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

PRESENT: Kapnick Justice PART 39m

CIFG Assurance

- v -

Assured

INDEX NO. 651090/10

MOTION DATE

MOTION SEQ. NO. 002

MOTION CAL. NO.

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

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

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

RECEIVED
JUN 15 2011
MOTION SUPPORT OFFICE
NYS SUPREME COURT - CIVIL

Dated: 6/14/11

BARBARA R. KAPNICK J.S.C.

Check one: ☒ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☒ SUBMIT ORDER/ JUDG. ☒ SETTLE ORDER/ JUDG.

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

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

CIFG ASSURANCE NORTH AMERICA, INC.,

Plaintiff,

-against-

ASSURED GUARANTY CORP.,

Defendant.

DECISION
Index No. 651090/10
Motion Seq. No. 002

BARBARA R. KAPNICK, J.:

Plaintiff CIFG Assurance North America, Inc. ("CIFG") commenced this action to recover for payments it made to its insured, Xenia Rural Water District ("Xenia"), under a financial guarantee insurance policy (the "Xenia Policy"), which payments it contends should have been made by defendant Assured Guaranty Corp. ("Assured") pursuant to the Quota Share Reinsurance Agreement ("Reinsurance Agreement") between CIFG and Assured. Further, CIFG alleges that Assured's failure to pay Xenia's claims constitutes a breach of the parties' Administrative Services Agreement ("Services Agreement").

CIFG now moves, by Order to Show Cause, for an order granting it summary judgment, declaring that Assured is obligated to reinsure the Xenia Policy and reimburse CIFG for losses related to it, dismissing Assured's counterclaims, and granting CIFG its costs and fees, including attorneys' fees associated with bringing this action, in light of Assured's alleged bad faith.

CIFG's complaint asserts claims for breach of the Reinsurance Agreement (Count One) and for breach of the Services Agreement (Count Two), and seeks:

1) an award of damages equal to the amount it paid for losses relating to and arising out of claims under the Xenia Policy;

2) a judgment declaring that Assured is responsible under the Reinsurance Agreement and the Services Agreement for paying losses relating to and arising out of claims under the Xenia Policy and ordering Assured to perform its obligations under the Reinsurance Agreement and the Services Agreement to provide payment to the appropriate parties for any future losses relating to and arising out of claims under the Xenia policy;

3) a judgment that Assured has acted in bad faith; and

4) costs and fees, including attorneys' fees, associated with bringing this action.

In its Answer, Assured asserts five affirmative defenses and two counterclaims.[1] The Fourth Affirmative Defense states that because CIFG failed to disclose that the Xenia Bonds were not

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[1] Assured asserts three affirmative defenses for which it makes no arguments in its opposition papers: 1) the Complaint fails to state a cause of action (First Affirmative Defense); 2) the causes of action are barred by the terms of the Reinsurance and Services Agreements (Second Affirmative Defense); and 3) the causes of action are barred by waiver, laches and/or estoppel (Third Affirmative Defense).

properly rated at the time of the Effective Date of the Reinsurance Agreement, CIFG would be unjustly enriched if it were to recover on its claims against Assured under the Xenia policy. The Fifth Affirmative Defense alleges that CIFG breached its duty of good faith owed to its reinsurer, Assured.

Assured's First Counterclaim seeks a declaratory judgment that the Xenia Policy is not a Covered Policy under the Reinsurance Agreement. The Second Counterclaim alleges that CIFG breached the Services Agreement by failing to reimburse Assured for fees and expenses relating to the Xenia Policy.

Background

On November 8, 2006, CIFG issued the Xenia Policy, whereby it agreed to make Xenia's principal and interest payments to holders of Water Revenue Bonds, Series 2006 (the "Xenia Bonds"), to the extent Xenia was unable to do so.

In August 2008, as part of a restructuring effort overseen by the New York Insurance Department, CIFG sought reinsurance for its domestic public finance portfolio. On October 23, 2008, Assured executed a "Master Agreement," pursuant to which it agreed to enter into a reinsurance agreement with CIFG. Subsequently, on January 21, 2009, Assured entered into the Reinsurance Agreement with CIFG,

retroactively effective to October 31, 2008. The parties also entered into the Services Agreement on that date, whereby Assured agreed to act as CIFG's agent in administering "Administered Policies" as defined by the Services Agreement.

When CIFG issued the Xenia Bonds, pursuant to the Xenia Bond Resolution, Xenia established a Reserve Fund out of which it could make payments to the bondholders if the water revenues were insufficient to cover those payments. Pursuant to the Resolution, if Xenia draws from the Reserve Fund, it is required to replenish the funds in monthly installments of one-eighteenth of the amount drawn.

Xenia drew from the Reserve Fund in December 2007, a fact reflected in its 2007 annual financial statement, which was released in June 2008. On March 4, 2009, Xenia issued a material Events Notice, which stated that Xenia had made an additional draw in December 2008 and that in February 2009 it had failed to make its monthly repayment to the Reserve Fund. CIFG alleges it received the Notice on March 4, 2009 and forwarded it to Assured on the same day.

In March 2010, Assured informed CIFG that it was unlikely Xenia would be able to make its full June 1, 2010 interest payments

and, by letter dated March 25, 2010, stated that it was "exploring" whether the Xenia Policy was a Covered Policy, citing Section 2.02(2) of the Reinsurance Agreement, which allows for automatic exclusion of policies that insure a risk that was rated, as of the Effective Date, either below BBB- by S&P or below investment grade according to CFIG's internal ratings scale.

By letter dated May 10, 2010, Assured informed CIFG that it was not considering the Xenia Policy a "Covered Policy" pursuant to Section 2.02(2). According to Assured, upon this notification, it automatically removed the Xenia Policy from Schedule A and its subsequent offers to return the premiums paid by CIFG for the Xenia Policy have been refused.

On May 27, 2010, 17 days after Assured's letter declaring the Xenia Policy a non-Covered Policy, Assured received a Notice of Claim and Certificate (the "May 27 Claim") from Wells Fargo Bank, N.A., which holds the Xenia Policy for the benefit of the bondholders. On May 28, 2010, Assured notified CIFG that it would not pay the claim, after which CIFG paid the claim in the amount of $78,773.49, later adjusted to $69,250.49.

On November 24, 2010, Xenia received another Notice of Claim and Certificate (the "November 24 Claim") from Wells Fargo in the

amount of $1,260,685.51. On November 30, Assured notified CIFG that it refused to pay the claim, and on December 1, 2010, CIFG paid it. According to CIFG, Xenia's next payment was due June 1, 2011,[2] with payments coming due semi-annually thereafter.

Discussion

The Reinsurance Agreement covers policies included in Schedule A, annexed thereto ("Covered Policy"); however, Section 2.02 provides that, even if included in Schedule A, if certain exceptions apply, "Schedule A hereto will be automatically amended to remove any such non-Covered Policy . . . Pursuant to Section 4.01(d), Reinsurer shall return any premium received by it in connection with any policy which is removed from Schedule A."

Included in the excluded policies are risks "rated, as of the Effective Date, below BBB- by S&P, Baa3 by Moody's (it being understood that this exclusion shall not apply to risks that are not rated by either of S&P or Moody's) or below investment grade according to the Ceding Company's internal ratings scale." (Section 2.02[2]).

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[2] This motion was fully briefed and argued prior to June 1, 2011.

There is no dispute that the Xenia Policy was included in Schedule A at the time the parties executed the Reinsurance Agreement.

CIFG maintains, and Assured does not dispute, that as of October 31, 2008, the Xenia Policy was rated BBB by S&P, and 68 according to CIFG's own internal ratings scale, which is equivalent to a BBB+ rating on S&P's scale and above BBB-, an investment grade rating. As such, CIFG argues, Assured had no basis for refusing to pay either the May 27 or November 24 Claims and the Xenia Policy is a Covered Policy under the Reinsurance and Service Agreements.

According to Assured, when the parties were negotiating the Reinsurance Agreement, time was limited and it was impossible to independently verify the investment grade status of each of the approximately 1300 policies included in Schedule A. Assured relied heavily on CIFG's own assessments of its risks (known as "surveillance") and internal credit rating scale.

Before entering into the Reinsurance Agreement, Assured obtained copies of CIFG's Surveillance Plan and Ratings Scale. In addition, Assured required CIFG to represent that it had continued to professionally conduct its surveillance and rating despite its distressed financial condition, and that it would continue to do

so. There is no allegation that CIFG veered from its usual business operations in this regard. According to Assured, CIFG's records gave no indication that Xenia was in any financial distress or unable to meet its obligations to bondholders in the ordinary course at the time of the Reinsurance Agreement.

Assured argues that the language of Section 2.02(2), which it refers to as the "Recourse Clause", allowing exclusion of any risk "that is rated, as of the Effective Date, below BBB- by S&P, Baa3 **by** Moody's . . . or below investment grade **according to** [CIFG's] internal rating scale," should be interpreted as allowing Assured to exclude any credit that either, (1) was already determined by the rating agencies or CIFG not to have been investment grade but inadvertently included on Schedule A, or (2) had suffered financial distress which would have caused it to fall below investment grade at the time of the transfer to Assured, but CIFG's rating had not yet been updated.

Assured draws the Court's attention to the different terms used, "**by** S&P or Moody's" and "**according** to" CIFG's ratings scale, arguing that this implies that the parties intended the terms to be accorded different meanings. This difference, according to Assured, reflects the fact that none of the parties have any control over how the ratings agencies issue their ratings, and the

Recourse Clause simply protected Assured against the possibility that the parties had inadvertently mischaracterized the rating agencies' rating as investment grade, or unbeknownst to the parties, the rating agencies lowered the rating of a credit prior to the Effective Date of the Reinsurance Agreement.

According to Assured, ratings "according to" CIFG's rating scale is another matter entirely. Unlike the rating agencies, Assured argues, CIFG is a party to the Reinsurance Agreement with ongoing obligations, and the parties would have no trouble whatsoever in taking facts discovered after the Effective Date, but existing before the Effective Date, and applying them "according to" CIFG's rating scale.

According to the Affidavit of James M. Michener, General Counsel and Secretary of Assured, dated January 21, 2011, after the parties executed the Reinsurance Agreement,

> Assured gradually adduced facts which suggested that, although the rating agencies and CIFG had rated Xenia as investment grade, the fact of the matter was that Xenia had - before the Effective Date of the Reinsurance Agreement - become unable to honor its commitments to bondholders in the ordinary course of business.

Assured does not argue or submit any evidence that CIFG knew of Xenia's financial condition and fraudulently or otherwise willfully failed to reevaluate its rating. In fact, at oral

argument, counsel for Assured explicitly denied that Assured was making any allegation of fraud or other deceptive conduct. However, Assured urges the Court to deny CIFG's motion and order that the parties engage in discovery regarding whether the Xenia Policy was, in fact, deserving of the investment grade rating it was given on the Effective Date of the Reinsurance Agreement.

Finally, Assured argues that CIFG's cause of action for bad faith should be dismissed as duplicative of the breach of insurance contract claim and because CIFG puts forth no evidence in support of this cause of action. At best, Assured argues, CIFG has failed to meet its burden and there remain issues of fact that require discovery on this cause of action.

In its reply, CIFG argues that the only issues regarding the terms of the Reinsurance Agreement that are before the Court are, 1) whether the language of Section 2.02(2) is unambiguous, and if it is, 2) whether the plain language excludes from reinsurance coverage only policies that were, in fact, "rated" below investment grade as of October 31, 2008 or also excludes policies that Assured argues *should have* been rated below investment grade at that time.

According to CIFG, Assured is ignoring the word "rated" in the Recourse Clause. Taken as a whole, it contends, the clause is

unambiguous and subject to an objective plain meaning interpretation that looks to how the Xenia Policy was rated at the time the Agreement took effect, not to Assured's subjective analysis in hindsight. The interpretation urged by Assured strains the language beyond its reasonable and ordinary meaning, CIFG argues. Because the clause is unambiguous, Assured's attempt to rely on extrinsic evidence such as earlier drafts of the Reinsurance Agreement is barred and inappropriate, according to CIFG.

Finally, CIFG contends that its claim for bad faith is premised on the fact that it took Assured over 15 months - just 17 days prior to the first claim being asserted - to suddenly assert that it had "come to Assured's attention" that the Xenia Policy was not a Covered Policy and refuse to insure it, a delay that is never explained by Assured, and the argument that no reasonable reinsurer would bargain for the specific clause at issue here, then argue to a Court of law that the language is ambiguous.

When interpreting a written instrument, the intention of the parties should be determined from the language of the instrument, and where the language is unambiguous, "resort cannot be had to extrinsic evidence to contradict the express terms of the writing." (*Matter of Wallace v. 600 Partners Co.*, 205 AD2d 202, 205 [1st

Dept. 1994], *aff'd* 86 NY2d 543 [1995]; *see also Teitelbaum Holdings v. Gold*, 48 NY2d 51 [1979]).

"It is incumbent on the court, when interpreting a contract, to give the words and phrases contained therein their ordinary, plain meaning (citations omitted)." *Matter of Wallace v. 600 Partners Co.*, supra at 208; see also *Mazzola v. County of Suffolk*, 143 AD2d 734, 735 (2nd Dept 1988).

Here, the language of Section 2.02(2), the "Recourse Clause", is unambiguous. It allows any policy listed on Schedule A at the time the Reinsurance Agreement was executed to be later excluded, unilaterally by Assured, only if it "is rated, as of the Effective Date, below BBB- by S&P . . . or below investment grade according to [CIFG's] internal ratings scale."

While Assured argued in its papers and at oral argument that traditional rules of construction require the Court to apply different meanings to different terms used in the same clause, citing to *NFL Enters. LLC v Comcast Cable Communications, LLC*, 51 AD3d 52, 60-61 (1st Dept 2008), application of this rule does not lead to the result urged by Assured.

Assured maintains that in referring to ratings "by S&P" and "by Moody's," the parties were acknowledging that they had no control over such ratings and that they were "static" - unchanging. This is contrasted, according to Assured, with the phrase "according to" CIFG's internal rating scale, which it argues reflects an acknowledgment by the parties that CIFG's ratings could change at any time, since CIFG's surveillance policy permitted ongoing ratings. Because CIFG's rating was not static and could change at any time, Assured argues, the parties anticipated that certain policies could be rated investment grade "according to" the internal rating scale but not actually deserve such a rating, allowing for an automatic and retroactive removal from Schedule A.

Such an interpretation, however, goes far beyond the plain meaning of the words found in the Reinsurance Agreement.

First, Assured seems to dismiss entirely the beginning of the relevant clause, which modifies the rest of the sentence, stating that a policy could be excluded if it is "a risk that is rated, as of the Effective Date" (emphasis added) investment grade as further specified.

The recent Appellate Division, First Department decision in *MBIA Ins. Corp. v Merrill Lynch,* 81 AD3d 419 (2011), decided only

two days before the oral argument on this motion, only serves to reinforce this determination.

In *MBIA*, the parties entered into a transaction by which plaintiff LaCrosse Financial Products, LLC sold credit protection to defendant Merrill Lynch in the form of "collateral debt obligations" (CDOs). The CDOs were insured by MBIA. Plaintiffs alleged that the parties' various agreements indicated that "Merrill Lynch would be delivering notes not merely 'nominally' rated AAA (S & P)/Aaa (Moody's), but ones exhibiting the credit quality an AAA rating was supposed to represent." *MBIA Ins. Corp. v Merrill Lynch*, 27 Misc3d 1233(A) at *6 (Sup Ct, NY Co, April 9, 2010) (Fried, J.).

In his Decision and Order declining to dismiss the plaintiffs' breach of contract cause of action, Justice Fried wrote that "plaintiffs had a right to expect that the AAA ratings were backed by intelligence which could verify that the notes were actually of the 'credit quality' an AAA rating implied." (*Id.* at *6-7)

The Appellate Division, First Department, modified Justice Fried's decision, noting that there was no dispute that defendants, in fact, provided securities with AAA ratings, and that "[n]owhere

in the plain language of the documents does there appear a promise of credit quality." (81 AD3d at 420).

As with the agreement at issue in *MBIA*, there is no promise of credit quality in the Reinsurance Agreement, and the plain language guarantees *only* that the policies actually be rated investment grade on the Effective Date of the Agrement.

The Court notes that Assured explicitly acknowledged in its opposition papers that it negotiated the addition of the Recourse Clause into the Reinsurance Agreement, demanding its inclusion. The interpretation urged by Assured would require the Court to read additional language into the contract, so that it reads "is properly rated" or "is accurately rated" investment grade, neither of which modifiers appear in the Agreement.

Further, Assured sought additional information for certain items before agreeing to include them on Schedule A. The Xenia Policy was one of the items for which Assured was provided such additional information. Had Assured wished to guarantee that the ratings assigned to the Schedule A policies reflected the most recent CIFG analysis, it could have sought to have those items, including the Xenia Policy, re-rated "according to" CIFG's internal

ratings scale prior to entering into the Reinsurance Agreement. It did not.

Conclusion

As the Recourse Clause is unambiguous, resort to outside evidence to determine the parties' intentions is unnecessary and improper. Section 2.02(2) clearly allows the exclusion of any policy which was, in fact, rated below BBB- by S&P, Baa3 by Moody's or below investment grade according to CIFG's internal rating scale, as of the Effective Date of the Reinsurance Agreement, even it was inadvertently included on Schedule A and listed as having a rating of investment grade at that time. Any retrospective analysis of the propriety of the rating actually applied to those risks on Schedule A is inappropriate under the express terms of the Agreement. CIFG is, therefore, entitled to summary judgment in its favor on both its First and Second Counts and a declaration that Assured is responsible for paying losses relating to and arising out of claims under the Xenia Policy.

As to CIFG's allegation that Assured has acted in bad faith, the Court, in its discretion, searches the record and grants Assured summary judgment dismissing this claim. Until the First Department addressed the issue squarely in *MBIA Ins. Corp. v Merrill Lynch, supra*, the Court cannot say that Assured acted in bad faith in denying its obligation to pay the Xenia Claims.

Assured has failed to raise an issue of fact regarding any of its affirmative defenses to defeat summary judgment, including the Fourth and Fifth Affirmative Defenses.

Assured's First Counterclaim, seeking a declaratory judgment that the Xenia Policy is not a Covered Policy under the Reinsurance Agreement is hereby dismissed.

Finally, Assured's Second Counterclaim, which alleges that CIFG breached the Services Agreement by failing to reimburse it for fees and expenses it paid relating to the Xenia Policy, necessarily fails by virtue of the determination that the Xenia Policy is a Covered Policy and, therefore, Assured was obligated to pay the fees and expenses it now seeks reimbursement for.

Settle order/Judgment.

Dated: June 14, 2011

BARBARA R. KAPNICK
J.S.C.

BARBARA R. KAPNICK
J.S.C.