IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

THIRD AVENUE TRUST and THIRD AVENUE VARIABLE SERIES TRUST,	)	
Plaintiffs,	)	
v.	)	C.A. No. 4486-VCS
MBIA INSURANCE CORP. and MBIA INSURANCE CORP. OF ILLINOIS,	)	
Defendants.	)	

MEMORANDUM OPINION

Date Submitted: October 5, 2009
Date Decided: October 28, 2009

Gregory P. Williams, Esquire, Rudolph Koch, Esquire, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; Scott A. Edelman, Esquire, Daniel M. Perry, Esquire, Robert C. Hora, Esquire, MILBANK, TWEED, HADLEY & McCLOY LLP, New York, New York, *Attorneys for Third Avenue Trust and Third Avenue Variable Series Trust*.

A. Gilchrist Sparks III, Esquire, S. Mark Hurd, Esquire, D. McKinley Measley, Esquire, MORRIS, NICHOLS, ARSHT & TUNNELL LLP, Wilmington, Delaware**;** Jonathan D. Siegfried, Esquire, John M. Nonna, Esquire, Lawrence A. Larose, Esquire, DEWEY & LEBOEUF LLP, New York, New York; Marc E. Kasowitz, Esquire, Kenneth R. David, Esquire, KASOWITZ BENSON TORRES & FRIEDMAN LLP, New York, New York, *Attorneys for MBIA Insurance Corp. and MBIA Insurance Corp. of Illinois*.

STRINE, Vice Chancellor.

The United States is a federal republic that depends on comity among the states for the peaceful and efficient conduct not only of public regulation, but also of private commerce. When a state court with little legitimate interest in a matter purports to speak on a subject of importance to a sister state, the reliability of state law is undermined and a counterproductive incentive is created for all state courts to afford less than ideal respect to each other. This case presents a clear example of a dispute where this court ought to refuse to make a determination of another state's law and refer the matter, by abstention and appropriate enforcement of a forum selection clause, to the courts of the state whose law and public policy is affected by the resolution of the key question.

In this matter, plaintiffs Third Avenue Trust and Third Avenue Variable Series Trust (collectively, "Third Avenue"), noteholders of MBIA Insurance Corp. ("MBIA Insurance"), a large insurance company domiciled in New York, claim that MBIA Insurance has sold substantially all of its assets to an affiliate, MBIA Insurance Corp. of Illinois ("MBIA Illinois"), for no consideration. The reason for this, says Third Avenue, is that MBIA Corp., the parent company of both MBIA Insurance and MBIA Illinois, wished to create a single healthy company—the transferee MBIA Illinois—that would have all of MBIA Insurance's productive assets, have the ability to prosper from the outset, and be able to write new business. MBIA Corp. accomplished this by a transaction effected on February 18, 2009 (the "Split-Up Transaction") that allegedly left behind in MBIA Insurance only dubious assets (and their corresponding liabilities) consisting of investments in and guarantees of collateralized debt obligations, credit default swaps, and asset-backed securities including mortgage-backed securities.

Specifically, MBIA Insurance was allegedly left with approximately $232 billion in structured finance products—the kinds of securities that were central to the recent market debacle. Third Avenue contends that immediately upon the announcement of the Split-Up Transaction, Moody's downgraded MBIA Insurance's senior debt rating from Ba1 to B3 (or "deep junk" territory), and other ratings agencies did the same. Third Avenue argues that MBIA Insurance's behavior was especially egregious because it sold $400 million of notes to the noteholders in January of 2008 without giving notice that it intended to use the proceeds not to invest in MBIA Insurance as it was then constituted, but to fund the separation of itself into good and bad parts, and leave the noteholders with the securities of an insolvent company.

Third Avenue argues that this transaction violated contractual promises made to the noteholders in the key instrument governing the noteholders' rights—the Fiscal Agency Agreement—that MBIA Insurance would not "sell, convey, transfer or otherwise dispose of all or substantially all of its assets" unless MBIA Insurance redeemed the notes or the transferee assumed MBIA Insurance's obligations under the notes.[1] Third Avenue also claims that the transfer to MBIA Illinois of $5 billion in cash and other assets lacked consideration and constituted a fraudulent transfer.[2]

In both instances, Third Avenue, noteholders who are Delaware trusts but whose principal places of business are in New York, admits that the noteholders' rights are governed by New York law under a clear choice of law provision in the Fiscal Agency

[1] Measley Aff. Ex. C § 6.01.
[2] The fraudulent conveyance claims are made pursuant to the New York Debtor and Creditor Law. *See* N.Y. Debt. & Cred. Law §§ 273-76.

Agreement.[3] Third Avenue also admits that the Fiscal Agency Agreement has a choice of forum provision providing that "the parties . . . shall submit any disputes related to the exercise of [the Superintendent's] regulatory authority to a court of competent jurisdiction in the state of New York."[4]

In response to Third Avenue's complaint, defendants MBIA Insurance and MBIA Illinois (collectively referred to as "MBIA Insurance" hereafter) have moved to dismiss the complaint on various grounds. In this decision, I consider only one of those grounds, which is that this case should be decided, at least initially, in New York under Article 78 of the New York Civil Practice Law and Rules ("CPLR").

The basis for MBIA Insurance's argument is that the Split-Up Transaction was approved by the New York Superintendent of Insurance (the "Superintendent") under relevant provisions of the New York State Insurance Law (the "New York Insurance Law").[5] In approving the Split-Up Transaction, the Superintendent found, among other things, that the Split-Up Transaction would allow MBIA Insurance to "retain sufficient surplus to support its obligations and writings," that the transaction was "fair and equitable," and that MBIA Insurance did not transfer "all or substantially all" of its assets.[6]

---

[3] Measley Aff. Ex. C § 13.02.
[4] *Id.*
[5] N.Y. Ins. Law § 101 et seq. (McKinney 2009). The Superintendent approved the transactions under Articles 13, 14, 15, 41, 69, and 71 of the Insurance Law. *See* Measley Aff. Ex. A (setting forth the findings of the Superintendent).
[6] Measley Aff. Ex. A.

According to MBIA Insurance, because Third Avenue bases its breach of contract and fraudulent conveyance claims on factual and legal arguments that are identical to or that overlap with issues determined by the Superintendent in deciding whether to approve the Split-Up Transaction, New York law considers Third Avenue to be engaging in a "collateral attack" on the Superintendent's findings.[7] Such a collateral attack, says MBIA Insurance, can only be brought by way of an action under Article 78 of the CPLR. That statute grants parties such as Third Avenue a specific and statutorily-defined opportunity to challenge the findings of administrative officers.[8] Therefore, MBIA Insurance asks this court to determine, under New York law, that Third Avenue cannot proceed with a plenary action for breach of contract and fraudulent conveyance, that this case must be dismissed, and that Third Avenue must limit itself to an action under Article 78.

By contrast, Third Avenue argues that, under New York law, the mere fact that the Split-Up Transaction was considered and approved by the Superintendent does not in any way affect its right to sue based on its independent contractual rights and New York fraudulent conveyance law. That is, although MBIA Insurance had the right to seek approval from the Superintendent before implementing the Split-Up Transaction so as to

---

[7] *Cf.* 73A C.J.S. *Pub. Admin. Law and Procedure* § 289 (2009) ("The order or determination of an administrative body, acting within its jurisdiction and under authority of law, is not subject to collateral attack. . . . The rule against collateral attack is particularly applicable where the question in issue is one that requires a background of specialized experience, so that the administrative agency is particularly qualified to determine it.").

[8] Article 78 of the CPLR requires that an action challenging the decision of an administrative body or officer, including whether "a determination was made in violation of lawful procedure, was affected by an error of law or was arbitrary and capricious or an abuse of discretion," be brought in an "Article 78" special proceeding in New York state court. N.Y. CPLR §§ 7803(3), 7804.

(one presumes) give MBIA Insurance some measure of assurance that the Superintendent could not later claim that the Split-Up Transaction violated the New York Insurance Law,[9] obtaining such approval did not immunize MBIA Insurance from suits by parties possessing contractual rights or from suits for torts. Third Avenue therefore asks me to determine that it may proceed on the merits with this case in Delaware, so that I, as a Delaware judge, can consider whether its New York law claims for breach of contract and fraudulent conveyance support relief.

Although the parties do not agree on anything, they have come together to convince me of something critical, which is that this court must make a determination about the scope of effect to be given to the findings of the New York Superintendent of Insurance in approving the Split-Up Transfer before it can consider the substantive merits of the Third Avenue's breach of contract and fraudulent conveyance claims. As Third Avenue admitted at oral argument,[10] MBIA Insurance has raised a non-frivolous argument that under New York law, the Superintendent's determinations that the Split-Up Transaction left MBIA Insurance with sufficient surplus to cover its "obligations," a statutory term under the New York Insurance Law that includes its obligations to

[9] MBIA Insurance submitted a private application to the New York Department of Insurance, requesting "the approval of transactions" under various articles of the New York Insurance Law. Measley Aff. Ex. A. New York Insurance Law Article 71 requires the Superintendent's approval of transfers or sales of "all or substantially all" of the assets of a domestic insurance company. *See* N.Y. Ins. Law § 7101. But, because the Superintendent found that the Split-Up Transaction was not an acquisition of "all or substantially all" of the assets of MBIA Insurance, the transaction "[did] not require the Superintendent's approval under Article 71 of the Insurance Law." Measley Aff. Ex. A. at 10.

[10] *Third Avenue Trust v. MBIA Insurance Corp.*, C.A. No. 4486-VCS, at 38-39 (Del. Ch. Oct. 5, 2009) (TRANSCRIPT).

noteholders,[11] and did not involve a transfer of substantially all of its assets are ones that cannot be reexamined in a separate plenary action brought by creditors such as Third Avenue based on claims raising substantively similar, albeit not identical, factual contentions.

Indeed, in *Shah v. Metropolitan Life Insurance Company*, the New York Supreme Court held that policyholders, who argued that it was a breach of fiduciary duty for a mutual life insurance company to demutualize, could not bring an action outside of an Article 78 proceeding because the claim addressed the same decision to demutualize that was approved by the Superintendent and, therefore, the fiduciary duty claim constituted a so-called "collateral attack" on the Superintendent's findings.[12] On appeal, the New York Court of Appeals affirmed in a decision called *Fiala v. Metropolitan Life Insurance Co.*, holding that the breach of contract and breach of fiduciary duty claims constituted "impermissible collateral attacks on the Superintendent's determination."[13] Admittedly, the courts in *Shah* and *Fiala* had reasons to dismiss other than the "collateral attack" doctrine, and Third Avenue cites them in support of its contention that I should not dismiss this case. But the decisions, and critically that of New York's highest court, seem to hold that a party who wielded claims not specifically dependent on the New

[11] Section 107(a)(33) of the New York Insurance Law defines "obligations" as "bonds, debentures, notes and other evidence of indebtedness." N.Y. Ins. Law § 107(a)(33).
[12] 2003 WL 728869, at *13 (N.Y. Sup. Ct. Feb. 21, 2003) ("Even though couched in terms of breach of fiduciary duty or fraud, a claim which seeks, indirectly, to challenge the sufficiency of a Plan which was approved by the Superintendent, constitutes a collateral attack on that approval, and must be made in an Article 78 proceeding.") (citations omitted), *aff'd in part sub nom. Fiala v. Metropolitan Life Ins. Co.*, 6 A.D.3d 320, 322 (N.Y. 2004).
[13] 6 A.D.3d 320, 322 (N.Y. 2004), *aff'g in part sub. nom. Shah v. Metropolitan Life Ins. Co.*, 2003 WL 728869.

York Insurance Law could not press those claims if the factual basis for those independent claims was sufficiently similar to and intertwined with the factual determinations the Superintendent made to support his decision as to render the prosecution of those non-insurance law claims a forbidden "collateral attack."[14]

Similarly, in *In re East New York Savings Bank Depositors Litigation*, the New York Supreme Court dismissed depositors' fraud and breach of fiduciary duty claims related to the conversion of a mutual savings bank to a stock corporation, which had been approved by the New York State Banking Department, because the claims were "an attack on the sufficiency of a plan that was approved by the [Banking] Department."[15] The depositors had argued that they, as owners and depositors of East New York Bank, were entitled to profit financially from any conversion of the bank, and that the Banking Department did not consider the rights of depositors in finding that the conversion was permissible under New York Banking Law. The court rejected this argument, stating that "the legal validity of the plan is not easily separated from its financial content," and that

[14] *See Shah*, 2003 WL 728869, at *13-14 (finding that the plaintiffs' breach of fiduciary duty and fraud claims were collateral attacks on the Superintendent's approval because "the primary allegations underlying the breach of fiduciary duty and fraud claims" were the same as those considered by the Superintendent); *Fiala*, 6 A.D.3d at 321 (holding that most of the plaintiff's claims were barred as impermissible collateral attacks on the determinations of the Superintendent where the claims were based in areas of law not considered by the Superintendent, but arising from the same approved transaction); *cf.* 2 AM. JUR. 2D *Admin. Law* § 373 (2009) ("Once a final [administrative] order is issued, the administrative-procedure acts generally provide the sole and exclusive method to obtain judicial review of a final administrative decision. An agency's final order, like the final judgment of a court of law, is immune from collateral attack . . . .").

[15] 547 N.Y.S.2d 497, 501 (N.Y. Sup. Ct. 1989).

the depositors' claims were still an attack on the form of a plan approved by the Banking Department.[16]

I acknowledge that Third Avenue makes a forceful, and potentially correct, argument that the Superintendent's approval of a plan like the Split-Up Transaction does not bar plaintiffs, such as Third Avenue, from exercising the legal and equitable rights that they possess under contracts or statutes not dependent on the New York Insurance Law. Third Avenue contends, with a rational basis, that *Shah*, *Fiala*, and *East New York Savings Bank* do not specify the exact scope and nature of the so-called collateral attack doctrine with clarity. Third Avenue, citing to *Staatsburg Water Co. v. Staatsburg Fire District*,[17] takes the plausible position that an insurance company's mere attainment of regulatory approval for the procession of a transaction does not immunize it against a challenge by creditors who may possess an independent legal right to block the transaction. In support of this position, Third Avenue points out that the Superintendent's decision was based largely on a factual record presented by MBIA Insurance on its own and in response to the Superintendent's information request—a record that was not the product of development through an adversarial litigation process.

Indeed, in an October 2, 2009 ruling dealing with a lawsuit brought by a group of insurance policyholders of MBIA Insurance challenging the same Split-Up Transaction, Judge Yates of the New York Supreme Court appeared to side with Third Avenue's view

[16] *Id.*

[17] 531 N.Y.S.2d 876, 878 (N.Y. 1988) (explaining that, in the context of the collateral estoppel doctrine, an agency decision has a preclusive effect only if both proceedings involved identical issues, and the administrative decision gave parties notice and an opportunity to be heard).

of the law. He denied a motion to dismiss brought on grounds of the collateral attack doctrine by MBIA Insurance—a motion largely premised on the same arguments MBIA Insurance has advanced here—and allowed both an Article 78 proceeding challenging the Superintendent's approval as arbitrary and capricious and the policyholders' fraudulent conveyance claims to proceed simultaneously.[18]

As a fellow trial judge, I am well positioned to state, and have it understood to be no matter of disrespect by my learned colleague in New York who denied MBIA Insurance's motion to dismiss, that the issuance of a trial court ruling against MBIA Insurance on a closely related issue does not definitively resolve the key question that must be answered before the merits of the claims pled in this case can be considered. That question is whether the approval of the Split-Up Transaction by the Superintendent forecloses this court or any other court from considering the breach of contract and fraudulent conveyance claims of Third Avenue, and whether Third Avenue's only remedy is to challenge the Superintendent's determinations under Article 78.

In my view, answering that question would clearly involve this court resolving, in the words of the Fiscal Agency Agreement's forum selection clause, a "dispute[ ] relating to the exercise of [the Superintendent's] regulatory authority."[19] Given that reality, the forum selection provision in the Fiscal Agency Agreement requires that this question be resolved in the courts of New York.[20]

---

[18] *ABN AMRO Bank N.V. et al. v. MBIA, Inc. et al.*, No. 601475/09 (N.Y. Sup. Ct. Oct 2, 2009) (TRANSCRIPT).
[19] Measley Aff. Ex. C § 13.02.
[20] *Id.*

Importantly, New York has a far greater interest than Delaware in resolving this question and should be given the opportunity to do so in the first instance. The entities involved in this action all have substantial ties to New York: MBIA Insurance is a New York corporation with its principal place of business in New York; MBIA Illinois has its principal place of business in New York; Third Avenue Trust and Third Avenue Variable Series Trust are headquartered in New York.[21] *Most crucially, the notes were issued in accordance with the New York Insurance Law,*[22] *the Fiscal Agency Agreement is governed by New York contract law,*[23] *and Third Avenue's claims are based entirely upon New York, not Delaware, statutes and common law*. This court only has personal jurisdiction over MBIA Insurance because it is licensed to transact business in Delaware.[24] Because of the importance of this question to New York public policy, and the absence of any legitimate interest Delaware has in the question, I believe that an appropriate regard for comity requires this court to abstain and allow the courts of New York to speak on the collateral effect to be given to the determinations of the Superintendent of the New York Insurance Department.[25]

It is plausible that the New York courts may deem the Superintendent's timely approval of the major financial transactions of insurers to be so critical that any interested

---

[21] *See* Compl. ¶¶ 10-13.
[22] According to the Offering Circular, Section 1307 of the New York Insurance Law governs the notes. Measley Aff. Ex. E. Section 1307 gives the Superintendent broad authority over the notes, requiring his approval before the notes were issued and also before any interest or principal could be paid on the notes. N.Y. Ins. Law § 1307(b), (d).
[23] Measley Aff. Ex. C. § 13.02.
[24] *See* Compl. ¶¶ 6-7.
[25] *Cf. Diedenhofen-Lennartz v. Diedenhofen*, 931 A.2d 439, 442 (Del. Ch. 2007) ("Of all the states of the union, Delaware should be most sensitive to the need to afford comity to the courts of the jurisdiction that charters an entity.").

constituencies must raise objections through the Article 78 process. But it is also plausible that the New York courts may find that administrative approval of an insurer's financial transaction is simply a matter of safeguarding the interests of policyholders as guaranteed by statute, and does not preclude policyholders or other affected constituencies from exercising any independent legal or equitable rights to challenge those transactions. The crucial point is that both scenarios are possible, and the decision regarding which is proper should be made by the courts of the only state whose law is at issue. Therefore, I will dismiss this case without prejudice. If the courts of New York resolve the issue regarding the collateral effect of the Superintendent's ruling on Third Avenue's ability to press its breach of contract and fraudulent conveyance claims in a forum outside of New York in favor of the ability of Third Avenue to proceed here,[26] Third Avenue may reinstitute its claims here by filing a new complaint.

IT IS SO ORDERED.

[26] I note that it is open to the New York courts to conclude that, even if the collateral attack doctrine does not require Third Avenue to proceed only under Article 78, the claims Third Avenue seeks to press bear the sufficient, contractually-specified relation to the matters addressed by the Superintendent so as to require, under the forum selection clause of the Fiscal Agency Agreement, the claims to proceed by way of an action in the New York courts.