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(The decision of the Court is referenced in a table in the New York Supplement.)

Supreme Court, New York County, New York.
LENOX HILL HOSPITAL, Plaintiff,
v.
AMERICAN INTERNATIONAL GROUP, INC., Lexington Insurance Company, and Commerce Bank, N.A., Defendants.

No. 602635–2008.
Oct. 20, 2008.

Timothy Butler, Esq., David J. McCarthy, Esq., Mario D. Cometti, Esq., Butler, **Fitzgerald**, **Fiveson** & McCarthy, New York, for Plaintiff.

Edward P. Krugman, Esq., David G. Januszewski, Esq., Cahill Gordon & Reindel, LLP, New York, for Defendants.

BERNARD J. FRIED, J.

***1** Before me is plaintiff's motion by Order to Show Cause for a preliminary injunction and temporary restraining order ("TRO") against American International Group, Inc. ("AIG"), Lexington Insurance Company ("Lexington"), and Commerce Bank, N.A. (the "Bank"), as follows: (a) enjoining Lexington and AIG from seeking any increased premium from Lenox under its 2004 insurance policy; (b) enjoining the Bank from honoring any sight draft against a $2 million letter of credit established by Lenox in favor of Lexington; and (c) enjoining Lexington and AIG from submitting to the Bank any further sight draft against the letter of credit and requiring Lexington to withdraw its present draft demand.

The parties consented to maintain the status quo *i.e.,* defendants agreed not to draw down the letter of credit, until I rendered my decision on the preliminary injunction, so it was not necessary to rule on the motion for a TRO. Having reviewed the parties' submissions carefully and heard oral argument, I now render my decision.

By way of background: it appears that Lenox entered into two excess insurance contracts with Lexington, a subsidiary of AIG [FN1] one policy covering insured events during 2004, and the other covering 2005.[FN2] Only the 2004 policy is at issue in this motion.

FN1. The parties at oral argument refer to Lexington and AIG interchangeably, so I will do the same.

FN2. Plaintiff insists that these contracts are properly categorized as "claims administration contracts," rather than insurance contracts, because AIG assumes claims administration obligations but no obligation to pay plaintiff's claims, except with the funds provided by plaintiff.

Lenox's premium under the policy consisted of the amounts paid out by AIG, plus a 5% fee, and any extra costs incurred by AIG. (Fajardo Aff. ¶ 4.) Defendants would periodically provide Lenox with a statement of the losses and the retrospective premium adjustments due from Lenox under the policies.

When it opened the 2004 policy, Lenox paid a $4 million premium. (Fajardo Aff. ¶ 3.) In 2006, $2 million of that was returned to Lenox as a retroactive premium adjustment, on condition that Lenox establish an irrevocable $2 million letter of credit at the Bank in favor of Lexington. (Fajardo Aff. ¶ 6.) It was intended to protect defendants if Lenox's incurred losses rose, and its premiums later needed to be adjusted upward. (Schultz Aff.[FN3] ¶¶ 7–9.) The letter of credit, dated October 31, 2006, states that it is "irrevocable," is "not subject to any condition or qualification," and is "extended automatically" on an annual basis, unless it is timely cancelled.

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(Schultz Aff. Ex. A.)

FN3. Because the Schultz Affidavit refers by name to particular claims, which are confidential, I accepted it *in camera,* and it will not be filed with the rest of the motion.

Between January 2005 and January 2008, AIG's loss statements reported incurred losses in the range of about $35,000 to $90,000. Since these losses were easily subject to the minimum premium already paid by Lenox, defendants did not ask for an additional premium. (Fajardo Aff. ¶¶ 6–8.)

In April 2008, however, plaintiff was surprised to receive a loss statement from defendants reporting over $8 million in losses a sharp increase from the previous loss statements. During each of the ensuing months between April and August 2008, defendants were in communication with Lenox about their new demand for an increased premium; during this time, Lenox raised the possibility that it might have trouble coming up with the money. (Schultz Aff. Exs. B F .)

***2** On September 11, Lenox filed an amended complaint alleging four causes of action for breach of the 2004 and 2005 policies, an injunction based on the letter of credit, and breach of fiduciary duty, along with this motion, which seeks an injunction only with respect to the 2004 policy.

Lenox cancelled both policies in writing on September 11, and demanded on September 15 that Lexington return its funds and transfer the claims administration to Lenox.

In this motion, plaintiff claims that defendants intend to draw down the letter of credit and fabricated the numbers in its April 2008 loss statement to justify their demand for a high premium, because AIG was in “dire financial straits” and plans to dip into the funds of its subsidiaries.FN4 (Butler Aff. ¶ 5.) In support of that claim, Lenox's Director of Risk Management, Janice Fajardo, avers that the $8 million sharp increase in losses was based on just three claims under the 2004 policy, and none of them should have required an increase in premium. (Fajardo Aff. ¶¶ 11–17.)

FN4. I take judicial notice that, on September 15, 2008, the Governor of the State of New York gave AIG permission to use $20 billion of assets from its subsidiaries, to avert what then looked like the prospect of bankruptcy. On September 16, the Federal Reserve Bank agreed to an $85 billion bailout of AIG.

Defendants have submitted an affidavit by Stephen Ruocco in AIG's Healthcare Malpractice Claims department, averring that, between February and June 2008, his staff determined that Lenox faced potentially significant exposure in large lawsuits covered by the 2004 policy. (Ruocco Aff. ¶¶ 7, 10–13.) Ruocco avers that the “loss runs' provided to Lenox in April 2008 reflected a comprehensive review of the claims, performed in the ordinary course of business. (Ruocco Aff. ¶¶ 14–18.)

In another affidavit submitted by defendants, Virginia Schultz, Regional Manager of another AIG subsidiary that provides Lexington with various kinds of insurance, avers that she discussed the incurred loss calculations with Lenox's insurance broker by email in April, May, June, and July 2008. (Schultz Aff. ¶¶ 14–23.) Ms. Schultz discussed the premium calculation by email and telephone with Ms. Fajardo in June 2008. (Schultz Aff. ¶¶ 18–19.) These discussions culminated in the issuance on July 9 of a notice that a $6 million premium was due on August 8 from Lenox on the 2004 policy. (Schultz Aff. ¶¶ 21–22.) Lenox has not paid this premium.

Schultz avers that Lexington's practice of keeping low reserves for claims under the 2004 policy, until it had completed its evaluation of the exposure, is common practice in handling claims under excess insurance policies. (Schultz Aff. ¶¶ 5–6.)

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"A letter of credit is a commitment on the part of the issuing bank that it will pay a draft presented to it under the terms of the credit, and if it is a documentary draft, upon presentation of the required documents of title." *United Bank Ltd. v. Cambridge Sporting Goods Corp.,* 41 N.Y.2d 254, 258–59 (1976). The purchaser of the letter of credit is not a party to the letter of credit contract between the bank and the beneficiary and ordinarily "cannot enjoin the bank from paying, or the beneficiary from demanding, the funds pursuant to the letter of credit." *Chiat/Day Inc. v. Kalimian,* 105 A.D.2d 94, 96–97 (1st Dept.1984) (holding that the plaintiff tenant, as purchaser of a letter of credit, was not a party to the letter of credit transaction and therefore could not enjoin the bank from paying, or the beneficiary from demanding, funds pursuant to the letter of credit, absent showing of fraud).

***3** The Uniform Commercial Code ("U.C.C.") provides that a court "may temporarily or permanently enjoin the issuer from honoring a presentation [of a letter of credit] or grant similar relief against the issuer or other persons only if the court finds," *inter alia,* that: "[o]n the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud." U.C.C. § 5–109(b)(4).

"The only way for the purchaser of a letter of credit to succeed on an action to defeat payment on that letter of credit is to demonstrate fraud in the transaction or presentment of the letter." *410 Sixth Ave. Foods, Inc. v. 410 Sixth Ave., Inc.,* 197 A.D.2d 435, 436–37 (1st Dept.1993)(plaintiff tenants were not entitled to injunction restraining landlord from drawing down letters of credit, because tenants had not alleged fraud in the presentment of the letter). *Accord Titleserv, Inc. v. Zenobio,* 210 A.D.2d 311, 313 (2d Dept.1994) (upholding trial court's refusal to grant injunction restraining landlord from drawing upon letter of credit, where tenant defaulted in rent payments, where tenant had not alleged fraud in the transaction or presentment of the letter of credit). The purchaser of a letter of credit "may apply to enjoin the issuer from paying drafts drawn under the letter of credit" where "fraud in the transaction has been shown and the holder has not taken the draft in circumstances that would make it a holder in due course." *United Bank,* 41 N.Y.2d at 259 (internal quotations omitted).

Here, Lenox purchased the letter of credit in favor of Lexington, its beneficiary. Lenox, as the purchaser, is not a party to the letter of credit between the Bank and Lexington. The letter of credit is a commitment on the part of the Bank that is independent of the insurance policy between Lenox and Lexington. Therefore, absent a showing of fraud in the transaction or presentment of the letter of credit, Lenox cannot enjoin the Bank from paying, or Lexington from demanding, funds pursuant to the letter of credit.

In addition to a showing of fraud, the applicant must establish that "[a]ll of the conditions to entitle a person to the relief under the law of this state have been met." U.C.C. § 5–109(b)(3). These conditions are: "a probability of success, danger of irreparable injury in the absence of an injunction, and a balance of the equities in [its] favor." *Aetna Ins. Co. v. Capasso,* 75 N.Y.2d 860, 862 (1990).

The threshold question is whether Lenox more likely than not to succeed in demonstrating fraud in the transaction or presentment of the letter of credit. Based on the record before me, it appears that Lenox is not.

Lenox's amended complaint does not allege fraud in the transaction or presentment of the letter of credit; it does not even mention the word "fraud." At oral argument, Lenox's counsel argued that I should interpret paragraph 14 of the Amended Complaint to allege fraud, based on its assertion that, around April 15, 2008, defendants "decided to fabricate" an Incurred Loss run "in support of a bad faith Premium Adjustment calculation," which was a "meteoric rise in Incurred Losses," in comparison to the Incurred Loss run in January 2008. (Am.Compl.¶ 14.) The alleged fraud appears to be

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the same conduct alleged in support of the breach of contract and fiduciary duty claims.

***4** Lenox asserts fraud for the first time in its reply brief. The allegations characterized as "fraud" are that "AIG has no right to present the letter of credit and no colorable claim to the funds secured by the letter of credit" because Lenox "terminated the 2004 policy," and that AIG is acting in "bad faith" by "asserting an increase in premiums" that "bears no relationship whatsoever to any potential exposure that is supposed to be covered under the 2004 Policy" in order to raise funds for AIG's own use. (Plf.'s Reply Br. at 3–4, 6.) Again, these are the same allegations that form the basis of the breach of contract and fiduciary duty claims.

"[T]he circumstances constituting [the fraud] must be stated in detail." C.P.L.R. § 3016(b). Even in its reply brief, Lenox has not explained in detail how defendants committed fraud, other than the conclusory assertion that the conduct that forms the basis for the breach of contract and fiduciary duty claims was fraudulent. While a fraud claim may be based on conduct that has some relation to the facts of a breach of contract claim, the First Department has repeatedly dismissed fraud claims as duplicative when the fraud cause of action adds no new allegation to a breach of contract claim, apart from the addition of the word "fraud." *E.g. Richbell Info. Servs., Inc. v. Jupiter Partners, L.P.,* 309 A.D.2d 288, 305 (1st Dept.2003) (dismissing fraud claim as duplicative that was based on same facts underlying the contract claim); *J.E. Morgan Knitting Mills, Inc. v. Reeves Bros., Inc.,* 243 A.D.2d 422, 423 (1st Dept.1997) (upholding dismissal of fraud claim as duplicative of contract claim, where fraud claim was "based on the same facts as underlie the contract claim" and was not merely "collateral to the contract").

Plaintiff's counsel asserted at oral argument, however, that fraud under U.C.C. § 5–109 is not the same as fraud under the tort law. He explained that, under the U.C.C., I may enjoin defendants from drawing down the letter of credit if I find that they have no "colorable right" to draw it down under the 2004 policy. (Trans. at 11–16.)

The phrase "colorable right" is invoked in the official comments to § 5–109, which state that "[m]aterial fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor." U.C.C. § 5–109 cmt. 1. The comments continue: "The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted." U.C.C. § 5–109 cmt. 4.

Courts have "uniformly" interpreted "fraud in the transaction" sufficient to enjoin payment of a letter of credit to require a showing of "active intentional fraud." *Chiat/Day Inc,* 105 A.D.2d 94, 97–98 (1st Dept.1984). Courts have denied applications for preliminary injunctions, where the applicant did not meet this standard. *E.g., Kvaerner U.S., Inc. v. Merita Bank PLC,* 288 A.D.2d 6, 732 N.Y.S.2d 215, 215 (1st Dept.2001) (affirming refusal to enjoin bank preliminarily from honoring demand on letter of credit, where the record did not support plaintiff's claim that defendant had fabricated defects in mine construction to justify drawing down the letter, and record at best supported allegations of breach of contract, not fraud); *Magar, Inc. v. Nat'l Westminster Bank, USA,* 189 A.D.2d 580, 581 (1st Dept.1993) (affirming denial of preliminary injunction enjoining demand on letter of credit, where record merely supported allegations of breach of contract, not fraud); *Mount Carmel Energy Corp. v. Marine Midland Bank,* 82 A.D.2d 729, 729 (1st Dept.1981) (reversing trial court's grant of preliminary injunction, where dispute as to whether plaintiffs' agent had actual or apparent authority to enter into the contract with the beneficiary of the letter of credit did not make the documents presented fraudulent nor did it constitute fraud in the transaction).

***5** Courts uphold preliminary injunctions enjoining payment of a letter of credit mostly in cases

involving shipments of undisputedly con-conforming and worthless goods. *E.g., United Bank,* 41 N.Y.2d at 260 (the shipment of old, unpadded, ripped and mildewed gloves rather than new gloves as ordered constituted fraud in the transaction); *Takeo Co. Ltd. v. Mead Paper, Inc.,* 204 A.D.2d 123, 124 (1st Dept.1994) (defendant committed active intentional fraud in the transaction by shipping non-conforming and virtually worthless goods that were to be paid for by letter of credit).

Applying this standard: I conclude that plaintiff has failed to show that it is more likely than not to succeed in its claim that defendants have engaged in active, intentional fraud. The Ruocco and Schultz Affidavits support defendants' assertion that the April 2008 loss statement was based on a review of several high-risk claims after they had matured. The fact that this review occurred many months *before* the widely-publicized financial troubles of AIG in September 2008 further supports defendants' contention that their numbers were not fabricated in order to prop up AIG's ailing finances. The fact that Ms. Fajardo believes these numbers to be fabricated is evidence of a contract dispute between Lenox and defendants about an unexpectedly high premium, but it does not tend to show active, intentional fraud.[FN5]

FN5. In its reply brief and more fully on rebuttal at oral argument, Lenox also argued that plaintiff is entitled to an injunction, because Lenox cancelled the policies on September 11, 2008. (Plf.'s Reply Br. at 3–4; Trans. at 36–37.) The 2004 policy provides that it may be canceled by Lenox "by surrendering it to us or any of our authorized representatives or by mailing to us written notice stating when thereafter the cancellation shall be effective." (2004 Policy ¶ IV.B.) It further provides that, in such a case, "the unearned premium shall be computed in accordance with the customary short rate table and procedure ... either at the time cancellation is effected or as soon as practicable after cancellation becomes effective." Plaintiff points out that the policy does not state that it *cannot* be cancelled after 2004.

Defendants maintain that the policy period ended at the end of 2004, and "there is no such thing as cancellation" after that, since defendants are now vulnerable to any claims brought by third parties under the 2004 policy. (Trans. at 45.)

Indeed, section 3420(a)(2) of the Insurance Law requires all liability insurance policies to provide that, if any judgment against the insured in an action for damages by a third party goes unsatisfied, the third party may maintain "an action ... against the insurer ... for the amount of such judgment" up to the policy limit. At oral argument, plaintiff's counsel admitted that plaintiff's "cancellation" leaves AIG vulnerable to third party claims, stating: "a third party under [§] 3420 ... would have a right against AIG if we didn't make the payment." (Trans. at 38.)

Neither party has briefed the issue. Whatever the merits of plaintiff's cancellation argument may be later in this litigation, perhaps after it is fully briefed in a dispositive motion, plaintiff has so far failed to convince me that it is likely to succeed on it.

In light of my conclusion that Lenox has not shown that it is more likely than not to succeed in demonstrating fraud, I do not reach the questions of whether plaintiff faces the threat of irreparable harm if the injunction is not granted,[FN6] or whether the balance of equities favors its position.

FN6. I note that plaintiff's assertion of irre-

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> parable harm rests mostly on the averment by Ms. Fajardo that Lenox is a non-for-profit hospital and will be "seriously damaged" if AIG takes $2 million from its operating budget. (Fajardo Aff. ¶ 23; *accord* Trans. at 20–21.) Plaintiff has not indicated that the loss of $2 million would have any real effect on the operation of the hospital, apart from this conclusory assertion. A conclusory statement that a party will be damaged if the desired relief is not granted is normally insufficient to justify the extraordinary remedy of a preliminary injunction.

Accordingly, plaintiff's motion is denied.

N.Y.Sup.,2008.
Lenox Hill Hosp. v. American Intern. Group, Inc.
21 Misc.3d 1123(A), 873 N.Y.S.2d 512, 2008 WL 4745664 (N.Y.Sup.), 2008 N.Y. Slip Op. 52154(U)

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