[Bond Case Briefs]

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[UBS On Its Own For Debt Bonds Defense, Insurers Say.]

Law360, New York (July 31, 2017, 5:02 PM EDT) — Insurers asked a Puerto Rico federal court Friday to shut down a $20 million suit by a UBS AG unit seeking coverage for claims UBS caused investors billions of dollars in losses by manipulating Puerto Rico's municipal debt bond market, citing an exclusion tailor-made for exactly those claims.

XL Specialty Insurance Co. had sold UBS Financial Services Inc. of Puerto Rico a $10 million financial services liability primary policy in 2012 covering the years 2013 to 2014, alongside two $5 million excess policies issued by Axis Reinsurance Co. and Hartford Fire Insurance Co.

The policies were issued in the wake of a string of scandals over UBS' allegedly deeply flawed and conflicted practices surrounding the bank's $10 billion closed-end funds holding Puerto Rican municipal debt, which came to a head in 2011.

"Not surprisingly, UBS found itself shopping for new insurance in 2011," the insurers said Friday. They eventually agreed to issue the Swiss banking giant's subsidiary new policies, but included a purportedly iron-clad exclusion for claims "in any way involving" the closed-end fund debacle.

UBS has since been hit with another wave of claims over its closed-end funds — the bank is facing $1.9 billion in claims as of last year and has already paid out $740 million to settle some of them, according to an SEC filing — and is trying to defray those costs by seeking coverage under the new policies. Not so fast, said the insurers, citing the exclusion.

"The undeniable ties between the [new closed-end fund claims] and the prior [closed-end fund claims] more than meet the low threshold to trigger the unambiguous language of the specific litigation exclusion," the insurers wrote in Friday's summary judgment bid. "The Insurers are entitled to have the policies' terms enforced according to their plain language."

The claims at issue all stem from UBS' alleged mismanagement of the closed-end funds and a series of allegedly misleading statements UBS made to entice investors to buy into them.

UBS acted as the underwriter for "highly risky" municipal debt bonds then treated the highly leveraged closed-end funds as a "dumping ground" for the bonds, while manipulating the secondary market in the closed-end fund notes to prop up the price of the funds and make them seem liquid, according to court documents.

UBS then continued to portray the closed-end funds as solid investments to both retirees and the island's upper crust, according to court documents, even as the bank internally sounded the alarm bell about the underlying government bonds and began exiting UBS' own positions in them.

Several lawsuits, dozens of Financial Industry Regulatory Authority arbitration episodes, and investigations by the U.S. Securities and Exchange Commission and the U.S. Department of Justice, among others, have dogged the bank since 2009 over its role in the funds.

By the time UBS negotiated its new batch of insurance policies with XL Specialty, Axis and Hartford in 2012, UBS had put some of those claims behind it, while others were ongoing and still others were yet to be filed.

UBS settled an investigation with the SEC in 2012, for example, agreeing to pay a total of $27 million and sign a cease-and-desist order. The same year, two proposed class actions were filed in federal court against the bank and some of its senior managers in Puerto Rico.

Then the island's entire debt market took a nosedive in 2013, roiled by media reports of Puerto Rico's precarious economic and financial situation. The event marked the beginning of the island's yearslong slide into quasibankruptcy under the Puerto Rico Oversight, Management and Economic Stability Act.

UBS has said that the 2013 Puerto Rican bond market crash also "provides both a temporal and causal break" between the earlier closed-end fund claims and the ones that continued to pour in after the crash.

In a deposition taken in the current coverage dispute, which UBS filed in 2015, the bank testified that the post-2013 claims "resulted because customers lost money in the market crash, and UBS did not cause the market crash," the insurers' motion said.

However, the insurers said the crash is irrelevant since the post-2013 claims still reference the bank's alleged misbehavior with its closed-end funds. The insurers also pointed to UBS' successful dismissal of one proposed class action against the bank last year, Fernandez v. UBS AG, as proof that UBS does not even believe its own argument.

The bank got Fernandez — filed in 2014 — dismissed mainly by arguing that the investors' claims were barred by the statute of limitations, since the investors should have known about the problems with the closed-end funds after suits began appearing in 2009. The Fernandez case is one of several that UBS is seeking coverage for under the 2013 policies.

"Given its prior, successful arguments to the contrary, UBS is now judicially estopped to assert that the [currently disputed suits] and [pre-2013 suits] are unrelated," the insurers said.

Neither side responded Monday to requests for comment.

UBS is represented by Jaime E. Toro-Monserrate and Nayda I. Perez Roman of Toro Colon Mullet Rivera & Sifre PSC and Michael I. Verde, David L. Goldberg, Tenley Mochizuki and Philip A. Nemecek of Katten Muchin Rosenman LLP.

XL Specialty is represented by Kimberly M. Melvin, Cara Tseng Duffield, John E. Howell and Karen L. Toto of Wiley Rein LLP. Hartford Fire is represented by Douglas M. Mangel, Joshua E. Holt and Joshua D. Weinberg of Shipman & Goodwin LLP. Axis is represented by Michael R. Goodstein and James M. Young of Bailey Cavalieri LLC. The insurers are also represented jointly by Francisco E. Colon-Ramirez of Colon Ramirez LLC.

The case is UBS Financial Services Inc. of Puerto Rico et al. v. XL Specialty Insurance Co. et al., case number 3:15-cv-03099, in the U.S. District Court for the District of Puerto Rico.

By Ryan Boysen

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