2012 NY Slip Op 51310(U)

WT HOLDINGS, INCORPORATED, Plaintiff, v. ARGONAUT GROUP, INC., Defendant.

600925/2009.

Supreme Court, New York County.

Decided July 10, 2012.

Steven C. Schwartz, David I. Wax, Lock Lord LLP, 3 World Financial Center, New York, NY 10281, for Plaintiff.

Peter Flocos, Michael E. Waller, Justin H. Roeber, K & L Gates LLP, 599 Lexington Avenue, New York, NY 10022, for Defendants.

BERNARD J. FRIED, J.

These competing motions — defendant's motion and plaintiff's cross-motion — for summary judgment arise in a contract action by which plaintiff WT Holdings, Inc. (WT) seeks indemnification, pursuant to Article 10 of a November 5, 2007 stock purchase agreement (SPA). Pursuant to the SPA, WT, as the acquiror, merged with PXRE Reinsurance Company (PXRE). Defendant Argonaut Group, Inc. (Argonaut) was the ultimate parent of PXRE, and guaranteed the indemnification provisions of Article 10. After the merger, the combined entity changed its name to the Argo Group, Inc. Both motions are denied. Questions of fact are presented whether WT incurred any losses, as that term is defined in the SPA, and whether any such losses were caused by the falsity of any representation made by PXRE in the SPA.

At the time of the merger, PXRE was a reinsurance company in runoff, having stopped issuing new policies because of catastrophic hurricane losses incurred in 2006. In 2001, PXRE wrote eight reinsurance contracts (the reinsurance contracts) to four Lloyd's syndicates. The reinsurance contracts covered the airplanes that later became involved in the World Trade Center (WTC) attack, including coverage for both the loss of the airplanes and for damages to third parties. The aggregate exposure of the reinsurance contracts was finite, being limited to $25,156,950.

PXRE's case reserves totaled $12,040,496, leaving $13,116,454 in potential claims for which PXRE did not have a case reserve booked at the time of the acquisition. In addition to case reserves, WT also booked reserves for claims that may have been incurred but not reported (IBNR), which can be either case or bulk IBNR reserves. PXRE also set an additional category of IBNR reserves called "catastrophe additional case reserves" (CACR) which is added to bulk IBNR to get total IBNR (*see* ex. 5 to mov. aff.). Total reserves are comprised of case reserves plus IBNR reserves.

In addition to the case reserves of $12.04 million relating to the reinsurance contracts, PXRE carried IBNR reserves of approximately $11.4 million, which covered losses to property. After the closing, WT reduced these IBNR reserves by $11.4 million because it believed that they were "likely to be unnecessary" (pltff.'s response to dfdt.'s Rule 19-a statement, ¶¶ 29 and 30), and increased its case reserves for aviation claims by $11.8 million (*id*. at 35).

WT has stipulated that, as of the date of service of its interrogatory responses, it has paid $6.275 million in claims, out of approximately $13 million in case reserves that PXRE had booked for the WTC exposures (pltff.'s response to dfdt.'s Rule 19-a statement, ¶ 82). WT acknowledges in its Rule 19-a statement that it

has not paid any claims on five out of the eight contracts, and, on the remaining three contracts, WT has paid $775,000 in excess of the case reserves set by PXRE (*id*., ¶ 83).

WT contends that PXRE was required to set case reserves for two losses rather than one, under the reinsurance contracts. The cedents took the position that the crash of each of the two jets into the WTC constituted a separate loss, so that PXRE was potentially liable for two losses under the terms of each contract, and this was reflected in the amounts stated on the broker's advices. It argues that PXRE was contractually required to set reserves in accordance with broker's advices, and that PXRE represented that such was its practice.

WT alleges that the documentation that PXRE provided in the course of due diligence concealed the fact that PXRE had received broker's advices for two rather than one loss. PXRE set case reserves on the basis of one rather than two losses, taking the position that the WTC events constituted terrorism, which does not constitute two losses, rather than hijacking.

Pursuant to the "General Conditions" section of each of the reinsurance contracts, specified clauses, known as "London Standard Writings" (LSW), are incorporated by reference into each contract. One such clause, LSW 339, captioned, "Hijacking Clause (all Losses)," provides, as pertinent, that the indemnity shall apply "to the total of all losses... which are covered hereunder and which arise out of or follow from each act of hijack separately..." (ex. 48 to Schwartz aff.). There is no such clause for losses caused by acts of terrorism. In setting the case reserves, PXRE took the position that the losses were caused by terrorism rather than hijacking.

All eight of the reinsurance contracts contain LSW 343, which requires that PXRE "follow the settlements." WT argues that PXRE had to consider this provision in setting its reserves because, if its cedents settle on the basis of two indemnities, PXRE would also be required to pay on that basis, and should reserve accordingly.

WT seeks $13.1 million in indemnification, in the form of damages for the benefit of its bargain, representing the difference between the case reserves and the total amounts of potential losses as indicated in broker advices.

WT argues that the following four representations and warranties contained in section 2.6 (e) of the SPA were materially false. These state, as pertinent, that PXRE's reserves

> were (i) determined in accordance with U.S. generally accepted actuarial standards... (ii) were based on actuarial assumptions that were reasonable in relation to the relevant policy and contract provisions... (iii) reflect each policy, contract and claim in the books and records of the Company that should, in accordance with U.S. generally accepted actuarial standards, applied on a consistent basis for the periods presented, have a reserve or other liability reflected in such Statutory Statement, and (iv) are in compliance in all material respects with the requirements of Applicable Law

(ex. 1 to Schwartz aff.).

WT also argues that PXRE falsely represented in section 2.6 (h) of the SPA that it had

> furnished to [WT] complete, true and correct copies of all documents and records of [PXRE] relating to claims and historical loss data. Such documents and records reflect all information provided to [PXRE] concerning claims and historical losses

(*id*.).

WT's indemnification rights are governed by section 10.3 (a) of the SPA, which provides, as pertinent, that WT

> agrees that its sole and exclusive remedy under [the SPA]... shall be under the indemnification provisions set forth in this Article X, and that such remedy shall be exercised solely by means of the exercise of its rights and remedies thereunder. In furtherance of the foregoing, [WT] hereby waives... to the fullest extent permitted under Applicable Law, any and all rights, claims and causes of action related to the transactions contemplated by this Agreement...

(ex. 1 to Schwartz aff.).

Section 10.1 of the SPA, captioned, "Indemnifiable Claims," provides, as pertinent, that the seller shall indemnify the buyer "from and against any and all Losses incurred by the Buyer... after the Closing Date... arising from (i) any inaccuracy of any representation... of the Seller." "Loss" or "losses" is defined by section 11.12 (kkk) of the SPA as "any liability, loss, damage, claim, cost or expense," and is further defined to include the cost of investigation, and counsel fees and disbursements.

Section 10.3 (c) of the SPA provides, as pertinent:

> in no event shall any Indemnifying Party be liable for any Losses representing indirect, special, incidental, consequential, or punitive damages or losses including, without limitation, lost profits.

In order to prevail on its motion for summary judgment, WT must first demonstrate as a matter of law that it suffered a loss, as that term is defined, as a result of the falsity of any of the five representations listed above, and Argonaut, to prevail on its summary judgment, must demonstrate as a matter of law that WT did not incur such a loss.

WT argues that benefit of the bargain damages are allowable because they do not fall within any of the categories of damages listed in section 10.3 (c), which provides that the indemnifying party shall not be responsible for "any Losses representing indirect, special, incidental, consequential, or punitive damages, or losses including, without limitation, lost profits" (ex. 1 to Schwartz aff.). WT argues further that benefit of the bargain damages may be a proper subject of indemnification under that part of the definition of "loss" that includes "damage," because the fact that it is in the singular does not change its intent. WT contends further that it is entitled to damages measured by the benefit of its bargain, or else it "would have no remedy for Argonaut's breach of warranty" (WT reply brief, at 14). This is not accurate. WT has exactly the remedy it agreed to in the SPA — indemnification for any "losses" caused by any breach of warranty by Argonaut.

WT's construction of the word "damage" in the definition of "loss" is untenable in light of the waiver in section 10.3 (a), quoted above, of "any and all rights, claims and causes of action related to the transactions contemplated by this Agreement." WT's claim for damages for loss of the benefit of its bargain is, in essence, a cause of action for damages for breach of contract, measured by the benefit of its bargain, and has been expressly waived by WT in the SPA. In light of WT's broad waiver of all causes of action, and consequential, indirect and incidental damages, Argonaut has demonstrated as a matter of law that WT is not entitled to indemnification measured by the benefit of its bargain.

Thus, WT's remaining claims require a showing that it suffered a loss, as that term is defined, as a result of the falsity of a representation by PXRE in the SPA.

The definition of "loss" is ambiguous, given the obvious tautalogy of defining a loss as a loss. The parties certainly did not intend that WT would be entitled to indemnification for every loss it paid under the

reinsurance contracts. Whether indemnification was only intended for losses paid in excess of case reserves on each reinsurance contract is a more reasonable construction, but neither party has established the meaning of the defined term as a matter of law (*see Mathey v Metropolitan Transp. Auth.*, 95 AD3d 842 [2d Dept 2012]).

WT argues that the inclusion of "liability" in the definition of loss means that the parties intended the indemnification provisions to cover its claims in this action because reserves are booked as a liability in insurance accounting. WT has not established this contention as a matter of law. Even if the meaning of "liability" in the definition of "loss" includes reserves, it would not require indemnification for "any reserve."

Neither party has established its entitlement to judgment as a matter of law on the issue of whether PXRE has incurred any losses, as that term is defined in the SPA, caused by WT's alleged misrepresentations in the SPA. Nor has either party established as a matter of law whether PXRE's reserving practices complied with the standards stated in the SPA. The expert testimony raises factual issues on that question.

PXRE's representation in the first subdivision of section 2.6 (e), that its reserves were "determined in accordance with U.S. generally accepted actuarial standards," is problematic because, unlike the similar sounding standards for the accounting and auditing professions, there is no compendium that is named "generally accepted actuarial standards." The several experts who have submitted opinions on these motions agree that there are other authoritative texts that provide guidance as to standards, but the experts have submitted opposing opinions as to whether PXRE's reserving practices met applicable professional standards. Even if WT had established as a matter of law that PXRE's reserving practices had not conformed to the represented standard, WT has not established as a matter of law that it suffered any loss caused by any falsity of PXRE's warranties as to its reserving practices.

Factual issues are presented whether PXRE accurately represented in the second subdivision of 2.6 (e), that its reserves "were based on actuarial assumptions that were reasonable in relation to the relevant policy and contract provisions," and also with respect to the third subdivision, which provides that PXRE's reserves "reflect each policy, contract and claim in the books and records of the Company that should, in accordance with U.S. generally accepted actuarial standards, applied on a consistent basis for the periods presented, have a reserve or other liability reflected in such Statutory Statement." Neither party has demonstrated as a matter of law that PXRE failed to have a proper reserve reflected in its Statutory Statements for each "policy, contract and claim" on its books.

Similarly, neither party has established as a matter of law whether PXRE complied with the extremely broad requirement of section 2.6 (h) of the SPA that it furnish "copies of all documents and records of the Company relating to claims and historical loss data" (ex. 1 to Schwartz Aff.). Even if WT had made such a showing as a matter of law, it has not demonstrated as a matter of law that it incurred any "loss," as that term is defined, caused by PXRE's non-production.

WT also has not demonstrated as a matter of law that PXRE violated the applicable Connecticut statute, which requires it to "maintain reserves equal in amount to its liability under all its policy contracts" (Conn Gen. Stat. § 38a-76 [a]). The statute does not distinguish between case reserves and total reserves, and WT has not demonstrated as a matter of law that the total reserves of PXRE are not "equal in amount to its liability under all its policy contracts" (*id.*).

Indemnity contracts are strictly construed "to achieve the apparent purpose of the parties," and "to avoid reading into it a duty which the parties did not intend to be assumed" (*Hooper Assoc. v AGS Computers*, 74 NY2d 487, 491 [1989]). "Although the words might seem to admit of a larger sense, yet they should be restrained to the particular occasion and to the particular object which the parties had in view [internal quotation marks and citation omitted]" (*id.*). Whether WT is entitled to indemnification on this record cannot be determined as a matter of law.

Accordingly, it is

ORDERED that the motion of defendant Argonaut Group, Inc. for summary judgment (CPLR 3212) dismissing the complaint is denied; and it is further

ORDERED that the cross-motion of plaintiff WT Holdings, Incorporated for summary judgment (CPLR 3212) on its complaint is denied.