Superior Court of New Jersey, Chancery Division.

SALOVAARA
v.
ECKERT III, et als.

No. MRS C-126-96.

Sept. 24, 2002.

MACKENZIE, J.

***1** The Court reserved decision on June 12, 2002, following oral argument on Defendants' Notice of Motion for Partial Summary Judgment, and for Protective Order and on Plaintiff's Notice of Cross-Motion for Summary Judgment.

FACTS: The Court has already ruled on many of the surrounding issues in this case. This particular action deals with the issue of whether Defendant Eckert should be indemnified for his court costs and legal expenses for the claims on which Plaintiff Salovaara failed to prevail, as well as the claims Salovaara did prevail upon. Further, Defendant seeks to enjoin any further deposition of him.

All of the SSP Partnerships contain the following indemnification clause found at § 10.4(a). In addition, it is undisputed that these clauses fall under Delaware law since they are Delaware entities. § 10.4(a) states:

> to the fullest extent permitted by law: The partnership shall indemnify and hold harmless the General Partner and each Affiliate ....from and against any and all liabilities, obligations, losses, damages, penalties, actions judgments, suits, claims, proceedings, costs, expenses and disbursements of any kind or nature whatsoever ..... that may be imposed upon, or incurred by, or asserted against the General Partner or any Affiliate ... in any way related to or arising out of, any action or inaction on the part of the General Partner or any Affiliate ..... that relates in any way to the Partnership or the business or assets thereof; provided, however, that the indemnification obligation .... shall not apply to the portion of any liability ... cost, expense, or disbursement that results from the breach of a duty expressly imposed by § 10.2 hereof. (emphasis added).

This Court found this 10.4 language to "be as broad in scope and as all encompassing as the English language would permit. It's obvious the intention of the parties was to provide to those that are covered by Section 10.4 the widest possible indemnification coverage that the law and language would permit." *Slip. Op.* 8/15/96 Tr. 23, In. 17-21.

Of equal importance, § 10.2 of the SSP Partnership agreements states the following:

> The sole duty of the General Partner to the Partnership and to the Limited Partners shall be to act in a manner that does not constitute willful misconduct or bad faith in connection with the management of the business and the assets of

> the partnership. (emphasis added).
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> Section 2.03 of the Greycliff Agreement is the final contractual clause of importance, for this is the heart of the claims Plaintiff has pursued against Defendant. Section 2.03 of the Written Greycliff Agreement states that:
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> Each partner hereby agrees to use his or her best efforts in connection with the purposes and objects of the Partnership set forth in Section 1.04, and to devote such purposes and objects of his or her time as shall be necessary for the management of the Partnership; it being understood, however, that nothing contained in this Section 2.03 shall preclude any Partner from acting, consistent with the foregoing, as a director, officer or employee of any corporation, a trustee ..... or from rendering investment advice and counsel to others. (emphasis added).
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> ***2** The duties under Section 1.04 are (a) to act as an advisor to a number of other entities the parties shared interests in, (b) to act as a broker-dealer, financial adviser, and other related services of any kind through November 30, 1994, and (c) to engage in other business activities and transactions from time to time.

Defendant Eckert has presented arguments based on findings made by this Court in its initial decisions in Salovaara I. He has cited the following phrases from this Courts opinion to argue his case that the Court did not find him to have acted in "bad faith":

> ....the facts presented at trial seem to establish that Eckert did not have his job offer from Primerica at the time the parties signed the written Partnership agreement. Furthermore, even if he did have the job offer in hand at the time the Partnership Agreement was signed, it is unclear as to whether Eckert was aware he could not continue on as partner with Greycliff and an employee with Primerica. Indeed, evidenced produced at trial seems to establish that Eckert thought he could work in both positions....
>
> For a variety of reasons, this Court will not award damages according to Salovaara's "Forfeiture" suggestion. As will be discussed under punitive damages, *infra,* Eckert's actions appear ill-advised rather than ill-willed. There is minimal evidence to support an egregious breach of trust by Eckert.
>
> ..in this case, such [punitive] damages would seem to be inappropriate. While it is true Eckert breached Section 2.03 of the written Partnership Agreement and his fiduciary duty by engaging in competition with Greycliff, it seems that his actions were more ill-advised than ill-intended.

Plaintiff as well has presented wording from this Court's opinion lending support to his argument that the Court held Eckert to have acted in "bad faith" Plaintiff cites to the following:

> It has already been established that Eckert violated his best efforts duty under the 1993 Written Partnership Agreement and by engaging in competition with Greycliff, has violated his fiduciary duty to the partnership. It is almost axiomatic that Eckert violated the implied covenant of goof faith and fair dealing. (emphasis added).
>
> Also, in referencing Eckert's actions towards Greycliff, the Court stated:
>
> Eckert's conduct became convinced that continued fund raising was not a good idea, he should have encouraged the Partnership to rethink its position, not just walk away from the effort ..... Eckert's conduct of essentially abandoning Greycliff's marketing effort in favor of the Greenwich Street Fund, is inconsistent with his obligation to use his "best efforts" to market SS2.

In *Salovaara I,* this Court held the following: (1) a rejection of Salovaara's claim that an oral Umbrella Agreement existed, (2) that Eckert violated the "best efforts" clause of the Greycliff Agreement, (3) a rejection of Salovaara's claim that Eckert usurped a corporate opportunity that should have gone to Greycliff, (4) that Eckert breached his fiduciary duty to Greycliff by becoming employed with Primerica, (5) rejected Salovaara's claim that Eckert was guilty of any type of fraud, (6) and that Eckert violated the implied covenant of good faith and fair dealing implied into every contract under New Jersey Law. There were also findings by the Court that but for Eckert's conduct, the 1993 South Street funds would have raised around an additional $16 million and would have realized an investment return significantly greater than what they actually did. Further, this court held that but for Eckert's conduct, the parties at hand would have received combined profits of $7.5 million.

Specifically, the court stated:

> ***3** The Court is mindful that but for Eckert's action, and particularly his diversion of attention away from the partnership, it is reasonably certain that several million beyond the $34 million would have been raised ... had Eckert continued to participate in the partnership ....his reputation and the value of his name would have drawn additional investors into the Fund.

Finally, this Court found that Eckert's supposed plan of serving both Greycliff and Travelers "was unprecedented in the financial business," and that Eckert's attempts to get Greycliff investors into Greenwich was "a pretty clear violation" of the contractual duties to Greycliff.

As for the amounts currently at issued, Counsel for Salovaara has stated in his certification that Eckert has received in excess of $2,000,000 in indemnification from the SSP partnerships for his legal fees and expenses incurred in *Salovaara I.* (*See* Buckley Cert at Ex. L). In addition, counsel for Salovaara has certified that Eckert has caused the SSP Partnerships to hold at least $2,000,000 in escrow to indemnify him for payment of the judgement in this action.

ANALYSIS:

POINT I: WHETHER ECKERT SHOULD BE REIMBURSED BY THE SSP PARTNERSHIPS FOR HIS LEGAL EXPENSES RELATED TO THE COUNTS HE LOST, AND WHETHER HE SHOULD ALSO BE REIMBURSED BY GREYCLIFF FUNDS ON THE COUNTS HE PREVAILED ON.

Under the Delaware Revised Uniform Partnership Act § 17-108, which governs the SSP Partnership Agreements, a limited partnership "may, and shall have the power to, indemnify and hold harmless any partner or other person from and against any and all claims and demands whatsoever." *6 Del. C. § 17-108.* Also, the Delaware Chancery Court has construed this section to mean that it "defers completely to the contracting parties to create and delimit rights and obligations with respect to indemnification and advancement of expenses." *Delphi Easter Partners LP v. Spectacular Partners, Inc,* 1993 WL 328097 (Del. Ch.1993). In addition, *6 Del. C. § 17-1101(c)* provides that "it is the policy of this chapter to give maximum effect to the principle of freedom of contract and to the enforceability of partnership agreements."

Moreover, Delaware Corporate law provides a more limited power to indemnify than Delaware Partnership law, but perhaps helps to define what "bad faith" means. *Delaware General Corporation Law,* *8 Del C. § 145(a)-(b),* allows a corporation to indemnify officers and directors for litigation expenses "if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation." Under this section, a Delaware corporation may not indemnify an officer or director who has not acted in good faith in the transaction that gives rise to the litigation for which he seeks to be indemnified. *See* *Green v. Westcap Corp.,* 492 A.2d 260, 254 (Del.Super.1985).

"Because partners at all times must act to promote and preserve the interests of the partnership, partners are not allowed to compete with the partnership unless the partnership agreement is clear in saying that such competition is allowed." *Stark v. Reingold,* 18 N.J. 251, 261, 113 A.2d 679 (1955); *Khin v. Zickerman,* 101 N.J. Eq. 469, 473, 138 A. 534 (Ch.Div.1927). To show "bad faith, a plaintiff must demonstrate the absence of reasonable basis for denying benefits under the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." *Picket v. Lloyd's* 131 N.J. 457, 621 A.2d 445 (1993). Bad faith "hinges on a tortious state of mind ....not simply bad judgment or negligence, but rather it implies the conscious doing of a wrong because of a dishonest purpose or moral obliquity." *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund,* 624 A.2d 1199, 1208 (Del.1993). "It is different from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with furtive design or will." *Id.*

***4** A court of equity will deny its available remedies to a party that has acted in bad faith, with fraud, or unconscionability in the transaction at issue. See Goodwin Motor Corp. v. Mercedes-Benz of North America, Inc., 172 N.J.Super. 263, 271, 411

A.2d 1144 (App.Div.1980). Equitable relief will also be granted to relieve a party of performance of a contract where a "great hardship or manifest injustice" would otherwise result. *See Brower v. Glen Wild Lake Co., 86 N.J.Super.* 341, 350, 206 A.2d 899 (App.Div.), *certif denied,* 44 *N.J.* 399, 209 A.2d 139 (1965).

Accordingly, the Court must grant summary judgment in favor of Salovaara by disallowing the indemnification of Eckert for the claims Salovaara prevailed upon. Although the parties have turned this issue into a rather complicated war of semantics, I do not think the issue is difficult to decide based upon the findings of this Court and its prior holdings. Delaware partnership law makes it clear that the parties are free to contractually adopted unlimited indemnification if they choose to do so. Here, however, indemnification is not automatic and judgment-proof as the defense seems to suggest. The words "bad faith" and "willful misconduct" have placed a contractual limitation on the option of indemnification. Plaintiff's argument that by agreeing to limit the right to indemnity for "bad faith," the parties adopted the inverse reference of "good faith" according to its meaning under Delaware law is a good one. Since the Court has held there was a breach of fiduciary duty by Eckert, essentially meaning a breach of loyalty, "bad faith" is virtually "axiomatic" as the court has stated. The breach of the duty of loyalty is one where there is a lack of good faith. This is exemplified by the fact that the "business judgment" rule does not apply in breach of loyalty setting since a lack of loyalty cannot realistically be made by accident, with reliance on sound judgment, or with reasonableness.

The Court stated in its prior Opinion that Eckert breached his fiduciary duty to Greycliff by going to work for a competing fund while simultaneously remaining partner in Greycliff. This is as clear as a breach of duty of loyalty can be. Further, the Court previously ruled that Eckert breached the implied covenant of "good faith and fair dealing" in the Greycliff agreement. Thus, if Eckert was not acting in "good faith" in carrying out the contract, he logically must have been acting in "bad faith." The law does not appear to make distinctions among "semi-good" or "semi-bad" faith. One must either act with good faith or with bad.

Moreover, Eckert's playful use of "bad faith" leads him nowhere fast. Delaware law makes it clear that "bad faith" results from a conscious wrongful act that lacks a reasonable basis for its performance. In this case, it is established that Eckert was a very successful and intelligent financial planner. He easily should have known he could not realistically be a partner and employee of two funds performing the same type of service and soliciting the same clients. The record demonstrates that such a situation was unheard of in the financial world since devoting oneself to two identical operation inevitably leads to a conflict of economic interest. In addition, it is virtually inconceivable that Eckert was not aware he would be directly competing with Greycliff given his vast knowledge of the industry and how it operates. Thus, I find it difficult to believe that Eckert did not "know" he would not be applying his "best efforts" to further the success of Greycliff. Good faith on a common sense level means one will do what one has promised to do to make the contract and arrangement successful. That does not appear to be what Eckert did in this instance.

***5** Finally, it appears unjust, inequitable and illogical to allow Eckert to recoup the amounts he owes Salovaara for his breach. Salovaara gains nothing if the amount awarded to him by this Court is paid out of funds from the SSP partnerships. Further, such an act would mean that Salovaara and Greycliff spent the legal fees and time they did for nothing while having won a $4 million judgment. I find it difficult to believe that the parties intended to be indemnified by the SSP entities if they became disinterested in Greycliff and ceased to try and further its success while simultaneously competing with it as an employee of another identical company. Such an interpretation would render the indemnification clause ineffective and illusory. The purpose of inserting the "bad faith and willful misconduct" language was to prevent the indemnification of a partner who pursued his own self interest. Such appears to be the case with Eckert here, and to allow him indemnification in this instance would undermine the parties' intent.

Plaintiffs also argue that Eckert should not be indemnified because he acted with

"willful misconduct," which also triggered the bar to indemnification. "Willful misconduct" is defined by *Black's Law Dictionary* as:

> the opposite of good faith ....an act from a conscious motion of will; voluntary, knowing, deliberate. Intending the result which actually comes to pass; designed; intentional; purposeful; not accidental or involuntary; purposeful; not accidental or involuntary. A willful act may be described as one done intentionally, knowingly, and purposefully, without justifiable excuse, as distinguished from an act done carelessly, thoughtlessly, heedlessly, or inadvertently. A willful act differs from a negligent act. The one positive and the other negative.
>
> "Willful conduct is more than a mere error in judgment or an act of negligence ..... a finding of bad faith is not necessary to a finding of willful misconduct in a disciplinary proceeding." *In Re Rowe*, 566 A.2d 1001, 1006 (Del.1989).

Under these circumstances, Eckert's conduct must be construed as "willful misconduct" in addition to being construed as "bad faith ." Eckert was a very experienced and well-known financial guru. There is little doubt he understood the implications of going to work for a company that directly competed with his Greycliff Partnership. His leaving to go to Primerica, his failure to provide his "best efforts" to Greycliff, and his direct solicitation of client that could potentially have become Greycliff clients were all voluntary and knowing acts. Although his belief that he could service both may have been "ill-advised" as this Court has ruled, his act to not give his "best efforts" was willful, and thus was misconduct as well. Therefore, because I find Eckert is both guilty of "bad faith" and "willful misconduct," he cannot be indemnified for the judgment amount and litigation expenses associated with the claims he lost.

***6** The question then remains how much of the money given to Eckert by the SSP entities for his legal expenses and the judgment should be returned. Counsel for Salovaara has certified that Eckert has received "in excess of $2,000,000" from the SSP entities for his "legal fees and expenses incurred in *Salovaara I.*" Additionally, counsel for Plaintiff certifies that Eckert has forced the SSP entities to hold "at least $2,000,0000" in escrow to indemnify him for the judgment entered against him in *Salovaara I.* Since Eckert has exhausted all his appeals regarding this matter, it appears this money will be used to satisfy the judgment entered against him by this Court. This Court previously entered judgment for Salovaara in excess of $4,000,000. Ironically, the amounts leaving the SSP entities for Eckert's benefit appear to be in conformity with the Court's judgment in *Salovaara I.* This is inconsistent with the Court ruling today that Eckert cannot be indemnified for the claims which Salovaara prevailed upon. Therefore, the Court orders Eckert to return the $2,000,000 plus to the SSP entities given to him for legal fees and expenses. In addition, the Court orders the removal of the other $2,000,000 plus from escrow, and its return to the SSP entities.

As for the claims Eckert successfully defended against, the Court grants summary judgment in Eckert's favor. Therefore, the Court will allow the SSP entities to indemnify him for these associated legal expenses. There can be no argument here that Eckert acted in bad faith or with wilful misconduct as to the claims he successfully defended against. Eckert was not held to have done anything wrong regarding these claims by Salovaara. The indemnification clause serves to indemnify Eckert for this exact scenario: where he is sued as a partner in regards to the partnership and successfully defends against the claims. Thus, Eckert's litigation costs should be reimbursed by the SSP partnerships for those claims he successfully defended against.

As for Eckert's counterclaim, the Court will not allow Eckert to be indemnified for this amount since the indemnification clause governs the defense of claims rather than the prosecution of such. The language of the indemnification clause does not seem to cover the costs of instituting a prosecutorial matter as a partner. The agreement states:

> The partnership shall indemnify and hold harmless the General Partner and each Affiliate ....from and against any and all liabilities, obligations, losses, damages, penalties, actions judgments, suits, claims, proceedings, costs, expenses and disbursements of any kind or nature whatsoever ..... that may be imposed upon, or incurred by, or asserted against the General Partner or any Affiliate ... in

> any way related to or arising out of, any action or inaction on the part of the General Partner or any Affiliate ..... that relates in any way to the Partnership or the business or assets thereof. (emphasis added).

***7** The wording above implies indemnification covers costs from being sued as a partner, not costs arising out of instituting an action as a partner. Words such as "imposed" and "asserted against" corroborate this. Accordingly, Eckert's costs for his counterclaim should not be indemnified by the SSP Partnerships.

POINT II: WHETHER FURTHER DEPOSITIONS OF ECKERT SHOULD BE PRECLUDED BY THE COURT BY PROTECTIVE ORDER.

Plaintiff Salovaara claims he still needs to seek discovery as to the "advice [Mr. Eckert] received by lawyers and others at the time he made the decision to desert Greycliff and unlawfully compete with the South Street Funds." Salovaara argues that he is entitled to further depose Eckert on this issue because Eckert is relying on the Court's language that Eckert's action in regards to taking a competing job were "more ill-advised than ill-intended." Salovaara claims that since he has never sought discovery on this issue, and that he should be allowed to pursue it since Eckert has claimed the attorney-client privilege as to it. Salovaara is apparently hoping to discover that perhaps Eckert accepted the Primerica job on advice other than from his legal team.

Eckert argues that further depositions of Eckert serve only to drag the case on, and to inevitably lead to yet more deposition of Eckert's attorneys as well. *Rule* 4:10-3 governs protective orders. It states:

> Upon motion by a party or by person from whom discovery is sought, and for good cause shown, the court may make any order which justice requires to protect a party or person from annoyance, embarrassment, oppression, or undue burden or expense, including but not limited to, one of more of the following:
> (A) that discovery not be had;
> (B) that discovery may be had only on specified terms and conditions, including a designation of the time or place;
> (C) that discovery may be had only by a method of discovery other than that selected by the party seeking discovery;
> (D) that certain matters not be inquired into, or that the scope of discovery be limited to certain matters;
> (E) That discovery be conducted with no one present except persons designated by the court;
> (F) That the deposition after being sealed .....
> If the motion for a protective order is denied in whole or in part, the court may, on such terms and conditions as are just, order that any party or person provide or permit discovery. The provisions of *R. 4:23-1(c)* apply to the award of expenses incurred in relation to the motion.

Eckert has shown cause to bar Salovaara from resuming the deposition. There is enough circumstantial and direct evidence to allow a fact-finder to conclude a reason for why Eckert acted the way he did. Further, there is little doubt Eckert will stick to his story that his legal advisers instructed him that he could take the Primerica job. No matter what Salovaara does, such communications will still be protected by the attorney client privilege. Considering this case's issues have previously been tried for 23 days with over 100 exhibits, it does not seem reasonable for Salovaara to argue that further depositions of Eckert are necessary; especially considering there are about seven other cases in New York and Delaware related to this matter. Public policy also favors a closing on this matter. Therefore, the motion for a Protective Order be granted.

CONCLUSION

***8** Accordingly, for the above reasons, the Court will enter an Order:

1) Granting Salovaara summary judgment barring SSP entities from indemnifing Eckert for the claims against him he lost;

2) Granting summary judgment to Eckert allowing indemnification by SSP entities for

the claims he prevailed upon;

3) Ordering Eckert to return the $2,000,000 plus given to him by the SSP entities for his legal expenses, as well as releasing the $2,000,000 plus from the SSP entities currently in escrow;

4) Granting Salovaara summary judgment refusing Eckert indemnification for the costs of his counterclaim and

5) Granting the motion for a Protective Order enjoining further depositions of Mr. Eckert.

2002 WL 32396171 (N.J.Super.Ch.)

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