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 UNDERWRITER'S MOTION DISMISS SOVEREIGN BANK'S AMENDED COUNTERCLAIM

This proceeding came before the Court on Defendant Government National Mortgage Association's ("GNMA") Motion to Dismiss the Second Amended Complaint for Lack of Subject Matter Jurisdiction (Docs. 205 and 207, Motion to Dismiss; *see also* Doc. 184, Second Amended Complaint). Also pending before the Court is GNMA's Motion for Order Protecting it From Party Discovery (Docs. 210 and 211, Motion for Protective Order). Plaintiffs, Certain Underwriters of Lloyd's, London and London Market Insurance Companies (collectively, the "Underwriters"), filed a Joint Response in Opposition to GNMA's Motion to Dismiss (Doc.

224). GNMA has filed a Reply Brief to the Underwriters' Joint Response in Opposition (Doc. 239). To date, no response regarding GNMA's Motion for Protective Order has been filed.

For the reasons set forth herein, GNMA's Motion to Dismiss will be denied and the Motion for Protective Order will be denied as moot.[1]

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.

In addition, a Rule 12(b)(1) motion to dismiss for lack of subject matter jurisdiction can be asserted on either facial or factual grounds. *Morrison v. Amway Corp.*, 323 F.3d 920, 925 n. 5 (11th Cir. 2003). Facial challenges to subject matter jurisdiction are based solely on the

[1] In the Motion for Protective Order, GNMA seeks protection from discovery pending the Court's ruling on the instant Motion to Dismiss (Doc. 210 at 1; Doc. 211 at 3-6). Therefore, entry of this Order renders the requested relief moot.

allegations in the complaint. *Id*. When considering such challenges, the court must, as with a Rule 12(b)(6) motion, take the complaint's allegations as true. *Id*. When, however, a defendant raises a factual attack on subject matter jurisdiction (such as here), courts "may consider extrinsic evidence such as deposition testimony and affidavits." *Carmichael v. Kellogg, Brown & Root Servs., Inc.*, 572 F.3d 1271, 1279 (11th Cir. 2009).

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 for various types of losses attributable to employee dishonesty (collectively, the "Bonds").[2] The Underwriters' Bonds provided base level, or primary, coverage and also the first level of excess coverage (Doc. 184, Exs. 1-17). National Union Fire Insurance Company of Pittsburgh, PA, United States Fire Insurance Company, U.S. Specialty Insurance Company, and the Great American Insurance Group provide additional layers of excess coverage with respect to the Bonds (Doc. 184, Exs. 1-17). Subject to certain exceptions not material to the Motion 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).

Generally, the Bonds provide that they are for the sole use and benefit of the Assured (TBW and certain of its subsidiaries) (Doc. 184-6 at 62, 76-77).[3] The Bonds, however, provide

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

[3] The Bonds refer to the insured(s) as the "Assured" (*see, e.g*, Doc. 184-6 at 62).

an exception to this provision. Specifically, insuring Clause 6 grants certain loss payees, such as GNMA, the right to bring a direct claim under the Bonds if the Assured "fails to pursue such [a] claim" (Doc. 184-6 at 77).[4]

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).[5] On September 21, 2009, an attorney for GNMA sent a series of email communications to the insurers requesting copies of the Bonds and advising the insurers to treat the message "as evidence of its claim to prevent any possible tolling of any timeframe associated with presenting a claim" (Doc. 208, Declaration of Paul St. Laurent, III, Ex. 1).[6] On December 28, 2009, Mr. St. Laurent, III sent a series of letters to the insurers advising them to treat the message as evidence of a claim, and requested for a second time that GNMA be provided with copies of the Bonds (Doc. 208, Ex. 2).

On February 12, 2010, TBW submitted to the Underwriters a preliminary proof of loss in support of its insurance claim(s) (Doc. 184 at 4). On July 28, 2010, TBW submitted a confidential proof of loss (Doc. 184 at 6).

---

4 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 (Doc. 184-6 at 62-63). The Bonds' definition of a "Secondary Market Institution" includes GNMA (Doc. 184-6 at 74).

5 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).

6 Mr. Paul St. Laurent, III is employed by GNMA as a Lead Mortgage Banking Analyst/Assistant Vice President (Doc. 208 at 1).

On May 13, 2011, Lloyd H. Randolph, Senior Trial Counsel, United States Department of Justice, Civil Division, sent a letter to counsel for the insurers advising that, after receipt and review of the various provisions contained in the Bonds, GNMA wished to withdraw the assertions previously made by it in the aforementioned series of email and letter requests (Doc. 208, Ex. 3). More particularly, counsel for GNMA stated that, in light of the fact it only has a right to pursue a direct claim under the Bonds if TBW fails to pursue a claim, and since TBW was presently pursuing such a claim:

> at this time, GNMA does not appear to be entitled to press a claim under the Bonds. For this reason, GNMA hereby withdraws the E-mail Requests and the Letter Requests [*supra*]. In view of this withdrawal, at least for now, GNMA should not be a party to the Adversary [Proceeding].

(Doc. 208, Ex. 3).

By way of the Second Amended Complaint (Doc. 184), 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 it relies to establish coverage (Doc. 184 at 2-3, 30). Consequently, the Underwriters filed the instant Adversary Proceeding seeking, *inter alia*, to declare that TBW's material misrepresentations and omissions void the Bonds and/or preclude coverage (Doc. 184 at 28-33).

The Underwriters dispute GNMA's right to pursue a direct claim under the Bonds (Doc. 224 at 3 n.1), but because GNMA is a named loss payee under the Bonds, and therefore has a potential interest in TBW's recovery, the Underwriters have included GNMA as a defendant in this Adversary Proceeding "to obtain a judicial declaration that GNMA has no right to pursue a direct claim under the Bonds, and to ensure that a judgment rescinding the Bonds applies [equally] to GNMA" (Doc. 224 at 3-10).

Discussion

The Declaratory Judgment Act (the "Act"), 28 U.S.C. § 2201, permits federal courts to declare the rights of parties only in cases involving an "actual controversy." In pertinent part, the Act provides:

> In a case of actual controversy within its jurisdiction, . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such [a] declaration, whether or not further relief is or could be sought. . . .

28 U.S.C. § 2201.

The statutory standard for determining whether an "actual controversy" exists within the meaning of the Act is the same as that under the "case or controversy" requirement of the Constitution. *Hendrix v. Poonai*, 662 F.2d 719, 721 (11th Cir. 1981). The Supreme Court has defined a "controversy" in the Constitutional sense as:

> one that is appropriate for judicial determination . . . . The controversy must be definite and concrete, touching the legal relations of parties having adverse legal interests . . . . It must be a real and substantial controversy admitting of specific relief through a decree of a conclusive character, as distinguished from an opinion advising what the law would be upon a hypothetical state of facts.

Id. (*quoting Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1937)). Thus, a declaratory judgment proceeding is generally only available for the determination of present rights that have become fixed under an existing state of facts.

The Supreme Court has articulated the test for an "actual controversy" under the Declaratory Judgment Act. In *Maryland Cas. Co. v. Pacific Coal & Oil Co*, the Court stated: "the question in each case is whether the facts alleged, under all the circumstances, show that there is a substantial controversy, between parties having adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment." 312 U.S. 270, 273

(1941). The overall purpose of the Act is "to settle actual controversies before they have ripened into violations of law or legal duty or breach of contractual obligations." *Franklin Life Ins. Co. v. Johnson*, 157 F.2d 653, 657 (10th Cir. 1946). In addition, the fact that a party's "liability may be contingent does not necessarily defeat jurisdiction of a declaratory judgment action." *Assoc. Indem. Corp. v. Fairchild Indus.*, Inc., 961 F.2d 32, 34 (2d Cir. 1992). Further, insurance litigation "has become the paradigm for asserting jurisdiction despite 'future contingencies that will determine whether a controversy actually becomes real.'" *Id.*; *see also Assoc. Indem. Corp.*, 961 F.2d at 35.

Courts have also recognized that "[t]o hold a person whose interest is contingent may not be compelled to defend an action for a declaratory judgment would greatly diminish the field and lessen the utility of declaratory judgment actions." *Franklin Life Ins. Co.*, 157 F.2d at 657 (finding a contingent beneficiary in a life insurance policy, whose right to any proceeds thereunder was contingent upon the death of the primary beneficiary, was an interested and proper party to the declaratory judgment action).

In its Motion to Dismiss, GNMA maintains the Court lacks subject matter jurisdiction as there is "no case or controversy" between itself and the Underwriters (Doc. 207 at 7-9). For the reasons stated below, the Court is not persuaded.

GNMA's argument in support of its contention in this regard is twofold. First, GNMA maintains that, since TBW is presently pursuing a claim under insuring Clause 6, any right it may have to pursue a claim is contingent upon whether TBW fails to pursue the claim; therefore, its right to pursue such a claim has not yet accrued and may never come to pass (Doc. 207 at 7-9). Second, GNMA states it has not submitted a proof of loss under the Bonds and that, by way

of its May 13, 2011 Withdrawal Letter, has "made clear that it is not asserting any claim under the Bonds" (Doc. 207 at 7).

With respect to its first contention, the Court would note that, although facts cannot be contingent, a declaratory judgment may be granted where the rights involved are contingent or based upon future events. *Lumbermens Mut. Cas. Co. v. Borden Co.*, 241 F. Supp. 683, 690-704 (S.D.N.Y. 1965). Therefore, a declaratory judgment action may lie where there is a present controversy as to what a party's rights will be and a decision is required to bring finality to the dispute and avoid piecemeal litigation. *Id*. at 698. Such is the case here.

To illustrate, the facts that underlie the instant Adversary Proceeding have already occurred. If the Court were to ultimately enter a judgment providing that the Bonds at issue are void, and that neither TBW nor GNMA are entitled to insurance proceeds thereunder, said judgment would not be advisory (*i.e.*, based on facts that have not yet occurred).

In *Lumbermens Mut. Cas. Co., supra*, the court found that the fact a plaintiff did not presently have a cause of action against the defendants was not determinative as to whether the court had subject matter jurisdiction in the declaratory judgment action. 241 F. Supp. at 698 (*citing Dotschay for Use and Benefit of Alfonso v. Nat'l Mut. Ins. Co.*, 246 F.2d 221 (5th Cir. 1957)).[7] The *Lumbermens* court stated "[t]he whole reason for the enactment of the statute [the Declaratory Judgment Act] was to declare the rights of parties and grant further and proper relief, though in a strict sense no cause of action had accrued." *Lumbermens Mut. Cas. Co.*, 241 F. Supp. at 698. The Court finds the reasoning of the *Lumbermens* court to be persuasive in this instance.

[7] Decisions of the Fifth Circuit rendered on or before September 30, 1981 are binding precedent in the Eleventh Circuit. *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (*en banc*).

Based on the foregoing, the Court finds the fact GNMA does not presently have a cause of action against the Underwriters does not deprive the Court of subject matter jurisdiction over the instant Adversary Proceeding.

As to GNMA's second contention—*i.e.*, the fact it is not presently asserting a claim under the Bonds militates against there being an active case or controversy (Doc. 207 at 7), the Court is likewise not persuaded.

To illustrate, under the provisions of the Bonds, GNMA has a right to pursue a direct claim if the Assured (TBW) fails to pursue such a claim (Doc. 184-6 at 77). Although GNMA maintains its Withdrawal Letter, dated May 13, 2011, "made clear that it is not asserting any claim under the Bonds" (Doc. 207 at 7), in the memorandum in support of the Motion to Dismiss, GNMA states:

> Nothing contained in this memorandum or the Withdrawal Letter [dated May 13, 2011] waives GNMA's right to pursue claims independent of TBW in the event that TBW fails to pursue its own claims under the Bonds, or to receive payment directly from the Underwriters.

(Doc. 207 at 11 n. 18). In the Withdrawal Letter, *supra*, GNMA emphasized that "at this time" it does not appear to be entitled to press a claim under the Bonds, and further noted that "at least for now" it should not be a party to the Adversary Proceeding (Doc. 208, Ex. 3).

Essentially, it appears that GNMA wishes to be dismissed from the instant declaratory judgment action while at the same time reserving the right to possibly pursue a claim, or litigate, under the Bonds at some future date. Granting GNMA such relief would contravene one of the primary purposes of the Declaratory Judgment Act, which is to avoid inconsistent or piece-meal judicial determinations. *Ohio Cas. Ins. Co. v. Farmers Bank of Clay, Ky.*, 178 F.2d 570, 575 (6th Cir. 1949).

Here, it is clear GNMA is an interested party. As the *Lumbermens* court noted,

> all persons who have an interest in the determination of the questions raised in the declaratory judgment suit should be before the court or the determination by the court is ineffective. It would result in but a partial disposition of the controversy. Obviously such should be avoided.

241 F. Supp. at 697; *see also, e.g., Franklin Life Ins. Co.*, 157 F.2d at 658 ("Ordinarily, in an action for declaratory judgment, all persons interested in the declaration are necessary parties.") (*quotations and citations omitted*); *Phoenix Ins. Co. v. Aetna Cas. & Surety Co.*, 120 Ga. App. 122, 127 (Ga. Ct. App. 1969) (stating, "all persons interested in the contract of insurance should be joined, in order properly to adjudicate the question of liability or non-liability of the insurer").

Under the facts presented, GNMA has a contingent right to pursue a claim under the Bonds, which it does not intend to relinquish. Therefore, there is a present controversy in this instance, and the Court finds it should exercise its discretion to retain jurisdiction.

Conclusion

Based on the foregoing, the Court finds there exists an actual controversy between the Underwriters and GNMA; therefore, GNMA is a proper party to the Underwriters' action. GNMA, of course, is at liberty to enter into a stipulated dismissal upon terms agreeable to the parties.

Accordingly, it is **ORDERED**:

1. Defendant Government National Mortgage Association's Motion to Dismiss the Second Amended Complaint (Doc. 205) is denied.

2. Defendant Government National Mortgage Association's Motion for Order Protecting it From Party Discovery (Doc. 210) is denied as moot.

DATED this 28th day of September, 2011 in Jacksonville, Florida.

/s/ Jerry A. Funk
Jerry A. Funk
United States Bankruptcy Judge

Copies to:

Denise D. Dell-Powell, Counsel for Plaintiffs
Christopher Emden, Counsel for Defendant