement to indemnification can be determined prior to the conclusion of the action, there is simply no need for the Company to advance funds to pay for Expenses incurred. (*See id.* at 46-47.)

Defendants assert that, not only is the "injunctive relief" contemplated by § 3.4.2 limited to that which is obtained upon final adjudication of an action, but further, that Plaintiffs' reading of this section would improperly amalgamate the concepts of indemnification and advancement, and thereby render the entire § 3.4.3 meaningless. Defendants insist that the structure of the Agreement clearly distinguishes between advancement and indemnification, with "advancement" used to refer to the funds that are provided to the Officer prior to the final disposition of an action, and "indemnification" referring only to those funds that are paid out upon a final determination that the Officer has not committed any wrongdoing. Because of this clear distinction, and because § 3.4.2 only presents a bar to indemnification, the "injunctive relief" mentioned in that section can only

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Defendants from taking any transfers or distributions outside the ordinary business of the Company, removing any Company or Copperfield books or records, and which granted to Plaintiffs immediate possession and control of PCG's operations.

be read to refer to those injunctions that are issued as a final form of relief at the conclusion of the action. There is therefore no basis for the assertion that a preliminary injunction – issued for any reason – would present a bar both to indemnification and advancement.

Plaintiffs' reading of the phrase in question is not implausible, given that the words "adjudged liable" are separated from the words, "subjected to injunctive relief" by the disjunctive "or." Thus, it is argued, the word "adjudged" (which connotes final adjudication) need not be read in conjunction with "subjected to injunctive relief," but rather, may be read as a separate clause. In other words, rather than reading this phrase to mean that the Officer must be adjudged to be liable, or *adjudged* to be subject to injunctive relief, Plaintiffs would read it to mean that the Officer may have been *either* adjudged to be liable, *or*, at some point in the proceedings, subjected to injunctive relief. Looked at in isolation from the rest of the Agreement, this reading might arguably allow for a prohibition on indemnification where the prospective indemnitee had been subjected to preliminary injunctive relief.

This section, however, may not be read in isolation, but rather, must be viewed within the context of the whole Agreement. *See, e.g.*, *Jones v. Warmack*, 967 So.2d 400, 402 (Fla. Dist. Ct. App. 2007) ("'The intention of the parties must be determined from an examination of the whole contract and not from the separate phrases of paragraphs.'") (*quoting Lalow v. Codomo*, 101 So.2d 390, 393 (Fla. 1958)).[11] And, when read in the context of the whole

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It is undisputed that Florida law governs the Operating Agreement, and therefore, its construction. (*See* Operating Agreement § 6.2.6, "...the parties expressly agree that all the terms and provisions of this Agreement are construed under and governed by the laws of the State of Florida.") I note that this rule of construction is consistent with New York law as well. *See, e.g., Empire Properties Corp. v. Manufacturers Trust Co.*, 288 N.Y. 242, 248 (1942) ("A written contract 'will be read as a whole and every part will be interpreted with reference to the whole; and if possible it will be so interpreted as to give effect to its general purpose.'") (*quoting* 3 Williston on Contracts, § 618); *see also Paige v. Faure*, 229 N.Y. 114, 118 (1920) ("The intention of parties to a contract must be ascertained, not from one provision, but from the entire instrument.")

Agreement, it is clear that § 3.4.2 provides for the indemnification of an Officer after the final adjudication of a proceeding, and § 3.4.3 provides for the reimbursement and advancement of Expenses "before final disposition of a Proceeding." (Operating Agreement § 3.4.3(a).) Section 3.4.2 expressly mentions only indemnification, and only prohibits indemnification where the Officer is subjected to injunctive relief. Reading this section to bar advancement in such a situation is incorrect. Furthermore, because entitlement to indemnification can only be determined at the conclusion of all proceedings, it also would be incorrect to read this section to prohibit both indemnification and advancement when preliminary injunctive relief is issued before the final disposition of the action.

Although Section 3.4 is entitled "Indemnification of Members, Manager and Officers," its subsections clearly differentiate between indemnification and advancement. The term "indemnification" or "indemnify" is used exclusively throughout § 3.4.2, which, as discussed above, sets forth the Company's obligation to indemnify and hold harmless any Officer from and against any Liability, including "the obligation to pay a judgment, settlement, penalty, fine ... or reasonable Expenses *actually incurred* with respect to a Proceeding." (*Id.* § 3.4.1(e).) (Emphasis added.) Section 3.4.3, however, uses the term "advancement" or "advance," and applies to the Company's obligation "to pay for or reimburse the reasonable Expenses incurred" by the Officer. (*Id.* § 3.4.3(a).) Whether such Expenses are reasonable is to be determined, pursuant to § 3.4.3(d)(i), by majority vote of Disinterested Members, or, under § 3.4.5, by the Court. Furthermore, if the Company fails to make a determination as to the reasonableness of the Expenses within thirty days of receiving the Officer's affirmation and undertaking or supporting documentation, then any

Expenses claimed by the Officer will be presumed to be reasonable. (*Id.* § 3.4.3(d)(ii).)

These provisions support the conclusion that entitlement to indemnification may only be determined at the final stages of an action, after reasonable Expenses have been actually incurred. Section 3.4.2 applies at the conclusion of all proceedings, to indemnify the Officer who is cleared of all wrongdoing against a judgment, fine, penalty, or Expenses incurred, which have already been determined to be reasonable pursuant to § 3.4.3. Contrariwise, the section on advancement, § 3.4.3, provides the mechanism for determining the reasonableness of Expenses during the proceeding, either by court, disinterested member, or pursuant to § 3.4.3(d)(ii) of the Operating Agreement, which provides that if the reviewing party fails to make a determination of reasonableness within thirty (30) days after receiving the affirmation and undertaking or the appropriate Supporting Documentation of Expenses, the Officer is entitled to a presumption that the Expenses are reasonable.

The only place where § 3.4.3 uses the word "indemnification" is where it refers to the repayment of advances if the Officer is "ultimately determined" not to be "entitled to indemnification." (*Id.* § 3.4.3(a).) The Agreement thus clearly distinguishes between the concepts of, and requirements for, advancement and indemnification, and recognizes that an Officer may, "before final disposition of a Proceeding," seek advancement of Expenses, and then, upon a final adjudication, seek to be indemnified and held harmless from and against any Liability.[12]

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[12] The persuasive authority cited by Defendants that delineates the differences between advancement and indemnification is helpful. The Delaware Court of Chancery, in *Bergonzi v. Rite Aid Corp.*, for example, stated that advancement and indemnification are recognized as separate legal rights, and concluded that a corporate director who may turn out not to be entitled to indemnification because he pled guilty to deliberate falsification of financial statements and receiving a fraudulently back-dated employment agreement, was nonetheless entitled

Further support for this conclusion is found in the requirement of the undertaking, set forth in §§ 3.4.3(a) and (b). Pursuant to the plain language of § 3.4.3(a), the "Company must ... advance funds ... if [the Officer] delivers to the Company a written affirmation ... and furnishes the Company a written undertaking ... to repay any advances if it is ultimately determined that he or she is not entitled to indemnification..." The following subsection, 3.4.3(b), goes on to provide that, where the Officer seeks court-ordered indemnification pursuant to § 3.4.5, the undertaking to repay "shall not be applicable or enforceable unless and until there is a final court determination that he or she is not entitled to indemnification, as to which all rights of appeal have been exhausted or have expired."

The Agreement thus clearly requires the advancement of Expenses first, and a determination of entitlement to indemnification at the conclusion of all proceedings. The undertaking acts as security for what is, in essence, a loan from the Company to be used for payment of Expenses during a proceeding. Such loan is to be paid back only upon a final determination that the Officer is not entitled to indemnification. If an Officer had to prove that he or she was entitled to indemnification in order to compel the Company to advance Expenses, then the undertaking would be unnecessary, as the determination of entitlement to indemnification can only happen upon a final adjudication. Thus, the entire action would play out, with the Officer unable to prove that he or she is entitled to indemnification, and therefore unable to show entitlement to advancement, until the conclusion of the proceedings. At that point, the Officer would either be indemnified for and against any

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to advancement under the corporate charter. 2003 WL 22407303 at * 2 (Del. Ch. 2003). Similarly, in *Homestore Inc. v. Tafeen*, the Supreme Court of Delaware held that, "Although the right to indemnification and advancement are correlative, they are separate and distinct legal actions. The right to advancement is not dependent on the right to indemnification." 888 A.2d 204, 212 (Del. 2005).

Liability (which, remember, includes Expenses actually incurred), or not. If indemnified, the Officer has clearly shown entitlement, thus obviating the need to enforce the undertaking; and if not, the Company has not advanced any monies that would require the security of an undertaking.

Plaintiffs also assert that Florida law, which undisputedly governs the Agreement, bars advancement here. They argue that the language of § 3.4.5, which provides for court-ordered indemnification and advancement, tracks the language of, and is thus governed by, the standard set forth in *Turkey Creek Master Owners Ass'n v. Hope*, 766 So.2d 1245 (Fla. Dist. Ct. App. 2000). In that case, a homeowners' association sued a former developer and directors for breach of fiduciary duty, conversion, breach of contract and an accounting. The trial court ordered indemnification of the defendants, pursuant to Florida's Corporations law. This was reversed by the District Court of Appeal, which held that "there was an insufficient basis for the trial court to conclude that the defendants were fairly and reasonably entitled to the payment of their expenses by Turkey Creek under the statute," which requires a consideration of "all the relevant circumstances." *Turkey Creek*, 766 So.2d at 1246. Because the basis for the trial court's decision to grant indemnification was not set forth in the ruling, the appellate court was unable to determine whether all relevant circumstances were, in fact, considered. *Id.* Plaintiffs rely on this case to support their assertion that a court determining whether defendants are "fairly and reasonably entitled" to advancement or indemnification must, pursuant to the Florida statute, consider "all the relevant circumstances," and that such circumstances include the nature of the claims against the defendants, the issuance of injunctive relief, and the allegations that the funds stolen from

the Company have been used to partially fund this litigation so far. (Pl. Opp. Mem. 12-15.) *Turkey Creek*, however, is distinguishable, because the right at issue here arises from contract, and not merely from statute, as it did in *Turkey Creek*.

Moreover, the statute implicated in this case is not the Florida Business Corporation Act, Fla. Stat. Ann. § 607 (2008), but rather, the Florida Limited Liability Company Act, Fla. Stat. Ann. § 608 (2008). In *Turkey Creek*, the right to indemnification arose solely out of the Business Corporations Act. *See* 766 So.2d at 1246 ("the trial court granted the defendants' motion based solely on the pleadings and statute"). Here, by contrast, the Defendants' right to indemnification and advancement is guaranteed by the Operating Agreement. Although § 3.4.2 provides that the Company may not indemnify where the Officer is adjudged liable or subject to injunctive relief, "or as otherwise prohibited by the Florida [LLC] Act," nothing in the Florida LLC Act prevents indemnification or advancement in the present situation, nor does it obligate the Company, or the court, to engage in the "all relevant circumstances" analysis.

The Florida Limited Liability Company Act simply provides that an LLC has the power to indemnify, subject to the standards set forth in its operating agreement. Fla. Stat. Ann. § 608.4229(1) (2008). Subsection (2) of this section then narrows this by prohibiting indemnification or advance of expenses "if a judgment or other final adjudication establishes that the actions, or omissions to act" constitute a violation of criminal law, willful misconduct or conscious disregard for the best interests of the LLC, or result in a personal benefit. *Id.* at § 608.4229(2). A Florida LLC is thus free to create its own standards and mechanisms for indemnification and advancement, provided that it does not indemnify or

advance where there is a judgment or other *final adjudication* that established willful misconduct on the part of the proposed indemnitee. The standard created by the LLC Act, and incorporated into the Operating Agreement, is thus not whether the Defendants have shown that they are entitled to advancement or indemnification in view of all the relevant circumstances, but rather, whether a final judgment determines them to have been liable, subject to injunctive relief, or to have committed a violation of criminal law, willful misconduct, conscious disregard for the best interests of the LLC, or to have obtained a personal benefit.

Although Plaintiffs contend that "the standard of *Turkey Creek* clearly applies" because § 3.4.5 uses the phrase "all relevant circumstances," this contention is based upon an incomplete reading of § 3.4.5. The section provides, first, that the court shall order indemnification or advancement if it determines that the Officer is so entitled. (Operating Agreement § 3.4.5(a)(i).) Subsection 3.4.5(a)(ii) provides the context for this determination, stating that the court may order indemnification or advancement if it determines, "in view of all the relevant circumstances, that it is fair and reasonable ... *even if he or she failed to comply with the requirements for advance of Expenses.*" (*Id.* § 3.4.5(a)(ii).) (Emphasis added.) Rather than providing a bar to advancement or indemnification in light of all relevant circumstances, this language actually provides an additional method by which the Court may order advancement or indemnification, if it is fair and reasonable to do so, even if the Officer has not complied with the prerequisites set forth in § 3.4.3(a) – the affidavit and undertaking.

Since I do not conclude that the plain language of the Operating Agreement prohibits

advancement of Expenses, I turn to the remaining grounds upon which Plaintiffs' opposition is based.

Plaintiffs further argue that Defendants are not entitled to advancement of Expenses because § 3.4.8 prohibits any duplication of payments. This subsection provides, in part:

> The Company shall not be liable under this Section 3.4 to make any payment to a Person hereunder to the extent such Person has otherwise actually received payment (under any insurance policy, agreement or otherwise) of the amounts otherwise payable hereunder.

(Operating Agreement § 3.4.8.)

Plaintiffs assert that Donovan has transferred millions of dollars in Company funds to himself, and that some of these transferred funds have been used to pay his legal expenses. Therefore, any additional advancement of funds by the Company would amount to a duplication of payment, which is prohibited by the above-quoted language.

Analysis of the Agreement, however, warrants rejection of this argument. The language of the parenthetical, "(under any insurance policy, agreement or otherwise)," indicates that the provision was intended to apply to payments received from an insurance company, e.g., under a directors and officers liability insurance policy. To the extent that the Officer receives payment for legal expenses under the terms of his or her insurance policy, requiring the Company to advance funds to cover the same expenses would leave the Officer with a windfall. Similarly, the word, "agreement" in this phrase would prohibit indemnification or advancement in a situation where the Officer received payment pursuant to some agreement, other than an insurance policy, of "the amounts otherwise payable hereunder." (*Id.*) Plaintiffs would read the words, "or otherwise," to require reduction of the indemnification or advancement by the amount of any payment, received by the Officer from

any source, including the Company. This reading, however, ignores the provision's requirement that the Officer has "actually received payment ... of the amounts otherwise payable hereunder." (*Id.*) These words limit the Agreement's contemplation of "duplicate payments" to those monies that are actually paid to the Officer and specifically designated for the payment of his or her Expenses. In other words, the funds that the Officer "actually receives" must be funds that are only paid over to the Officer so that he or she can use them for payment of the amounts that would otherwise be covered by the indemnification and advancement provisions of the Agreement.

The funds received by Donovan, which Plaintiffs claim should bar advancement, are those that were allegedly stolen from the Company in the form of unauthorized loans and other unsanctioned withdrawals from Company accounts. Regardless of whether those funds were, in fact, used by Donovan to pay some of his attorneys' fees, they were not intended by the Company to be so used. And, because they were not paid to Donovan with the express instruction that they be used to cover his Expenses in this action, they are not payments actually received of the amounts otherwise payable under the Agreement, and thus do not come within the ambit of § 3.4.8.

The question of whether those funds were wrongfully taken by Donovan or, as he claims, rightfully transferred pursuant to a loan agreement or otherwise, has yet to be determined. While my granting of preliminary injunctive relief did require a showing that Plaintiffs were likely to succeed on the merits, such a showing does not imply or guarantee ultimate success on the merits. "A judicial determination regarding likelihood of success on the merits does not ... amount to a predetermination of the issues. Rather, 'the showing of

a *likelihood* of success ... must not be equated with the showing of a *certainty* of success on the merits." *Bingham v. Struve*, 184 A.D.2d 85, 88 (1st Dep't 1992) (quoting *Tucker v. Toia*, 54 A.D.2d 322, 326 (4th Dep't 1976) (emphasis in original)). Plaintiffs couch their § 3.4.8 argument in the section's language of "duplication of payments," but in fact, they are making an equitable argument, to wit: Donovan is accused of stealing money from the Company; he used some of that money to pay his lawyers; his unclean hands should render him estopped from receiving – or even asking for – any more money from the Company.

Whether Donovan has improperly obtained or stolen money from the Company, of course, remains to be decided, and the Operating Agreement does not bar indemnification or advancement on the basis of mere allegations. Indeed, the Company is obligated to advance Expenses unless and until it is ultimately determined that the Officer is not entitled to indemnification. If such a determination is made upon final disposition of the proceedings, then the Officer is obligated to repay any advanced funds, in accordance with his or her undertaking.

Furthermore, the Delaware cases cited by Defendants in support of the proposition that indemnification and advancement are not prohibited, even in the face of allegations of theft by an officer or director, are persuasive.[13] In *Reddy v. Electronic Data Systems Corp.*, for example, the Court of Chancery upheld the right to advancement of a corporate director accused of falsifying financial records. 2002 WL 1358761 (Del. Ch., June 18, 2002). The

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Defendants cite to Delaware case law because "Florida's state and federal courts apparently have not had the opportunity to opine on this issue," and because Delaware, with its "'rich abundance of corporate law,' ... guides courts throughout the country due to 'the special expertise and body of case law developed in the Delaware Chancery Court and the Delaware Supreme Court.'" (Def. Supp. Mem. 13-14, n. 9 [citations omitted].)

corporation had argued, in part, that an officer who purposely harms the corporation should be estopped from demanding advancement, as to do otherwise would "be to permit a thief to steal twice." *Id.* at *9. In rejecting this argument, the court stated that the Delaware General Corporation Law expressly authorizes advancement and "presupposes that the corporation will front expenses before any determination is made of the corporate official's ultimate right to indemnification." *Id.*

Thus, to conclude, as Plaintiffs urge, that an Officer who is accused of intentional wrongdoing is not entitled to advancement, would, as *Reddy* stated, "turn every advancement case into a trial on the merits of the underlying claims of official misconduct." *Id.* Notably, the Operating Agreement provides for advancement of Expenses prior to the final adjudication, and leaves the ultimate determination of whether the Officer has engaged in willful misconduct until the conclusion of all proceedings. If, at that point, the Officer is determined not to be entitled to indemnification, then the undertaking required under the Agreement will serve to obligate him or her to repay all funds advanced. Indeed,"[t]he scope of an advancement proceeding is usually summary in nature and limited to determining the issue of entitlement in accordance with the corporation's own uniquely crafted advancement provisions." *Homestore, Inc. v. Tafeen*, 888 A.2d 204, 213 (Del. 2005) (*citing Kaung v. Cole Nat'l Corp.*, 884 A.2d 500, 510 (Del. 2005), "[A]n advancement proceeding is summary in nature and not appropriate for litigating indemnification or recoupment.").

Therefore, the right to advancement is not barred by § 3.4.8, as funds advanced by the Company for the purposes of covering reasonable Expenses do not represent a duplication of payment. Moreover, as required by the Agreement, each Defendant has

submitted an affidavit denying any misconduct, along with an undertaking that protects the Company if it is determined, at the conclusion of the proceedings, that the Defendants are, in fact, not entitled to indemnification. As there is no dispute that Donovan was an Officer, he is entitled to advancement. The remaining question is whether Chalavoutis and Kamran are also entitled to advancement as Officers.

Plaintiffs assert that neither Chalavoutis nor Kamran was a "Member, Manager or Officer" within the meaning of the Agreement. Defendants, on the other hand, contend that Chalavoutis was the chief financial officer of PCG until around April 2007, and that Kamran was the vice president until about the same time. The Operating Agreement provides for mandatory advancement and indemnification for a person who was or is a "Member, Manager or Officer" (§§ 3.4.2-3.4.3), but leaves the decision of whether to advance or indemnify an employee or agent to the discretion of the Manager (§ 3.4.16). Ficus is the Manager of the Company, pursuant to § 3.1.2.

Plaintiffs assert that Chalavoutis and Kamran are not (and never were) Officers because neither of them was appointed in accordance with the terms of the Agreement, which provides that the "CEO, President and other officers, if any shall be appointed by the Manager..." (Operating Agreement § 3.2.2.) Only two officers were named in the text of the Agreement itself: Donovan as CEO and Cline as president. (*Id.* §§ 3.2.4-3.2.5.) "At no point did Ficus appoint Christopher Chalavoutis as Chief Financial Officer or the Company or Peter Kamran as Vice-President of the Company. Donovan and Cline were running the Company, but they had no authority to make officer appointments under the Operating Agreement." (Voss Aff. ¶ 5.) Thus, Plaintiffs argue, even if Donovan is entitled to advance

of Expenses, Chalavoutis and Kamran are not.

Defendants do not dispute that Chalavoutis and Kamran were never formally named as officers of PCG. (*See* Chalavoutis Affirm. ¶ 6, "Although I was not formally named CFO of PCG (FL) by Ficus, I assumed that position on January 1, 2006, when the Company commenced operations."; *see also* Kamran Affirm. ¶ 6, "Although Ficus Investments, Inc. as Managing Member of PCG (FL) may not have formally named me an Officer of PCG (FL), I was regarded as an Officer of PCG (FL) both within and without PCG (FL)." Defendants argue that, lack of formal appointment notwithstanding, PCG held them out as Officers until the commencement of this lawsuit, and that Ficus has referred to Chalavoutis and Kamran as Officers in its pleadings, as well as ratified their status by not objecting to their signing of documents as officers.

Regardless of how Ficus and PCG have referred to Chalavoutis and Kamran, whether in pleadings, motions, or otherwise, the action before me concerns the interpretation and enforcement of an agreement. This is not an action at equity, but rather, an action under contract. By asking me to take into account evidence that Chalavoutis and Kamran acted as, and were held out as Officers, and that Ficus referred to them as such in the Complaint, Defendants are asking me to look beyond the four corners of the Agreement, and essentially, to conclude that Ficus and PCG now are estopped from denying their status as Officers. I do not see how Defendants can be entitled to a strict reading of those terms of the Agreement concerning their right to advancement, and yet ignore, or only loosely interpret, the provision that defines the term, "Officer." If the plain language of the Agreement guarantees the right of an Officer to advancement and indemnification, then it is that same plain language that

will determine whether a particular person is to be considered an Officer entitled to mandatory advancement, or rather, an employee, agent or otherwise, whose right to advancement and indemnification is left to the discretion of the Company. And here, the Agreement expressly provides that any Officers "shall be appointed by the Manager and serve at the pleasure of the Manager." (Operating Agreement § 3.2.2.) As neither Chalavoutis nor Kamran disputes the assertion that Ficus failed to appoint him as Officer, neither one of them can now claim that he is entitled to reap the benefits that the Agreement reserves for Officers, Members and Managers.

Therefore, neither Chalavoutis nor Kamran is entitled to advancement or indemnification under the Agreement. As Donovan is thus the only Defendant who is entitled to advancement of Expenses, I must now address the question of how to determine whether his claimed Expenses are reasonable.

Where court-ordered indemnification and advancement is sought, the Operating Agreement provides that, "[r]egardless of any determination by the Reviewing party as to the reasonableness of Expenses, and regardless of any failure by the Reviewing party to make a determination as to the reasonableness of Expenses, such court's review shall be a *de novo* review." (Operating Agreement § 3.4.5(a).) Defendants thus seek an order that would:

> (a) establish[] their entitlement to advances as a matter of law, (b) direct[] immediate payment of any fees that the Court finds to be clearly reasonable in the circumstances, and (c) appoint[] a Special Master or JHO with instructions to conduct a prompt determination on a monthly basis of any future dispute about the Expenses that PCG (FL) must advance."

(Def. Reply Mem. 19.)

Plaintiffs argue that the invoices submitted by Defendants with this Motion include

the legal fees associated with not only Donovan's defense, but also that of Cline, Chalavoutis, Kamran, PCM, and other non-covered parties. (Plf. Opp. Mem. 20-22.) Furthermore, Plaintiffs seek to reduce the amount of advanced Expenses by any fees that were accrued during the defense or prosecution of any related actions, such as the Copperfield Investments bankruptcy proceedings taking place in the Eastern District of New York, and the *Donovan v. Ficus* action, or for the purposes of facilitating Defendants' transition from one law firm to another. (*Id.* at 22-24.) Plaintiffs also assert that the invoices submitted by Defendants in connection with this Motion are insufficient evidence, and that more discovery is required in order for a proper determination of reasonableness to be made. (*Id.* at 25.)

In light of my determination that Donovan is the only one of the three Defendants who is entitled to advancement/reimbursement of Expenses under the Agreement, it is clear that the invoices submitted by Defendants with this Motion, which also itemize the legal fees allocable to Cline, Chalavoutis, Kamran, and PCM, among others, are overly broad. I am referring to a Special Referee the factual inquiry as to: (a) which of the Expenses apply to Donovan, (b) which Expenses were incurred as a result of Donovan's being "a Party to a Proceeding because he ... is a[n] ... Officer" (Operating Agreement § 3.4.3), and (c) the reasonableness of such Expenses.

Rather than burden the Special Referee with continual hearings on the reasonableness of Expenses, however, once this initial determination is made, Donovan and his attorneys should be able to identify, in good faith, those reasonable costs and fees incurred by Donovan and subject to advancement under the Agreement. The parties are therefore instructed to

adhere to the following protocol, which is informed by the language of *Weaver v. Zenimax Media, Inc.*, 2004 WL 243163 (Del. Ch. Ct. Jan. 30, 2004).

(1) Thirty (30) days after the Special Referee has heard and reported on the questions set forth above, Donovan shall submit a demand for advancement, along with Supporting Documentation, as defined in § 3.4.1(i) of the Agreement, to the Company. Such Supporting Documentation shall include the amount of Expenses sought to be advanced/reimbursed, as well as other relevant information, such as the name of the attorney performing the work, the rate at which such attorney bills, the number of hours expended on the particular project, and a general description of the work performed.

(2) Along with the demand and Supporting Documentation, Donovan shall also submit an affidavit, sworn to and signed by counsel, certifying that, to the best of counsel's informed and good-faith belief, the Expenses set forth in the demand are (i) reasonable, and (ii) relate only to Donovan's participation in the proceedings. The Company shall then have ten (10) days to advance the funds or to refuse to advance, on the basis that the demand is unreasonable or is for funds that are not properly covered Expenses.

(3) In the event that the Company refuses the demand, its counsel shall submit to opposing counsel, with a copy to the Court, a letter explaining the basis for refusal, along with an affidavit certifying its good-faith belief that the amount demanded is not reasonable, or was not incurred in connection with Donovan's defense.

(4) The question of the reasonableness of any demand refused shall then be referred to

the same Special Referee who is designated to hear and report on the initial question of reasonableness, as set forth above. The Special Referee shall be authorized to hear and report on each subsequent question of reasonableness.

(5) Upon receipt of a letter of refusal and affidavit from counsel to Plaintiffs, counsel for Donovan shall contact the same Special Referee, in order to schedule a hearing.

In accordance with the foregoing it is therefore

ORDERED that Defendants' Motion for Advancement of Litigation Fees and Expenses (Mot. Seq. No. 022) is granted in part, as it pertains to the litigation fees and expenses of Defendant Thomas B. Donovan; and it is further

ORDERED that Defendants' Motion for Advancement is denied as to Defendants Christopher Chalavoutis and Peter Kamran; and it is further

ORDERED that the initial determination of the reasonableness of fees is hereby referred to a Special Referee to hear and report with recommendations, except that, in the event of and upon the filing of a stipulation of the parties, as permitted by C.P.L.R. § 4317, the Special Referee, or another person designated by the parties to serve as referee, shall determine the aforesaid issue; and it is further

ORDERED that a copy of this Order with notice of entry shall be served on the Special Referee Clerk (Room 119) to arrange a date for the reference to a Special Referee; and it is further

ORDERED that the parties shall comply with the protocol set forth in this Decision

as to the determination of future questions of reasonableness; and it is further

ORDERED that Plaintiffs' Cross-Motion for Sanctions is denied.

Dated April 24 2008

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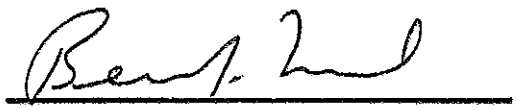

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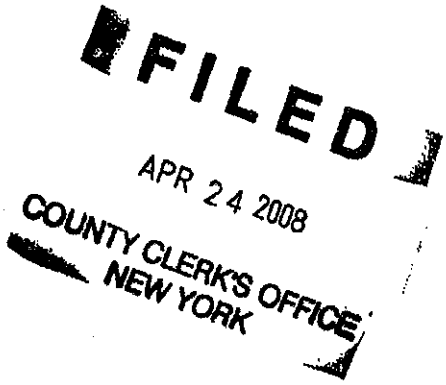
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