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

BARBARA R. KAPNICK

PART 39

Index Number : 650557/2009
ASR LEVENSVERSEKERING NV
vs.
BREITHORN ABS FUNDING P.L.C.
SEQUENCE NUMBER : 005
DISMISS ACTION

INDEX NO. 650557/09
MOTION DATE
MOTION SEQ. NO. 005
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

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

Dated: 10/11/13

BARBARA R. KAPNICK J.S.C.
J.S.C.

Check one: ☒ FINAL DISPOSITION ☐ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/ JUDG. ☐ SETTLE ORDER/ JUDG.

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

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ASR LEVENSVERZEKERING NV,
NV AMERSFOORTSE LEVENSVERZEKERING MAATSCHAPPIJ, and
ASR SCHADEVERZEKERING NV,

Plaintiffs,

-against-

SWISS RE FINANCIAL PRODUCTS CORPORATION, AND BANK OF NEW YORK MELLON CORPORATION,

Defendants.

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DECISION/ORDER
Index No. 650557/09
Motion Seq. Nos. 005 and 006

BARBARA R. KAPNICK, J.:

Motion sequence nos. 005 and 006 are consolidated for disposition. In motion sequence no. 005, defendant Swiss Re Financial Products Corporation ("Swiss Re") moves, pursuant to CPLR 3211 (a) (1) and (7), to dismiss the Supplemented and Amended Complaint ("Amended Complaint") as to it. In motion sequence no. 006, defendant Bank of New York Mellon Corporation ("BNYM") moves to dismiss the Amended Complaint as to it.

Background

The Amended Complaint alleges the following four causes of action against Swiss Re: breach of contract (first cause of action); breach of implied duty of good faith and fair dealing (second cause of action); fraud (third cause of action) and negligent misrepresentation (fourth cause of action); and the

following two causes of action against BYNY: breach of contract (fifth cause of action) and breach of fiduciary duty (sixth cause of action).

This action arises out of three principal agreements: 1) a Credit Default Swap Agreement (the "Master Agreement"), dated July 2, 2003, between Swiss Re and non-party Breithorn ABS Funding p.l.c. ("Breithorn ABS"); 2) an Indenture issued that same day by Breithorn ABS and Breithorn ABS Funding LLC (as the Co-Issuer), (collectively, "Breithorn") to JPMorgan Chase Bank ("JPMorgan Chase"), later succeeded by BNYM, as Trustee; and 3) a Collateral Administration Agreement ("Collateral Agreement") between Breithorn ABS and JPMorgan Chase, also dated as of July 2, 2003.

In a credit default swap, the buyer, here Swiss Re, purchases, in return for periodic payments to another party, the seller, here, Breithorn ABS, protection against certain pre-defined credit risks arising from a transaction between the buyer and one or more third parties. The obligations held by the buyer are referred to as the "Reference Pool." *See generally Eternity Global Master Fund Ltd. v Morgan Guar. Trust Co. of New York*, 375 F3d 168 (2d Cir 2004). On or about July 2, 2010, Swiss Re notified Breithorn ABS and BNYM that obligations in the Reference Pool had defaulted; JPMorgan Chase turned over the principal that it had been holding to Swiss Re; and plaintiffs lost their investment.

Discussion

Motion by Swiss Re (Motion Seq. No. 005)

Plaintiffs allege that Swiss Re breached the Master Agreement by, among other things, making a substitution in the reference pool that greatly increased the risk of a default. Inasmuch as plaintiffs are not parties to the Master Agreement, or to the accompanying Credit Support Annex and Schedule, they can have standing to allege a breach of that contract, or of the covenant of good faith and fair dealing that is implied in every contract, only if they are found to be third-party beneficiaries of the Master Agreement. "One who seeks to recover as a third-party beneficiary of a contract must establish that a valid and binding contract exists between other parties, that the contract was intended for his or her benefit, and the benefit was direct rather than incidental." *Edge Mgt. Consulting, Inc., v Blank*, 25 AD3d 364, 368 (1st Dept 2006), *lv dism.* 7 NY3d 864 (2006). "The best evidence of the contracting parties' intent is the language of the agreement itself." *Id.* at 369; *see also LaSalle Natl. Bank v Ernst & Young LLP*, 285 AD2d 101 (1st Dept 2001).

Plaintiffs contend that three passages in the Master Agreement and the Indenture show that the parties thereto intended plaintiffs to be third-party beneficiaries of the Master Agreement. The first of these, which appears in the Preliminary Statement of the Indenture, provides that "[a]ll covenants and agreements made by [Breithorn] herein are for the benefit and security of the

Noteholders [plaintiffs] and the Credit Swap Counterparty [Swiss Re] (collectively, the `Secured parties')." This passage refers, and applies, solely to the Indenture, not to the Master Agreement.

The second passage, upon which plaintiffs relied in their opposition to the initial motion to dismiss the initial Complaint[1], and to which they also refer in their current opposition, appears in section 15.1 of the Indenture. It provides that:

> [Breithorn] ... hereby assigns ... to the Trustee, for the benefit of the Secured Parties, all of the Issuer's ... right, title and interest in, to and under the Master Agreement [and] the Credit Swap, ... including ... (i) the right to give all notices, consents and releases thereunder, [and] (ii) the right to give all notices of termination or default and to take any legal action upon the breach of an obligation of the Credit Swap Counterparty ... including the commencement ... of proceedings at law or in equity ... .

This section assigns certain rights to the Trustee, for the benefit of the Secured Parties, i.e., Swiss Re and plaintiffs. It does not evince any intent by the parties to the Indenture to grant plaintiffs a right to enforce the Master Agreement directly against Swiss Re.

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[1] After the defendants herein and Breithorn, which was then also a defendant, moved to dismiss the initial Complaint, plaintiffs amended their Complaint by Stipulation, which also provided for defendants to move to dismiss the Amended Complaint.

The Schedule to the Master Agreement provides, in Part 5 (15) on page 12, that "[Swiss Re] confirms that it has received and read the provisions of the Indenture relating to this Agreement, and agrees that it shall be bound by and comply with Section 15.4 of the Indenture." Section 15.4 (b) of the Indenture provides that:

> [Swiss Re] acknowledges that [Breithorn ABS] is assigning all of its right, title and interest in, to and under the Credit Swap to the Trustee for the benefit of the Secured Parties, and [Swiss Re] agrees that all of the representations, covenants and agreements made by [it] in the Credit Swap are also for the benefit of the Trustee and the other Secured Parties and [Swiss Re] acknowledges that the Trustee shall have the right to give all notices of termination of the Credit Swap to [Swiss Re] on behalf of [Breithorn ABS].

Thus, in the Master Agreement, Swiss Re acknowledges that Breithorn's assignment of its rights under the Master Agreement to the Trustee, in the Indenture, is for the benefit both of Swiss Re and of plaintiffs. That Swiss Re acknowledges that the assignment of rights in the Indenture is, in part, for the benefit of plaintiffs, however, does not make plaintiffs third-party beneficiaries of the Master Agreement. In addition, Swiss Re acknowledges that the covenants it made in the Master Agreement "are also for the benefit of the Trustee and the other Secured Parties," that is, plaintiffs. The word "and," in the phrase "the Trustee and the other Secured Parties," cannot reasonably be read as meaning that both the Trustee and "the other Secured Parties" are, independently, beneficiaries of Swiss Re's covenants in the

Master Agreement, because there is no sense in which the Trustee can be such a beneficiary.

This phrase, like the beginning of the sentence in which it appears, as well as the other two passages in the Indenture upon which plaintiffs rely, gives certain powers to the Trustee, for the benefit of plaintiffs. What Swiss Re is agreeing to is that in addition to Breithorn's assignment of its rights under the Master Agreement to the Trustee, the Trustee may also enforce Swiss Re's covenants in the Master Agreement on behalf of "the other secured parties." In short, the language of the various agreements among the parties does not evince any intent that plaintiffs be entitled to sue for breach of the Master Agreement.

Neither *Kassover v Prism Venture Partners, LLC* (53 AD3d 444 [1st Dept 2008]), nor *East NY Savings Bank v 520 W. 50th St., Inc.* (160 Misc 2d 789 [Sup Ct, NY Co. 1994]), upon which plaintiffs rely is to the contrary. In *Kassover*, the governing document expressly stated that the shareholders who subsequently became the plaintiffs "shall be a third party beneficiary pursuant to this Agreement." Record on Appeal, at 154. In *East NY Savings Bank, supra* at 792, the governing document provided that "[t]he provisions of the Paragraph are intended for the benefit of present and future mortgagees of the land or building ... and may not be modified or annulled without the prior written consent of such mortgage holder." By contrast, the governing documents here do not

expressly give plaintiffs any right to enforce the Master Agreement.

Plaintiffs argue that, even if the language of the agreements does not show them to be third-party beneficiaries of the Master Agreement, Breithorn ABS was a mere conduit; the principal that plaintiffs paid for the Notes issued by Breithorn ABS constituted the financial basis of the credit protection that Breithorn ABS extended to Swiss Re; and the quarterly payments from Swiss Re to Breithorn ABS were, in turn, paid over to plaintiffs in the form of interest on the Notes that plaintiffs purchased. Accordingly, plaintiffs argue that the circumstances in which the Master Agreement was entered into show that plaintiffs were the true protection sellers, and that Swiss Re and Breithorn ABS intended plaintiffs to be third-party beneficiaries of the Master Agreement.

It is undisputed that plaintiffs were involved, from the start, in structuring the various transactions among the parties. Plaintiffs and Swiss Re, each highly sophisticated commercial entities, chose not to enter into a credit derivative swap between themselves, but instead, to interpose both Breithorn ABS and the Trustee between them. Although derivative swaps are often structured in this way, they need not be. *See e.g. DKR Soundshore Oasis Holding Fund Ltd. v Merrill Lynch Intl.*, 80 AD3d 448 (1st Dept 2011). Plaintiffs are bound by the agreements that they made.

Finally, plaintiffs argue, citing *Fourth Ocean Putnam Corp. v Interstate Wrecking Co.* (66 NY2d 38 [1985]), that they should be recognized as third-party beneficiaries of the Master Agreement, because no other party can recover for Swiss Re's alleged breaches thereof. *Fourth Ocean* does not hold, however, that the mere fact that no one, other than the plaintiff, can recover for an alleged breach of contract is a sufficient basis for the plaintiff to be deemed a third-party beneficiary of the contract. Rather, the case holds that, in some circumstances, that fact may be considered as evidence that the parties intended the plaintiff to be a third-party beneficiary. However, a plaintiff can be a third-party beneficiary of a contract only if "`the contract was intended for his benefit and ... the benefit to him is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate him if the benefit is lost.'" *State of Cal. Pub. Employees' Retirement Sys. v Shearman & Sterling*, 95 NY2d 427, 434-435 (2000) (citation omitted).

A plaintiff is a third-party beneficiary only if the parties to the contract had a "clear intention to confer the benefit of the promised performance" upon the plaintiff. *PT. Bank Mizuho Indonesia v PT. Indah Kiat Pulp & Paper Corp.*, 25 AD3d 470, 471 (1st Dept 2006). Here, there is no indication that Swiss Re and Breithorn ABS intended plaintiffs to have any rights to Swiss Re's performance of its obligations under the Master Agreement, other

than by the Trustee's exercise of the rights expressly set forth in the Indenture.

Plaintiffs' additional contention, that the Trustee could not have commenced an action on their behalf, because Swiss Re, as the holder of all the Notes of the Controlling Class, governed any action that the Trustee might take with regard to such litigation, is no more than a retroactive attempt to change the terms pursuant to which plaintiffs purchased their Notes. Plaintiffs made their purchase with full knowledge that, as the holder of Class A Notes, Swiss Re would have effective control of the Trustee. *See* Confidential Offering Circular, Howell Affirm., Exh. 4, at 56, and Indenture, at 18 (definition of "Controlling Class").[2] Moreover, it is undisputed that plaintiffs never asked the Trustee to act on their behalf. Accordingly, their claim that any such request would have been futile is conclusory.

Plaintiffs' fraud and negligent misrepresentation claims allege that Swiss Re issued false and misleading broker quotes as to the market value of plaintiffs' Class B Notes, and that, as both the initial Complaint and the Amended Complaint state, had Swiss Re issued broker quotes "reflecting the actual market value of the Class B Notes ... [p]laintiffs would have immediately sought to

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[2] The parties have stipulated that documents submitted on the initial motions to dismiss are deemed resubmitted on the instant motions.

sell the Class B Notes back to [Swiss Re], found another buyer on the secondary market for the Class B Notes, or taken other actions to mitigate their damages." (Amended Complaint, ¶ 118).

At the time that plaintiffs filed their initial Complaint, dated September 9, 2009, these claims would clearly have been barred by the out-of-pocket rule. *See Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413 (1996); *Starr Found. v American Intl. Group, Inc.*, 76 AD3d 25 (1st Dept 2010). In *Starr*, the plaintiff alleged that it had been induced to set an excessively high minimum price at which it would sell its AIG stock by misrepresentations made as to the risk attached to AIG's credit default swap portfolio, and that it had been damaged by holding that stock as its value plummeted. The Court held that such a "holder's" claim fails, as a matter of law, because "under the out-of-pocket rule `the loss of an alternative contractual bargain ... cannot serve as a basis for fraud or misrepresentation damages because the loss of the bargain was "undeterminable and speculative."'" *Id.*, at 27-28, quoting *Lama Holding Co., supra* at 422, quoting *Dress Shirt Sales v Hotel Martinique Assoc.*, 12 NY2d 339, 344 (1963).

Plaintiffs' claim here, that they were induced to hold the Notes by misrepresentations of their value, suffers from exactly the same infirmity as the claim in *Starr*, that is, that the price at which plaintiffs could have sold the Notes at any particular time is indeterminable. Indeed, plaintiffs' claim here is even

more speculative than that of Starr Foundation because, in the instant action, the very existence of a secondary market for the Notes is indeterminable.

However, now that plaintiffs have lost their entire investment, their claim is closer to the claim of the plaintiffs in *Continental Ins. Co. v Mercadante* (222 App Div 181 [1st Dept 1927]) rather than to the plaintiff in *Starr*. The *Mercadante* plaintiffs claimed that they had purchased bonds with the intention of selling them before maturity, if the obligor's financial condition deteriorated, and that on the basis of misrepresentations as to the obliger's earnings and solvency they continued to hold the bonds and, indeed, to exchange them for other securities, which became substantially worthless. The *Starr* Court distinguished *Mercadante* on the grounds that the measure of damages in that case was the loss of plaintiff's investment, rather than "the amount for which the bonds could have been sold at some point before they lost their value." *Starr Found. v American Intl. Group, Inc., supra* at 33. While the *Starr* Court cast doubt on the "continuing vitality of *Mercadante*" (*id.* at 33), the Court did not overrule it, and this Court remains bound by it. To be sure, plaintiffs' formulation of their claim posits their damages as the loss of an opportunity to sell the Notes before they became worthless, a claim squarely barred by *Starr*. However, the factual allegation in the Amended Complaint, that plaintiffs have lost their entire investment, brings their claim within the rule of *Mercadante*.

Nonetheless, plaintiffs' fraud claim, as well as their negligent misrepresentation claim, must fail, because they cannot show that they reasonably relied upon the broker's quotes that they were given by Swiss Re. Plaintiffs do not dispute that the new obligations in the reference pool to which they attribute the precipitous decline in the value of the Notes (the "new Cheetahs") were identified by name in the Trustee's reports that were provided to plaintiffs, that the portfolios of those obligations were available on the Bloomberg Professional Service, and that the underlying bonds in those portfolios were traded on the open market. *(See,* Exhs. 18-20 of the Affidavit of Michael Minnich, Managing Director of Swiss Re, dated November 13, 2009). Accordingly, plaintiffs had the ability to gauge for themselves the changing value of the Notes. *See Stollsteimer v Kohler,* 77 AD3d 1259(3d Dept 2010); *Howard v Weaver,* 244 AD2d 225 (1st Dept 1997).

Motion by BNYM (Motion Seq. No. 006)

The contracts that plaintiffs allege BNYM to have breached are the Master Agreement and the Collateral Agreement. As discussed above, plaintiffs are neither parties to, nor third-party beneficiaries of, the Master Agreement. The Collateral Agreement requires the Trustee to monitor the Reference Pool held by Swiss Re on an ongoing basis, and to submit to Breithorn ABS and to Swiss Re certain calculations of, and reports concerning, the Reference Pool. Plaintiffs are also not parties to that contract; nor are

they referred to therein. Plaintiffs' sole argument in support of their contention that they are third-party beneficiaries of the Collateral Agreement is that the Trustee's performance of its terms, as those terms are understood by plaintiffs, would have benefitted plaintiffs. However, the potential receipt of benefits alone does not establish third-party beneficiary standing. *LaSalle Natl. Bank v Ernst & Young, supra* at 108 ("the parties' intent to benefit the third party must be apparent from the face of the contract"); *see also Aymes v Gateway Demolition Inc.*, 30 AD3d 196 (1st Dept 2006).

Plaintiffs' contention that the Trustee owed them a fiduciary duty is based upon section 6.1 (g) of the Indenture. That subsection provides, in relevant part, that "[w]ith respect to the security interests created hereunder, the Trustee acts as a fiduciary for the Noteholders only ... ." However, section 6.1 (a) of the Indenture provides that:

> Except during the continuance of an Event of Default:
>
> (i) the Trustee undertakes to perform such duties and only such duties as are specifically set forth in this Indenture, and no implied covenants or obligations shall be read into this Indenture against the Trustee.

While an Event of Default occurred in July 2010, the Amended Complaint alleges no violation of fiduciary duty in relation to that Event. Plaintiffs' complaints pertain to an earlier time, in

relation to which plaintiffs have not alleged that there was a continuance of an Event of Default under the Indenture.

Plaintiffs further argue that section 16.1 (d) of the Indenture required the Trustee to act so as to protect plaintiffs' interests. That section provides that, if the Credit Swap becomes subject to early termination, "the Issuer and the Trustee shall take such actions ... to enforce the rights of the Issuer and the Trustee thereunder ... as may be permitted ... ." The section does not refer to plaintiffs.

Finally, in this regard, plaintiffs contend that BNYM was required to protect their interests on the occurrence of a Mandatory Redemption Event. However, the occurrence of such an Event gives no rights to plaintiffs. Rather, it "entitles [but does not require Swiss Re] or [Breithorn] to cause an early termination of the Credit Swap," in certain circumstances. (Indenture Agreement at 30, definition of "Mandatory Redemption Event").

Moreover, in connection with Breithorn's assignment of the Master Agreement and certain other agreements to the Trustee, section 15.2 of the Indenture provides that:

> The assignment made hereby is executed as collateral security, and the execution and delivery hereby shall not in any way impair or diminish the obligations of the Issuer under the provisions of the Credit Swap ... nor

shall any of the obligations contained in the Credit Swap ... be imposed on the Trustee.

This collateral assignment of rights does not shift to the Trustee the obligations of Breithorn under the Master Agreement. "[T]he assignee of rights under a bilateral contract does not become bound to perform the duties under that contract unless he expressly assumes to do so." *Sillman v Twentieth Century-Fox Film Corp.*, 3 NY2d 395, 402 (1957) (citations omitted).

Conclusion

Accordingly, based on the papers submitted on the initial three motions to dismiss as well as the two motions dealt with herein, and the oral arguments held on May 5, 2010 and February 28, 2011, the motions by defendants Swiss Re Financial Products Corporation and Bank of New York Mellon Corporation to dismiss this action are granted in their entirety and the action is dismissed with prejudice and without costs or disbursements.

The Clerk is directed to enter judgment accordingly.

This constitutes the decision and order of this Court.

Date: October 11, 2011

Barbara R. Kapnick
J.S.C.

BARBARA R. KAPNICK
J.S.C.