UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

In re:

TAYLOR, BEAN & WHITAKER MORTGAGE CORPORATION,

Case No.: 3:09-bk-7047-JAF

Debtor.
_____/

CERTAIN UNDERWRITERS AT LLOYD'S, LONDON AND LONDON MARKET INSURANCE COMPANIES, etc.

Plaintiffs,

v.

Adv. Pro. No. 3:10-ap-243-JAF

TAYLOR BEAN & WHITAKER MORTGAGE CORPORATION, FEDERAL HOME LOAN MORTGAGE CORPORATION, GOVERNMENT NATIONAL MORTGAGE ASSOCIATION, and SOVEREIGN BANK,

Defendants.
_____/

ORDER DENYING MOTION TO DISMISS DEFENDANT FEDERAL HOME LOAN MORTGAGE CORPORATION'S COUNTERCLAIM

This proceeding is before the Court upon the Motion to Dismiss Defendant Federal Home Loan Mortgage Corporation's ("Freddie Mac") Counterclaim (Docs. 234, 235), filed by Counterclaim-Defendants, Certain Underwriters of Lloyd's, London and London Market Insurance Companies (collectively, the "Underwriters"). Also before the Court is Counterclaim-Defendant, Taylor Bean & Whitaker Mortgage Corporation's ("TBW"), Motion to Dismiss Freddie Mac's Counterclaim (Doc. 236).[1] Freddie Mac filed a consolidated response in opposition to the Motions to Dismiss (Doc. 254). Both the Underwriters and TBW filed reply briefs to Freddie Mac's

[1] Hereinafter, the Court will refer to the instant motions collectively as the "Motions to Dismiss."

consolidated response in opposition (Docs. 260, 263). For the reasons stated herein, the Motions to Dismiss (Docs. 234, 236) will be denied.

Background

On August 24, 2009, TBW filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code, thereby commencing Case No. 3:09-bk-7047-JAF. Included in the assets of TBW's bankruptcy estate are certain fidelity bonds and insurance policies that cover TBW and other affiliated entities for various types of losses attributable to employee dishonesty (collectively, the "Bonds").[2] In August, 2009, TBW submitted a preliminary claim under the Bonds, alleging that its former officers, directors, and shareholders engaged in a knowing scheme to misappropriate large sums of money for the benefit of themselves and TBW (Doc. 184 at 4).[3]

The Underwriters' Bonds provided base level, or primary, coverage and also the first level of excess coverage (Doc. 184, Exs. 1-17). Subject to certain exceptions not material to the Motions to Dismiss, the Bonds providing excess coverage mirror the terms of the primary Bonds (*see* Doc. 184, Exs. 1-17). The Bonds also provide that "any dispute concerning interpretation" of the Bonds "shall be governed by the laws of Florida" (Doc. 184-6 at 54).

[2] The Bonds are more particularly described in the Underwriters' Second Amended Complaint (Doc. 184 at 2-3). The Underwriters subscribe to the Bonds.

[3] On June 15, 2010, Lee B. Farkas, TBW's former Chairman, was indicted by the federal government for conspiracy, bank fraud, wire fraud, and securities fraud (Doc. 184-8 at 2-31). *See also United States v. Farkas*, Case. No. 1:10-CR-200-LMB (E.D. Va. June 15, 2010). On April 19, 2011, Mr. Farkas was found guilty of fourteen (14) counts related to conspiracy, bank fraud, wire fraud, and securities fraud (Doc. 184-8 at 72-76).

In this Adversary Proceeding, the Underwriters contend, *inter alia*, that TBW, in its initial applications for coverage under the Bonds, failed to disclose to the Underwriters the conduct upon which TBW relies to establish coverage (Doc. 184 at 2-3, 30). The Underwriters joined Freddie Mac in this proceeding seeking, among other forms of relief, a declaration that TBW's alleged material misrepresentations and omissions void the Bonds and/or preclude coverage (Doc. 184 at 28-33). In response, TBW filed a counterclaim against the Underwriters (Doc. 218) asserting, *inter alia*, a breach of their respective insurance contracts for their collective failure to cover TBW's losses. For its part, Freddie Mac filed a counterclaim against TBW and the Underwriters (Doc. 213, the "Counterclaim") seeking, among other forms of relief, a reformation of the 2008 Primary Bond and a declaratory judgment with respect to the 2008 Primary Bond and the 2008 First Excess Bond (collectively, the "2008 Bonds"). The 2008 First Excess Bond is a "follow form" policy to the 2008 Primary Bond, meaning the terms and conditions of the 2008 Primary Bond apply equally to the 2008 First Excess Bond, unless otherwise indicated.

Freddie Mac is a corporate instrumentality of the United States. Freddie Mac purchases mortgage loans from seller/servicers and contracts with those seller/servicers to service the loans (Doc. 213 at 25). Freddie Mac states the seller/servicers agree to sell and service mortgages pursuant to the terms and conditions contained in certain purchase documents (collectively, the "Purchase Documents") consisting of, among other things, a purchase contract, Freddie Mac's Single-Family Seller/Servicer Guide (the "Guide"), and various bulletins issued periodically by Freddie Mac to its seller/servicers that supplement the parties' agreement as set forth in the Purchase Documents (Doc. 213 at 25-26). TBW was one such seller/servicer.

Freddie Mac maintains the business relationship between itself and TBW was governed by, among other things, the Guide (Doc. 213 at 27). The Guide apparently sets forth requirements with which TBW was obligated to comply. It required, among other things, that TBW obtain fidelity insurance coverage to "[p]rotect Freddie Mac, as an investor, against losses that Freddie Mac incurs in connection with dishonesty, theft and/or fraud committed by any partner, sole proprietor or major shareholder of the Seller/Servicer" (Doc. 213 at 27). Freddie Mac states the Guide further requires that the fidelity insurance:

> [g]ive Freddie Mac, as an investor, the right to file a claim directly with the insurer for losses that Freddie Mac incurs in connection with acts covered by insurance, irrespective of whether the Seller/Servicer tenders a claim under the bond in connection with the events that give rise to the claim filed by Freddie Mac.

(Doc. 213 at 27). Freddie Mac maintains that, consistent with the requirements of the Guide, *supra*, TBW obtained (and the Underwriters provided) fidelity insurance coverage from 2004 to 2008 (Doc. 213 at 27).

Generally, the Bonds provide that they are for the sole use and benefit of the Assured (TBW and certain of its subsidiaries) (*see, e.g.*, Doc. 213-1 at 28).[4] The Bonds, however, provide an exception to this provision. Specifically, insuring Clause 6 grants certain loss payees, including Freddie Mac, the right to bring a direct claim under the Bonds; however, such loss payees may only bring a direct claim under the Bonds if the Assured "fails to pursue such [a] claim" (*see, e.g.*, Doc. 213-1 at 28).[5] Freddie Mac asserts, however, that (consistent with the Guide) the 2004-2007 Bonds included an additional provision in favor of Freddie Mac (the "Freddie Mac Endorsement") which,

[4] The Bonds refer to the insured(s) as the "Assured" (*see, e.g*, Doc. 213-1 at 24, 28).

[5] In general, insuring Clause 6 relates to theft or wrongful appropriation or sale of a Secondary Market Institution's money or collateral being held by, or otherwise entrusted to, the Assured (*see, e.g.*, Doc. 213-1 at 18). The Bonds' definition of a "Secondary Market Institution" includes Freddie Mac (*see, e.g*, Doc. 213-1 at 26, 28).

in certain instances, entitles Freddie Mac to directly pursue claims for coverage under the 2004-2007 Bonds irrespective of whether TBW pursues any such claim(s) (*see, e.g.*, Doc. 213-1 at 42-43).

According to Freddie Mac, however, the Freddie Mac Endorsement was not attached to the 2008 Primary Bond because it was either lost, missing, or omitted by mutual mistake (Doc. 213 at 34). Count III of the Counterclaim seeks reformation of contract to correct this mistake by including the Freddie Mac Endorsement on the 2008 Primary Bond (Doc. 213 at 42-46). By way of Count I of the Counterclaim, Freddie Mac seeks, *inter alia*, a declaration that the 2008 Primary Bond includes the Freddie Mac Endorsement (Doc. 213 at 38-40). Freddie Mac asserts that, since the 2008 Excess Carrier Bond is a follow-form to the 2008 Primary Bond, any such reformation and/or declaration would affect the 2008 Excess Carrier Bond and entitle Freddie Mac to directly pursue claims for coverage under the 2008 Excess Carrier Bond (Doc. 213 at 39).

Count II is a breach of contract claim, which alleges the Underwriters breached the terms of the 2008 Bonds by denying coverage to Freddie Mac for its losses, damages, and expenses caused by the dishonest acts of TBW's employees (Doc. 213 at 40-41). In this regard, Freddie Mac claims it suffered, among other things, a direct financial loss as the direct result of theft by a partner, sole proprietor or major shareholder of TBW, committed either alone or in collusion with others, of Freddie Mac's custodial funds and/or collateral (Doc. 213 at 40).

Motion to Dismiss Standard

A motion to dismiss pursuant to Rule 12(b) tests the sufficiency of a complaint and asks the court to determine whether the complaint sets forth sufficient factual allegations to establish a claim for relief. When evaluating whether a plaintiff has stated a claim, a court must determine whether the complaint satisfies Rule 8(a)(2), which requires "a short and plain statement of the claim

showing that the pleader is entitled to relief." To survive a Rule 12(b) motion, the complaint must contain enough factual matter (taken as true) to "raise [the] right to relief above the speculative level." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007). "[N]aked assertions devoid of further factual enhancement" will not satisfy Rule 8(a)(2)'s requirement of a short plain statement of the claim showing the pleader is entitled to relief. *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1949 (2009) (*citing Twombly*, 550 U.S. at 557) (*internal quotations omitted*). A "formulaic recitation of the elements of a cause of action will not do." *Id*. Thus, a plaintiff must plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the conduct alleged." *Twombly*, 550 U.S. at 555. A mere possibility that the defendant acted in contravention to the law will not suffice. *Id*. Although a court must accept all well pleaded facts as true, it is not required to accept legal conclusions. *Sinaltrainal v. Coca-Cola Co.*, 578 F.3d 1252, 1260 (11th Cir. 2009). A complaint must contain sufficient factual matter, accepted as true, to state a claim for relief that is plausible on its face. *Iqbal*, 129 S.Ct. at 1949.

Discussion

The Court will address the Underwriters' and TBW's (collectively, "Defendants") arguments in conjunction. Here, Freddie Mac seeks to reform the 2008 Primary Bond to include the Freddie Mac Endorsement. If Freddie Mac is successful, then it will have standing to pursue its breach of contract claim(s) against the Underwriters. Thus, two primary issues arise: (1) whether Freddie Mac has standing to pursue its reformation claim under Count III; and (2) whether Freddie Mac sufficiently pleaded a claim for reformation of the 2008 Primary Bond.

I. Standing to Pursue Reformation of Contract

It is well settled in Florida that an intended third-party beneficiary to a contract has standing to sue for enforcement of the contract. *See, e.g.*, *Enterprise Leasing Co. v. Demartino*, 15 So. 3d 711, 714 (Fla. Dist. Ct. App. 2009). This principal extends to a third-party beneficiary seeking reformation of a contract to reflect the true intent of the contracting parties. *Royal Ins. Co. v. Smith*, 29 So. 2d 244, 246 (Fla. 1947) (finding reformation for mutual mistake could be had where the insurance policy, as written, did not insure the person or interest intended to be insured). Even the cases cited by Defendants support this proposition.

For instance, in *American Int'l Specialty Lines v. Blakemore*, the court found the plaintiffs did not have standing to pursue reformation of a contract because they were "neither a party to the contract, an insured, *nor a third party beneficiary*." 776 F. Supp. 2d 215, 221-22 (W.D. La. 2011) (*emphasis added*). In *Zaiontz v. Trinity Universal Ins. Co.*, the court found certain parties did not have standing to seek reformation of a contract because they were "not parties" to the contract. 87 S.W.3d 565, 574 (Tex. Ct. App. 2002). In support of its findings in this regard, the *Zaiontz* court quoted *Merrimack Mut. Fire Ins. Co. v. Allied Fairbanks Bank*, which provides: "[e]ven a person with a substantial interest in the contract may not maintain an action for reformation if he [or she] is not a party *or privy* thereto." 678 S.W.2d 574, 577 (Tex. Ct. App. 1984) (*emphasis added*). Here, it is clear Freddie Mac, as an intended third-party beneficiary, is privy to the 2008 Bonds.[6] Thus, the Court finds Freddie Mac has standing to pursue its reformation claim.

[6] Black's Law Dictionary defines "privy," in pertinent part, as a person or entity having a legal interest in the same subject matter or transaction. *Black's Law Dictionary* 1238 (8th ed. 2004).

II. Sufficiency of the Pleadings

Rule 9(b) of the Federal Rules of Civil Procedure (made applicable by Rule 7009 of the Federal Rules of Bankruptcy Procedure) provides that: "[i]n all averments of fraud *or mistake*, the circumstances constituting fraud *or mistake* shall be stated with particularity." Fed. R. Civ. P. 9(b) (*emphasis added*). Rule 9(b), however, "must be read in conjunction with Rule 8(a)" of the Federal Rules of Civil Procedure, which requires a plaintiff to plead only a short, plain statement of the grounds upon which he or she is entitled to relief. *Brooks v. Blue Cross & Blue Shield of Fla., Inc.*, 116 F.3d 1364, 1371 (11th Cir. 1997). Thus, the application of Rule 9(b) "must not abrogate the concept of notice pleading." *Id*.

By way of the Counterclaim, Freddie Mac maintains the Freddie Mac Endorsement was mistakenly omitted from the 2008 Primary Bond (Doc. 213 at 34). In *PYR Energy Corp. v. Samson Resources Co.*, a case cited by the Underwriters in support of its Motion to Dismiss (Doc. 235 at 7), the court found the plaintiff met the heightened pleading requirements of Rule 9(b) with respect to its claim for contract reformation when it alleged: (1) an agreement; (2) what was done regarding the mistake or omission; and (3) how the mistake came to be made. No 1:05-CV-530, 2007 WL 858804, at *4 (E.D. Tex. Mar. 19, 2007).[7]

In *Blumberg v. American Fire & Casualty Co.*, the Supreme Court of Florida noted that a mistake is mutual when it is shown that the parties agreed on one thing, yet the contract reflects something different. 51 So. 2d 182, 184 (Fla. 1951). Thus, the existence of an agreement is a necessary element of a reformation of contract claim based on mutual mistake. "A mistake is mutual when the parties agree to one thing and then, due to either a scrivener's error or inadvertence,

[7] Unpublished opinions are not considered binding authority; however, they may be cited as persuasive authority pursuant to the Eleventh Circuit Rules. 11th Cir. R. 36-2.

express something different in the written instrument." *L&H Const. Co., Inc. v. Circle Redmont, Inc.*, 55 So. 3d 630, 634 (Fla. Dist. Ct. App. 2011) (*quoting Providence Square Ass'n, Inc. v. Biancardi*, 507 So. 2d 1366, 1372 (Fla. 1987)). In addition, parol evidence is admissible to show that the true intent of the parties was something other than that expressed in the written instrument. *Biancardi*, 507 So. 2d at 1371.

Regarding whether there was an agreement in this instance, Freddie Mac claims TBW and the Underwriters "intended to include the Freddie Mac Endorsement on the 2008 Primary Bond" (Doc. 213 at 44). In support of this contention, Freddie Mac asserts that the fact the Guide required the Freddie Mac Endorsement to be included in any fidelity insurance procured by TBW, coupled with the fact the Freddie Mac Endorsement was included in each of the 2004-2007 Primary Bonds, evidences the agreement between TBW and the Underwriters to have said endorsement included on the 2008 Primary Bond (Doc. 213 at 43). The Court finds Freddie Mac has asserted enough factual matter (taken as true) to raise its claim in this regard above the speculative level. *See Twombly*, 550 U.S. at 555. Thus, Freddie Mac has sufficiently pleaded the existence of a prior agreement between TBW and the Underwriters to include the Freddie Mac Endorsement on the 2008 Primary Bond.

As to the second element of a reformation claim (*i.e.*, that through a mistake in reducing the parties' agreement to writing the contract fails to reflect the actual agreement of the parties), Freddie Mac alleges the Freddie Mac Endorsement was not attached to the 2008 Primary Bond because it was either lost, missing, or omitted by mutual mistake (Doc. 213 at 34). *See DR Lakes Inc. v. Brandsmart U.S.A. of West Palm Beach*, 819 So. 2d 971, 974 (Fla. Dist. Ct. App. 2002) (finding reformation of a contract should be granted where, through a mistake, the instrument contains a scrivener's error or fails to define the terms as agreed upon by the parties).

In this respect, Freddie Mac has alleged what was done regarding the mistake or omission and how the mistake came to be made. *See PYR Energy Corp.*, 2007 WL 858804, at *4. To be more precise, Freddie Mac asserted: (1) what was done (the Freddie Mac Endorsement was not attached to the 2008 Primary Bond); and (2) how the mistake came to be made (the Freddie Mac Endorsement was either lost, missing, or omitted by mutual mistake) (Doc. 213 at 34).

Conclusion

Based on the foregoing, the Court finds Freddie Mac has adequately alleged the failure of the 2008 Primary Bond to reflect the parties' agreement was due to a mutual mistake or omission. As any reformation would bestow standing upon Freddie Mac to pursue a direct claim under the Bonds, at this juncture, the Court is not inclined to dismiss Freddie Mac's counterclaim for breach of contract based on arguments such as ripeness or lack of standing.[8]

Accordingly, it is **ORDERED**:

1. Certain Underwriters of Lloyd's, London and London Market Insurance Companies' Motion to Dismiss Freddie Mac's Counterclaim (Doc. 234) is denied.

[8] Defendants assert that Freddie Mac has failed to allege sufficient facts to support its breach of contract claim. The Court, however, finds that the proofs of loss (attached as exhibits to the Counterclaim) contain enough factual matter to support a plausible breach of contract claim. For instance, the Proof of Loss purportedly submitted by TBW on February 12, 2010, provides, in pertinent part, the following:

> TBW believes that it has suffered or will in the future suffer a loss by reason of a claim first made against TBW during the Bond Period for the direct financial loss sustained by Freddie Mac and others as the direct result of Theft (as that term is defined in the Bonds) by Lee B. Farkas, the majority shareholder of TBW, committed either alone or in concert with others, of [. . .] money from a Custodial Account maintained by TBW for Freddie Mac. . . .

(Doc. 213-15 at 17, ¶ 42). Although this document is unsigned, the Underwriters placed this document into the record and stated it was a "true and correct copy of TBW's preliminary proof of loss" (*see* Doc. 66 at 9, ¶ 33; *see also* Doc. 66-12 at 16, ¶ 42).

2. Taylor Bean & Whitaker Mortgage Corporation's Motion to Dismiss Freddie Mac's Counterclaim (Doc. 236) is denied.

DATED this 26th day of October, 2011 in Jacksonville, Florida.

/s/ Jerry A. Funk

JERRY A. FUNK
United States Bankruptcy Judge

Copies to:

Denise D. Dell-Powell,
James D. Gassenheimer, and
David E. Peterson