

UNITED STATES DISTRICT COURT  
SOUTHERN DISTRICT OF NEW YORK

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:  
AURELIUS CAPITAL MASTER, LTD., :  
*et al.*, :  
:  
Plaintiffs, : 09 Civ. 2242 (RJS)  
:  
-against- :  
:  
MBIA INC., *et al.*, :  
:  
Defendants. :  
:  
----- X

**REPLY MEMORANDUM OF LAW IN SUPPORT OF  
DEFENDANTS' MOTION TO DISMISS**

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Defendants, the MBIA Group, respectfully submit this Reply Memorandum of Law in Support of their Motion to Dismiss the Complaint.

## **ARGUMENT**

### **I.**

#### **THE COMPLAINT IS BARRED BY THE COLLATERAL ATTACK DOCTRINE**

As set forth in our main brief, Plaintiffs' request – that this Court "set aside" and declare "null and void" Transactions that the Superintendent and the Department expressly approved pursuant to the regulatory authority vested in them by the New York State Legislature – is clearly improper as a matter of law. (Def. Br. at 12-16). The exclusive means to challenge these Transactions – and the very issues decided by the Superintendent – is an Article 78 proceeding in New York State court, not a back-door collateral attack on the Superintendent's decision via a plenary action against the MBIA Group. (*Id.*)<sup>1</sup>

Plaintiffs misstate the legal issue before this Court, arguing that the MBIA Group "in effect" asks this Court to find that Plaintiffs are "collaterally estopped from bringing" their claims. But this is *not* a case of issue preclusion. Plaintiffs are free to assert their arguments to set aside these Transactions, but must do so in an Article 78 proceeding, as required by New York law. Plaintiffs also seek to limit the collateral attack doctrine to situations where a party claiming injury from an administrative decision had prior notice and opportunity to be heard. Plaintiffs' argument is unsupported by case law and directly contradicted by the express statutory language of Article 78.

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<sup>1</sup> As Plaintiffs' opposition makes clear, they have brought suit in this Court because of their apparent concern that they will be unable to meet the legal standard set forth in Article 78 for overturning the Superintendent's decision. But the collateral attack doctrine is designed to prevent parties such as Plaintiffs from attempting to do indirectly what they apparently feel they cannot do directly, namely, successfully challenge in an Article 78 proceeding the Superintendent's Approval.

**A. This Lawsuit Challenges "The Very Issues" Decided by the Superintendent.**

A cause of action – no matter how Plaintiffs style it – violates the collateral attack doctrine and must be dismissed if it challenges "the very issues necessarily encompassed in [the Superintendent's] decision." *Shah v. Metro. Life Ins. Co.*, No. 00 Civ. 108887, 2003 WL 728869, at \*12 (N.Y. Sup. Ct. Feb. 21, 2003). Plaintiffs' claims are indisputably and "necessarily encompassed" within the Superintendent's approval of these Transactions.

Plaintiffs ask this Court to set aside the Transactions as fraudulent transfers because the Transactions allegedly rendered MBIA Insurance insolvent. As such, Plaintiffs attack the very issue the Superintendent decided – that the Transactions would not and did not render MBIA Insurance insolvent or unable to honor its commitments to policyholders. Applying the legal test for determining solvency of an insurance company, the Superintendent concluded that post-Transformation, MBIA Insurance would have sufficient surplus to meet all of its obligations as they become due. (Siegfried Decl., Exh. A, p. 6). The Superintendent made this determination after the Department conducted its own thorough review of MBIA Insurance's financials.<sup>2</sup>

In order to avoid application of the collateral attack doctrine, Plaintiffs attempt to recast their challenge to the Superintendent's solvency determination by arguing that the Approval Letter does not refer to New York Debtor and Creditor Law. The argument is fallacious. The specific provisions of the Insurance Law, not the general provisions of Debtor and Creditor Law, provide the definition of insolvency for an insurance company, and the Legislature specifically authorized the Superintendent to determine whether or not an insurance company is insolvent. *See*

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<sup>2</sup> Plaintiffs repeatedly state that the Superintendent issued the Approval "in reliance on the truth of the representations and submissions provided by MBIA Insurance." Just as the Complaint failed to advise the Court that the Superintendent approved the Transactions, so too, Plaintiffs fail to acknowledge that the Department conducted its own independent "examination of the MBIA Entities' financial condition prior to ... and after  
*continued on the following page...*

N.Y. Ins. Law §§ 1309, 1310, Art. 74; *see also* 68 N.Y. Jur. 2d *Insurance* § 297.<sup>3</sup> Plaintiffs' suggestion in a footnote (Pl. Mem. at p. 7, n.2) that the Superintendent did not make a solvency finding is absurd. It would be contrary to his statutory duty to approve the Transactions if they rendered MBIA Insurance insolvent. His determination that the Company would have sufficient surplus to meet all of its obligations as they become due follows the statutory language of Insurance Law § 1309.<sup>4</sup> Thus, to maintain a claim under Debtor and Creditor Law §§ 274-276, Plaintiffs necessarily ask this Court to set aside the Superintendent's determination that the Transactions did not render MBIA Insurance insolvent and substitute its judgment for the Superintendent's.

Accordingly, Plaintiffs' claims are not "independent" of the Superintendent's determinations.<sup>5</sup> Plaintiffs attack the "very issues encompassed within his decision." Further, unlike Plaintiffs' cited cases (Pl. Mem. at 13-16), the relief sought here would, if awarded, require this Court to overturn the Superintendent's Approval and unwind the Transactions. Accordingly,

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*...continued from the preceding page*

effectuation of the Transformation" in approving each Transaction. (Siegfried Decl., Exh. A, p. 6, 7 and 8). The Superintendent did not simply take at face value the company's submissions.

<sup>3</sup> It is a "basic principle of statutory construction that a specific statute ... controls over a general provision." *Stoltz v. Brattleboro Hous. Auth. (In re Stoltz)*, 315 F.3d 80, 93 (2d Cir. 2002) (citation omitted); *Wabco Trade Co. v. SS Inger Skou*, 663 F.2d 369, 371 (2d Cir. 1981). Insurance Law § 1309 entitled "Insolvency of Insurer" is the specific statute defining insolvency of insurance companies. It was also enacted after the Debtor and Creditor Law. *Nat'l Org. for Women v. Metro. Life Ins. Co.*, 516 N.Y.S.2d 934, 936 (1st Dept 1987) ("[W]hen two statutes ... conflict, ... the later constitutional enactment ordinarily prevails.").

<sup>4</sup> As the Superintendent stated, "Consistent with New York State Insurance Law, the New York State Insurance Department only approved the transaction after deciding that both companies would have sufficient statutory capital to meet the letter and spirit of the Insurance Law." (Siegfried Decl., Exh. B).

<sup>5</sup> Plaintiffs' reference to *Richards v. Kaskel*, 32 N.Y.2d 524, 535 n.5 (1993) and to a single claim in *Fiala* are both inapposite. As the *Richards* Court noted, had plaintiff there challenged the "content" of the conversion plan approved by the New York State Attorney General – as Plaintiffs here challenge the content of the Transactions approved by the Superintendent – such challenge was required to be brought as an Article 78 proceeding. In *Fiala*, the alleged misrepresentations were made to plaintiffs, not to the Superintendent. Here, Plaintiffs do not claim a misrepresentation to them; at best they question the submissions made to the Superintendent. Similarly, the *LaFarge*, *Doyle*, *Drain* and *Rowen* cases (Pl. Mem. at 15-16) all involved claims that those courts found were outside the jurisdiction of the insurance department, did not involve "technical insurance regulatory matters" and/or did not require "expertise of the insurance industry." *See, e.g., Rowen v. Le Mars Mut. Ins. Co.*, 230 N.W.2d 905, 911-12 (Iowa 1975).

under the collateral attack doctrine, Plaintiffs' challenge to the Superintendent's determinations must be made in an Article 78 proceeding, not in a federal plenary action against the MBIA Group.

**B. Plaintiffs Are Not Collaterally Estopped From Bringing Their Claims.**

Plaintiffs allege that they cannot be "collaterally estopped" from challenging these Transactions since the Superintendent's Approval was obtained without their having notice or an opportunity to be heard. (Pl. Mem. at 9-13). The collateral attack doctrine, however, has nothing to do with issue preclusion or collateral estoppel. Plaintiffs are free to claim in an Article 78 proceeding that the Transactions rendered MBIA Insurance insolvent, or that the Superintendent improperly relied on the MBIA Group's submissions,<sup>6</sup> or that he failed to properly consider Plaintiffs' interests and any adverse effects of his Approval. What the collateral attack doctrine mandates is that Plaintiffs make these arguments to overturn the Superintendent's Approval in an Article 78 proceeding.<sup>7</sup>

**C. Article 78 Is Not Limited to Challenges Based on Notice and Opportunity to Be Heard.**

Plaintiffs' argument that this Court should limit the collateral attack doctrine only to those situations where a plaintiff has had notice and opportunity to be heard at the agency level is

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<sup>6</sup> Claims that insurers obtained approvals from the Superintendent based upon misrepresentations must be brought in an Article 78 proceeding, not a plenary action against insurers. *In re Empire Blue Cross & Blue Shield Customer Litig.*, 622 N.Y.S.2d 843, 846-47 (N.Y. Sup. Ct. 1994); *Minihane v. Weissman*, 640 N.Y.S.2d 102, 102 (1st Dept. 1996).

<sup>7</sup> Plaintiffs' reliance on *Staatsburg Water Co. v. Staatsburg Fire Dist.*, 527 N.E.2d 754 (N.Y. 1988) and *Marine Midland Bank v. Home Ins. Co.*, 263 A.D.2d 374 (1st Dept. 1999) is misplaced. Those courts were asked to find issue preclusion based upon an agency determination. Neither case involved the collateral attack doctrine. In *Staatsburg*, the court also held that it would not give preclusive effect to "an unsolicited advisory opinion" of the PSC which the PSC lacked the statutory authority to issue. *Staatsburg*, 527 N.E.2d at 757. Here, by contrast, Plaintiffs do not challenge the Superintendent's legal authority to approve the Transactions. In *Marine Midland*, the court was asked to give "full faith and credit" to an administrative decision from a sister state to preclude claims. In addition, the *Marine Midland* court found that the "issues in the instant action [are not] the same as those that were before the ... administrative body." *Midland*, 693 N.Y.S.2d at 551. Here, of course, quite the opposite is true. Similarly, in *Martin v. Gauvin*, No. 08 Civ. 0191, 2009 WL 348426, at \*1-2 (N.Y. Sup. Ct. Feb. 11, 2009), also cited by Plaintiffs, the issue was whether collateral estoppel precluded plaintiffs' claims. Significantly, the *Martin* court also concluded that there was "no definitive decision that plaintiffs could have sought review under CPLR Article 78." *Id.* at \*3.

unsupported by case law and refuted by Article 78. Indeed, Plaintiffs cite no case for this proposition.<sup>8</sup>

Plaintiffs' argument might be cogent if the law only permitted an Article 78 challenge to be brought by a party who had notice and opportunity to be heard. But that is simply not the case. As set forth in our main brief (Def. Br. at 15), the New York Legislature drafted Article 78 in order to give any aggrieved party the right to challenge agency determinations whether or not it had prior notice or an opportunity to be heard. *See* 6 N.Y. Jur. 2d *Article 78* §§ 51 and 52. Accordingly, the relevant inquiry with respect to the collateral attack doctrine is simply whether the issues raised in the plenary action are encompassed within the Superintendent's decision. If they are, then a plaintiff is required to bring its Article 78 proceeding either under CPLR § 7803(3) (if it did not have prior notice or opportunity to be heard like Plaintiffs here), or under CPLR § 7803(4) (if it did). The suggestion that an Article 78 challenge to the Superintendent's Approval may be more difficult (or afford Plaintiffs less discovery), even if true, is legally irrelevant. As the *Shah* Court held:

Permitting plaintiffs to simply disregard and bypass the Superintendent's decision, and bring an action directly against [the insurer] on the very issues necessarily encompassed in that decision, would not be consistent with the overall legislative scheme.

2003 WL 728869, at \*12.

Since Plaintiffs' claims go to the very issues encompassed within the Superintendent's Approval, and since Plaintiffs ask this Court to declare the Transactions subject to

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<sup>8</sup> In contrast, as set forth in our main brief, one of the claims the *Shah* Court dismissed under the collateral attack doctrine was a challenge to the amendment of the plan which the Superintendent approved without notice or hearing. Plaintiffs allege that the *Shah* plaintiffs challenged only the procedure by which the Superintendent approved this amendment. The decision, however, clearly demonstrates that the *Shah* plaintiffs challenged the substance of the amendment as well. *See Shah*, 2003 WL 728869, at \*6. Accordingly, the *Shah* court's holding that the collateral attack doctrine barred plaintiffs' challenge is dispositive of Plaintiffs' contention here that the collateral attack doctrine is limited only to agency determinations made on notice and after hearing.

that Approval "null and void," Plaintiffs must bring their claims, if at all, in an Article 78 proceeding in New York State court.

## II.

### **ABSTENTION UNDER *BURFORD* IS BOTH APPROPRIATE AND WARRANTED**

As set forth in our moving brief (Def. Br. at 16-21), the Second Circuit has consistently held that *Burford* abstention applies to decisions of the Superintendent, and that "the administrative and judicial scheme erected by New York to regulate insurance companies ... operates pursuant to an express federal policy of noninterference in insurance matters." *Levy v. Lewis*, 635 F.2d 960, 963 (2d Cir. 1980).<sup>9</sup>

Plaintiffs respond that abstention is inappropriate because they cannot raise the issues they assert here in an Article 78 proceeding. As set forth *supra*, Plaintiffs are free to raise the same arguments they assert here, as well as any other arguments, in an Article 78 proceeding in an effort to show that the decision of the Superintendent was arbitrary and capricious or contrary to law. Thus, Plaintiffs have an adequate (and mandated) state law remedy through an Article 78 proceeding in state court. (See Def. Br. at 18); see also *Travelers Ins. Co. v. Home Ins. Co.*, No. 98 Civ. 9709, 1999 U.S. Dist. LEXIS 5523 (C.D. Cal. Feb. 22, 1999) (abstaining from hearing common-law claim because it was "collateral attack" on state insurance commissioner's order).

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<sup>9</sup> Courts have applied that reasoning outside the liquidation context as well. *Alleghany Corp. v. Haase*, 708 F. Supp. 1507, 1538-40 (W.D. Wis. 1988) (applying *Burford* abstention to determination upon proposed acquisition of insurer), citing, e.g., *Levy v. Lewis*, 635 F.2d at 963-64. Contrary to Plaintiffs' assertion, *Alliance of Am. Insurers v. Cuomo*, 854 F.2d 591, 600 (2d Cir. 1988) does not stand for the proposition that abstention outside the liquidation context is invariably inappropriate. Rather, *Alliance of American Insurers* holds that abstention may not be appropriate where plaintiffs bring a facial constitutional challenge to an insurance statute. *Id.* at 601 ("There are no factual determinations of state agencies or courts at issue in this case. This case is a direct challenge to the constitutionality of a state statute, a controversy federal courts are particularly suited to adjudicate."). Plaintiffs' further contention that abstention is inappropriate where, as here, Plaintiffs seek both equitable relief and damages is also wrong as a matter of law. (Def. Br. at 17, n.9).

Plaintiffs' analysis of the factors warranting abstention is similarly flawed.

Regarding the first two factors, Plaintiffs do not challenge – nor could they – that the Superintendent made discretionary determinations, within his specialized expertise, on complex Insurance Law matters. (*See* Def. Br. at 18-20). Rather, Plaintiffs disingenuously contend that they ask this Court to interpret only New York Debtor and Creditor Law, not New York Insurance Law.<sup>10</sup> To establish a fraudulent conveyance claim, Plaintiffs must establish that MBIA Insurance was rendered insolvent by the Transactions. As set forth *supra*, the Insurance Law sets forth the definition of insolvency of an insurance company, and the New York State Legislature vests that determination in the Superintendent. *See, e.g.*, N.Y. Ins. Law §§ 1309 (titled "Insolvency of an Insurer"), 1310 (titled "Impairment of a Stock Insurer"), and Article 74. Thus, Plaintiffs ask this Court both to interpret New York Insurance Law with respect to MBIA Insurance's solvency, and to substitute its judgment on that issue for the Superintendent's.

With respect to the last factor warranting abstention, there is little doubt that insurance is traditionally, and exclusively, a state concern.<sup>11</sup> (*See* Def. Br. at 20-21). This is not a case in which there is a mere "general assertion that insurance law is important to the State," or a "run-of-the-mill contract dispute" for damages. (Pl. Mem. at 19). At issue here are at least three separate and important issues of state concern. First, the integrity of the Superintendent's determinations in approving the Transactions pursuant to his regulatory authority in a complex area of insurance law. Second, the integrity of the system established by the New York State Legislature

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<sup>10</sup> Plaintiffs' argument also ignores their own allegations that at least one of the Transactions violates Insurance Law § 4105 and their reservation of rights to bring claims under this section in this action. (Compl. ¶40).

<sup>11</sup> Plaintiffs' contention that the New York State courts lack specialized expertise in insurance matters is inaccurate. *See Law Enforcement Ins. Co. v. Corcoran*, 807 F.2d 38, 43 (2d Cir. 1986) ("The New York courts have long been active partners in the state's regulatory plan."). In any case, "the absence of consolidation of state court judicial review... has never been thought to be indispensable to *Burford* abstention." *Bethphage Lutheran Serv., Inc. v. Weicker*, 965 F.2d 1239, 1245 (2d Cir. 1992).

for judicial review of determinations of the Superintendent. Third, the strong public interest, as expressed by the Superintendent, in approving these Transactions to unfreeze the municipal bond market so that municipalities could "increase spending for infrastructure projects" such as "building bridges or schools, housing or hospitals." (Siegfried Decl., Exh. B).

Accordingly, abstention under *Burford* and its progeny is squarely appropriate.

### III.

#### **PLAINTIFFS FAIL TO STATE A CLAIM**

##### **A. Plaintiffs Fail to Allege Plausible Facts to Withstand Dismissal of their Fraudulent Conveyance Claims.**

Plaintiffs do not plead facts plausible to support claims under the Debtor and Creditor Law. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555-56 (2007). As discussed in our main brief at 22, Plaintiffs' conclusory allegations that the Transactions render MBIA Insurance insolvent are refuted by the Superintendent's determinations. *See Hirsch v. Arthur Andersen & Co.*, 72 F.3d 1085, 1095 (2d Cir. 1995) (affirming dismissal where "attenuated allegations" supporting plaintiff's claim "are contradicted ... by facts of which we may take judicial notice").<sup>12</sup>

Plaintiffs' opposition papers evidence their recognition that the Complaint fails to plead plausible facts. In a futile effort to prop up their claims, Plaintiffs improperly introduce new documents and facts outside of the four corners of their Complaint. (*See, e.g.*, Pl. Mem. at 12; Shilling Decl., Exhs. C-F). The Court should disregard these documents on this motion. *Metro Furniture Rental, Inc. v. Alessi*, 770 F.Supp. 198, 201 n.2 (S.D.N.Y. 1991).<sup>13</sup>

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<sup>12</sup> The cases relied upon by Plaintiffs for the proposition that insolvency has been properly pled involve transferors in bankruptcy proceedings, where insolvency was established and not in dispute. (Pl. Mem. at 20-23).

<sup>13</sup> Defendants do not respond to the factual arguments made by Plaintiffs based upon these extraneous documents, so as to avoid converting this into a summary judgment motion. *See Livnat v. Lavi*, No. 96 Civ. 4967(RWS), 1998 WL 43221, at \*2 (S.D.N.Y. Feb. 2, 1998). Moreover, under New York law, it is the Superintendent – not this Court or Defendants – to whom Plaintiffs should address their solvency arguments. As noted *supra*, the  
*continued on the following page...*

Similarly, Plaintiffs have not alleged plausible facts of intent to defraud. Each of the "badges of fraud" alleged by Plaintiffs is contradicted by the determinations of the Superintendent, the Department's independent examination, or by undisputed facts. Thus, the Superintendent found that after Transformation, MBIA Insurance would be solvent, that terms of the transfers were reasonable and equitable and that the Transactions between members of the MBIA Group are "fair and equitable." (Siegfried Decl., Exh. A, p. 7). MBIA Insurance, as transferor, did not "retain the use and benefit of the property transferred." Finally, the Transactions were not conducted in secret or "questionable," since they were submitted to the Superintendent and approved by him as required by the Insurance Law. *See N.Y. Dist. Council of Carpenters Pension Fund v. KW Constr., Inc.*, No. 07 Civ. 8008 (RJS), 2008 WL 2115225 (S.D.N.Y. May 16, 2008) (discussing "flip side" of badges of fraud) (citation omitted). In short, there are no plausible facts pled evidencing "badges of fraud."

**B. Plaintiffs Fail to Allege a Plausible Claim for Breach of the Duty of Good Faith and Fair Dealing.**

Plaintiffs also cannot allege plausible facts constituting a breach of the duty of good faith and fair dealing when MBIA Insurance has not defaulted on any of its obligations. Indeed, as Plaintiffs acknowledge, MBIA Insurance has been paying all of its policyholder claims. Any allegation that the Transformation "will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract" is purely speculative. This is especially true in light of the Superintendent's findings that the Transactions left MBIA Insurance with sufficient surplus to satisfy all its obligations, and were "fair and equitable."

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Superintendent has both the requisite expertise and statutory authority to evaluate the solvency of MBIA Insurance and to take appropriate action if he determines that Plaintiffs have – which they do not – a valid solvency concern. Defendants are prepared if there is an oral argument to answer any questions the Court might have regarding the documents, since they actually demonstrate that MBIA Insurance is solvent and fully capable of paying its obligations as the Superintendent found.

While a party is entitled to receive the fruits of its contract, the contract here is the policy.<sup>14</sup> The fruit of the contract is the payment of that principal and interest when due, which Plaintiffs still enjoy, not a particular credit rating. Plaintiffs cite *Dalton v. Educational Testing Service*, 87 N.Y.2d 384 (1995). In *Dalton*, the contractual provision to cancel test scores based on reasonable evidence implied an obligation to consider the evidence presented. Here, the contractual obligation to pay principal and interest does not require that the Company maintain a particular credit rating. Indeed, the Company has honored its payment obligation to policyholders notwithstanding, as Plaintiffs recognize (Compl., ¶34), both pre and post-Transformation downgrades by rating agencies. Thus, a covenant to maintain a particular rating level would be a new independent contract term, not an implied obligation. (Def. Br. at 24-25).

### **CONCLUSION**

Accordingly, for all of the foregoing reasons, and for the reasons set forth in our moving brief, Defendants request that the Complaint be dismissed with prejudice and that they be awarded their costs and expenses and such other relief as the Court deems appropriate.

Dated: May 26, 2009

Respectfully Submitted,

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<sup>14</sup> Plaintiffs again improperly cite to documents (Shilling Decl., Exhs. A and F) extraneous to the Complaint. Neither is the contract between the parties, and Exhibit A does not represent that the company's financials will not change over time.