

Ambac Assur. (UK) Ltd. v J.P Morgan Inv. Mgt., Inc.
2017 NY Slip Op 30322(U)
February 21, 2017
Supreme Court, New York County
Docket Number: 650259/2009
Judge: Saliann Scarpulla
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 39

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AMBAC ASSURANCE (UK) LTD., in the name
of BALLANTYNE RE PLC,

Plaintiff,

-against-

J.P MORGAN INVESTMENT MANAGEMENT, INC.,

Defendant.

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HON. SALIANN SCARPULLA, J.:

DECISION/ORDER

Index No. 650259/2009
Motion Seq. No. 003

Plaintiff Ambac Assurance (UK) Ltd. ("Ambac") moves for partial summary judgment on the portion of its first cause of action, in which it alleges that defendant J.P. Morgan Investment Management Inc. ("JPMIM") breached the parties' investment management agreement as a matter of law. Ambac seeks an immediate trial on damages.

On May 4, 2009, Ambac commenced this action in its own right and on behalf of Ballantyne Re plc ("Ballantyne"). Ballantyne is a special purpose vehicle formed by reinsurance company Scottish Re (U.S.), Inc. ("Scottish Re") to meet capital reserve requirements for certain life insurance policies that it reinsured.

In 2006, Scottish Re caused Ballantyne to reinsure life insurance policies with an aggregate insured amount of approximately \$190 billion. Ballantyne then issued more than \$1.7 billion in notes and preference shares. Ambac is the guarantor of Ballantyne's payment of interest and principal on \$900 million of the Ballantyne notes, and Assured Guaranty (UK) Ltd. is the guarantor of \$500 million of the Ballantyne notes.

In May 2006, Ballantyne entered into an Investment Management Agreement (“the IMA”) with JPMIM. Under the IMA, JPMIM agreed to act as an investment manager for Ballantyne’s assets, which were placed into an “excess reserve account” (the “Reinsurance Trust Account”). The IMA stated that “subject to and in accordance with the Investment Guidelines and Clause 4(d) hereof, Investment Advisor [JPMIM] shall have complete discretion and authority, without obtaining Client’s instructions, to make such sales, exchanges, investments or reinvestments or to take any action that it deems necessary or desirable in connection with the assets in the Accounts.”

Section 4(d) of the IMA specifically provided that “with respect to the assets held in the Reinsurance Trust Account, investments must be made in compliance with . . . (ii) Chapter 13 of the Delaware Insurance Code, a copy of which is attached as Exhibit D-2 . . .” In addition, the IMA contained an Exhibit B entitled “Investment Guidelines,” which specified percentage limitations on certain types of asset-backed securities.

Ambac alleges that JPMIM invested Ballantyne’s assets of approximately \$1.65 billion in “almost exclusively risky subprime and Alt-A residential mortgage-backed and home-equity backed securities . . . despite its duty to diversify and manage the [p]ortfolio prudently to meet the conservative investment objectives, and did so even after its corporate parent, JPMorgan Chase, had enough evidence about the growing risk of collapse of the Subprime Securities market.” Ambac alleges that “[b]y July 2007, the [p]ortfolio had started suffering losses as a direct result of JPMorgan’s failure to properly and prudently manage the securities it purchased for Ballantyne,” and that the portfolio ultimately lost \$1 billion. Ambac claims that, as a result of JPMIM’s conduct, Ballantyne was unable to meet its obligations to its noteholders, which triggered Ambac’s obligation to make payments to Ballantyne’s noteholders.

In this action, Ambac and Ballantyne seek to recover damages resulting from JPMIM’s

alleged breaches of contract, breaches of fiduciary duty, and acts of gross negligence. By decision

dated March 24, 2010, Justice Barbara Kapnick dismissed the complaint in its entirety. However, the Appellate Division, First Department, *inter alia*, reinstated the breach of contract claim alleging that JPMIM violated the Delaware Insurance Code.

Ambac now seeks partial summary judgment on its breach of contract claim alleging that JPMIM failed to comply with Chapter 13 of the Delaware Insurance Code.¹ In response, JPMIM does not separately move for summary judgment, but argues that the Court should grant summary judgment dismissing this claim because: (a) JPMIM complied with the Delaware Insurance Code; (b) Ambac failed timely to object to the investments within ninety days of receiving account statements; (c) Ambac cannot establish gross negligence; and (d) Ambac is equitably estopped from asserting its breach of contract claim.

Discussion

Ambac argues that it is entitled to partial summary judgment because JPMIM breached section 4(d) of the IMA by failing to comply with the Delaware Insurance Code. Specifically, Ambac contends that JPMIM violated Delaware Insurance Code § 1305(4), which caps an insurer's investment in non-agency mortgage-backed securities ("MBS") to 50% of all assets. Ambac asserts that JPMIM concentrated the Reinsurance Trust Account with non-agency MBS holdings in excess of the 50% cap and in breach of Section 4(d) of the IMA.

Chapter 13 of the Delaware Insurance Code establishes limitations on investments made by insurance companies. Delaware Insurance Code § 1302(a) entitled "Eligible investments" states that "[i]nsurers shall invest in or lend their funds on the security of, and shall hold as invested assets, only eligible investments as prescribed in this chapter."

¹ Ambac does not move on its other claims for breach of contract, breach of fiduciary duty or gross negligence, including its claim that JPMIM over-concentrated and maintained Ballantyne's assets in "highly risky subprime and alt-A mortgage-backed securities" despite Ballantyne's objective of obtaining a high level of safety of capital.

Pursuant to Delaware Insurance Code § 1305(4), an “insurer shall not at any 1 time have more than 50% of its assets invested in obligations under § 1323 of this title, exclusive of that portion of such obligations guaranteed or insured by an agency of the United States government.” Section 1323 entitled “Real estate mortgages” provides in part that “[a]n insurer may invest in bonds, notes or other evidences of indebtedness secured by first or second mortgages.”

Together, Delaware Insurance Code §§ 1305 and 1323 set forth a 50% cap on non-agency MBS investments. *Ambac Assur. UK Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*, 88 A.D.3d 1, 12 (1st Dep’t 2011) (determining that plaintiff stated a claim for breach of contract based on defendant’s alleged violation of Section 1305 through investing more than 50% of assets in non-agency MBS). Generally, non-agency MBS are securities collateralized by mortgage loans that are not guaranteed or insured by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation.

In support of its claim that JPMIM invested the assets in the Reinsurance Trust Account in violation of the 50% cap on non-agency MBS, Ambac submits an expert affidavit from Dr. George S. Oldfield. In his affidavit, Dr. Oldfield states that he “found that during September 2006 the amount of non-agency MBS in the Ballantyne Reinsurance Trust Account first exceeded 50%. Thereafter, at its peak, the non-agency MBS in the Ballantyne Reinsurance Trust Account constituted more than 91% of the book value of all the assets in that account.” Dr. Oldfield agreed with JPMIM expert Kenneth Lehn’s finding that the 50% cap on non-agency MBS was exceeded beginning on August 25, 2006.

JPMIM does not submit any evidence to oppose Ambac’s evidence that the assets in the Reinsurance Trust Accounts exceeded the 50% cap. In fact, JPMIM concedes that “the MBS and ABS-HEL in the Ballantyne Account exceed 90% of the Account’s book value.” I therefore find

that Ambac sufficiently demonstrates that JPMIM breached the IMA by allowing investments in excess of the 50% cap for non-agency MBS, in violation of Delaware Insurance Code § 1305.

JPMIM nevertheless argues that it should not be held liable for breaching section 4(d) of the IMA because the parties and Scottish Re believed that the Delaware Insurance Code did not impose a 50% cap on non-agency MBS, and that investments made pursuant to the Investment Guidelines were in compliance with the Delaware Insurance Code. However, when parties contract to require compliance with a statute – as the parties did here – the parties enter into “an agreement to comply with it as correctly interpreted, whether or not the correct interpretation was known to the parties at the time of contracting.” *Ramos v. Simplex Grinnell LLP*, 24 N.Y.3d 143, 148 (2014).

Accordingly, evidence that the parties may have thought that investments in non-agency MBS could exceed 50% under the Delaware Insurance Code, or that the investments separately met the percentages permitted by the Investment Guidelines, does not prevent a finding that JPMIM breached of section 4(d) of the IMA by failing to comply with the Delaware Insurance Code. JPMIM expressly agreed that the investments would comply with the Delaware Insurance Code, notwithstanding the investment standards set forth in the Investment Guidelines. *See* IMA § 4(d) (“[n]otwithstanding any other provision of this Agreement or the Investment Guidelines . . . investments must be made in compliance with the provisions of . . . Chapter 13 of the Delaware Insurance Code”).

JPMIM further contends that its compliance with Section 1308 of the Delaware Insurance Code is sufficient to meet its obligation under section 4(d) of the IMA. Section 1308(a) states that “[a]n insurer may invest any of its funds in obligations rated 1 or 2 by the SVO if they are issued, assumed or guaranteed by any solvent institution created or existing under the laws of the United States or Canada or of any state, district, province or territory thereof.” Although JPMIM may be

JPMIM's argument that compliance with Section 1308 is sufficient to demonstrate compliance with the Delaware Insurance Code. *Ambac Assur. UK Ltd. v. J.P. Morgan Inv. Mgmt., Inc.*, 88 A.D.3d 1, 12 (1st Dep't 2011) (stating that "[w]e further reject the defendant's argument that it complied with § 1308 of the Delaware Code, and that compliance with any section is sufficient to render an investment compliant with the Code").

While Ambac has established that JPMIM breached the IMA by failing to comply with the Delaware Insurance Code, an issue of fact remains as to whether JPMIM's breach constitutes gross negligence. Under the IMA, the parties expressly agreed that "JPMC Entities and Persons shall not be liable to Client [Ambac] or its representatives for any Losses suffered by Client arising from any depreciation in the value of the Accounts or from the income derived from it . . . or other Losses that result from Investment Advisor's actions hereunder, *except to the extent such Losses are judicially determined to be proximately caused by the gross negligence or willful misconduct of Investment Advisor*" (emphasis added).

To prove gross negligence, a plaintiff must demonstrate "the type of conduct that smacks of intentional wrongdoing and evinces a reckless indifference to the rights of others." *Abacus Federal Savings Bank v. ADT Sec. Services, Inc.*, 18 N.Y.3d 675, 670 (2012). "Ordinarily the question of gross negligence is a matter to be determined by the trier of fact." *Lubell v. Samson Moving & Storage*, 307 A.D.2d 215, 217 (1st Dep't 2003).

Ambac asserts that JPMIM's breach of the IMA is conduct that amounts to gross negligence as a matter of law. In support of this argument, Ambac submits the deposition testimony of JPMIM portfolio manager, Mark Stancher. At his deposition, Stancher testified that he created a spreadsheet listing the investment guidelines for the Ballantyne account in order to help him understand and manage the transaction. He then explained that he discussed "with Scottish [Re]

regulations” and that it was his understanding “that if the securities were purchased were within the guidelines that were in the prospectus, they would be in compliance with the various insurance regulations.” Stancher did not recall who conveyed that information to him from Scottish Re.

Stancher further testified that he did not recall whether he sought any legal advice on whether the investments complied with the Delaware Insurance Code; whether any internal discussions at JPMIM occurred regarding how to comply with the Delaware Insurance Code; or whether JPMIM undertook any steps to track the investment portfolio’s compliance with the provisions of the Delaware Insurance Code.

In addition, Ambac submits the deposition testimony from other members of the team that worked with Stancher on the Ballantyne account. In their depositions, JPMIM team members Kyongsoo Noh, Jeffrey Sisko, and Cecilia Junker testified that they were unaware of the requirement that investments must comply with the Delaware Insurance Code. Further, Ron Arons testified that JPMIM’s automated “Compliance Master” software program was not programmed to measure whether the investments in the Reinsurance Trust Account remained under the 50% cap.

JPMIM argues that its conduct does not amount to gross negligence, or alternatively that an issue of fact exists as to whether its conduct rises to the level of gross negligence. JPMIM points out that it did not engage in any intentional misconduct because it relied on Scottish Re’s representation that compliance with the Investment Guidelines was sufficient to satisfy the Delaware Insurance Code. JPMIM asserts that Scottish Re is “the party who sought the Delaware Code provision, received the only benefit from that provision, and is most knowledgeable about the requirements of its regulatory regime,” and that its reliance on Scottish Re was “entirely reasonable and appropriate.” In addition, JPMIM contends that the parties did not know that the Delaware Insurance Code imposed a 50% cap on non-agency MBS investments, and JPMIM did not possess

JPMIM submits deposition testimony from Ballantyne board member Adrian Masterson. At his deposition, Masterson testified that Ballantyne wanted investments of the assets held in the Reinsurance Trust Account to comply with the Delaware Insurance Code in order for Scottish Re to take reserve credit for those assets. JPMIM also submits deposition testimony from Scottish Re's vice president of capital markets, David Webb, who explained that the Investment Guidelines were designed to be compliant with the Delaware Insurance Code. At his deposition, Webb testified that the Investment Guidelines were "the general parameters but were always subject to compliance with the Delaware and the New York requirements here which would supercede the investment guidelines. Certainly, there was no intent to put something in the guidelines that would have not been noncompliant with that, but this was always there to provide . . . the framework from which investments ultimately would need to be assessed for compliance."

Based on the parties' submissions, I find that Ambac has failed to demonstrate that JPMIM acted with gross negligence as a matter of law, and that a triable issue of fact exists as to whether JPMIM was grossly negligent in relying on Scottish Re's representations regarding the Delaware Insurance Code and Scottish Re's act of taking reserve credit in order to meet its own contractual obligation to ensure that investments complied with the Delaware Insurance Code. *Abacus Federal Savings Bank*, 18 N.Y.3d at 670; *American Home Assur. Co. v. Amerford Intern. Corp.*, 200 A.D.2d 472, 473 (1st Dep't 1994) (holding that "summary judgment should not be granted where there is any doubt as to the existence of a triable issue"). Accordingly, I deny Ambac's motion for partial summary judgment on its breach of contract claim against JPMIM for failure to comply with the Delaware Insurance Code.

JPMIM contends that Ambac's breach of contract claim should be dismissed because Ambac failed timely to object to the investments as required by the IMA. While it is true that the First

further stated that the 90-day period only applies to conduct apparent on the face of the statements. Because the face of the statements did not contain an indication as to whether the investments complied with the Delaware Insurance Code, JPMIM's timeliness objection fails. *See Ambac Assur. UK Ltd.*, 88 A.D.3d at 12–13 (holding that where “plaintiff’s claims are based on defendant’s failure to manage the accounts in accordance with the investment objective rather than upon any specific act or transaction . . . they are based on conduct that would not have shown on any statement” and may not be dismissed based on the 90-day limitations period).

JPMIM also argues that Ambac should be equitably estopped from advancing its claims based on the Delaware Insurance Code. JPMIM asserts that Scottish Re acted as Ballantyne’s agent, and that Ballantyne is therefore bound by Scottish Re’s representation that compliance with the Investment Guidelines equates to compliance with the Delaware Insurance Code.

The doctrine of equitable estoppel is applied by courts “to preclude a person from asserting a right after having led another to form the reasonable belief that the right would not be asserted, and loss or prejudice to the other would result if the right were asserted.” *Shondel J. v. Mark D.*, 7 N.Y.3d 320, 326 (2006). I find that JPMIM fails conclusively to demonstrate in its opposition papers that Scottish Re acted as Orkney’s agent when discussing the requirement that investments must comply with the Delaware Insurance Code, or that JPMIM reasonably relied on Scottish Re’s representations. These are issues of fact for trial and I therefore do not dismiss Ambac’s breach of contract claim based on equitable estoppel at this time.

In accordance with the foregoing, it is

ORDERED that plaintiff Ambac Guaranty (UK) Ltd.’s motion for partial summary judgment on the portion of its first cause of action alleging that defendant J.P. Morgan Investment Management Inc. breached the Investment Management Agreement by failing to comply with

Chapter 13 of the Delaware Insurance Code is denied as to the issue of gross negligence; and it is further

ORDERED that a trial in this action shall be conducted before the Court on March 13, 2017.

This constitutes the decision and order of the Court.

DATE: 2/21/17


SALIANN SCARPULLA, JSC