

Bond Case Briefs

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BOND INSURANCE - LOUISIANA

New Orleans City v. Ambac Assur. Corp.

United States Court of Appeals, Fifth Circuit - March 2, 2016 - F.3d - 2016 WL 825388

To help fund a pension plan for firefighters, the City of New Orleans decided to issue municipal bonds in December 2000. City officials enlisted the help of an accounting firm, three law firms, and a financial advisory firm to consult in the bond issuance. At the time, the City's credit rating was just above "junk" status. The City contracted with Ambac Assurance Corporation to provide municipal bond insurance. The City paid Ambac a nonrefundable, up-front premium of \$6,388,658.80 for the Municipal Bond Insurance Policy. Under the Policy, Ambac guaranteed payment of principal and interest to the bondholders in the event of non-payment by the City. When the Policy was issued, Ambac enjoyed a Aaa credit rating from Moody's.

Starting in late 2007, securities analysts and market commentators began to question the exposure of bond insurers to sub-prime residential mortgage backed securities and similar consumer finance asset-backed securities. As a result, Ambac's credit rating began to fall. As Ambac's credit rating fell, so too did the rating of the City's bonds, despite not missing a payment to the bondholders. The bonds became costlier for the City to service, and Paine Webber eventually stopped remarketing them. Consequently, the City has paid tens of millions of dollars in additional debt service and refinancing costs.

The City brought action against Ambac alleging breach of agreement to provide credit enhancement, bad faith, and misrepresentations as to value of insurer's credit enhancement product. The United States District Court granted insurer's motion to dismiss. City appealed.

The Court of Appeals held that:

- No larger credit enhancement agreement bound insurer under policy;
- Any error by city as to what it was purchasing was unilateral error that did not vitiate city's consent; and
- City did not sufficiently allege detrimental reliance cause of action.

Under municipal bond insurance policy, pursuant to which insurer guaranteed payment to bondholders of principal and interest if city failed to make such payment, no larger credit enhancement agreement bound insurer, precluding city's Louisiana-law breach of contract claim. Policy made no mention of such agreement, no written statement recognizing existence of such agreement was attached to policy, insurer was only party to policy and surety bonds, rendering other alleged agreements mentioning such agreement irrelevant in this analysis, city's use of term "credit enhancement device" to describe policy did not create any obligation for insurer, and city failed to provide sufficient factual allegations to support existence of oral agreements with insurer.

Any error about what city was purchasing when it paid insurer more than six million dollars for municipal bond insurance policy was unilateral error by city, and such error was neither reasonable nor excusable, and thus error did not vitiate city's consent, precluding its claim for damages under Louisiana contract law. Policy's clear language promised municipal bond insurance, not credit

enhancement, and insurer's marketing of policy as form of credit enhancement and its assistance in drafting city's resolutions did nothing to support belief that city was purchasing larger agreement for credit enhancement.

City did not allege sufficient facts that insurer represented that it would maintain its credit and underwriting standards for term of municipal bonds, precluding its Louisiana-law detrimental reliance claim against insurer, as related to municipal bond insurance policy, where city's resolutions showed only that city purchased policy from highly-rated insurer, which, at time of issuance, lessened perceived credit risk of city's bonds, and any alleged representation by insurer to provide larger credit enhancement was foreclosed by clear policy language.

Even if city sufficiently pled that insurer represented that it would maintain its credit and underwriting standards for term of municipal bonds, city was not reasonable in relying on such representations, precluding its Louisiana-law detrimental reliance claim against insurer, as related to municipal bond insurance policy, where insurer made only general statements in its annual reports and references to term credit enhancement in city's resolutions, and city and insurer were sophisticated parties that engaged in arm's-length negotiations with respect to bond offering.