SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH, *Justice* **PART** 54

Index Number : 650422/2012
PHOENIX LIGHT SF LIMITED
vs.
ACE SECURITIES CORP.
SEQUENCE NUMBER : 002
DISMISS ACTION

INDEX NO. _____
MOTION DATE 3/20/13
MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, were read on this motion to/for _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ **No(s).** 19-46
Answering Affidavits — Exhibits _____ **No(s).** 72-83, 87
Replying Affidavits _____ **No(s).** 84-85

Upon the foregoing papers, it is ordered that this motion is

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE _____
FOR THE FOLLOWING REASON(S): _____

Dated: 4/24/13

SHIRLEY WERNER KORNREICH
J.S.C.
_____, J.S.C.

1. **CHECK ONE:** ..... ☐ CASE DISPOSED ☒ NON-FINAL DISPOSITION
2. **CHECK AS APPROPRIATE:** .....MOTION IS: ☐ GRANTED ☐ DENIED ☒ GRANTED IN PART ☐ OTHER
3. **CHECK IF APPROPRIATE:** ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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PHOENIX LIGHT SF LIMITED, SILVER ELMS CDO PLC, SILVER ELMS II CDO PLC, KLEROS PREFERRED FUNDING V PLC, and BLUE HERON FUNDING V LTD,

Plaintiffs,

-against-

ACE SECURITIES CORP., DEUTSCHE ALT-A SECURITIES INC., DB STRUCTURED PRODUCTS, INC., DEUTSCHE BANK SECURITIES INC., and DEUTSCHE BANK AG,

Defendants.

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Index No.: 650422/2012

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Defendants ACE Securities Corp. (ACE), Deutsche Alt-A Securities, Inc. (DAAS), DB Structured Products, Inc. (DBSP), Deutsche Bank Securities Inc. (DBSI), and Deutsche Bank AG (DBAG) (collectively, Deutsche Bank) move to dismiss the Complaint pursuant to CPLR 3211. Defendants' motion is granted in part and denied in part for the reasons that follow.

This case arises from plaintiffs' purchases of over $150 million in residential mortgage backed securities (RMBS). RMBS are securities which pool residential mortgages and use the monthly interest and principle payments to pay the security holders. The mortgage pools are divided into tranches, with the senior tranches carrying the least risk, having the highest rating and earning the lowest returns. To invest in an RMBS tranche, the investor purchases a "certificate" in that tranche.

I. Factual Background & Procedural History

As this decision involves a motion to dismiss, the facts recited are taken from the Complaint.

A. The Parties

Plaintiff Phoenix Light SF Limited (Phoenix) is a limited liability company incorporated in Ireland. Complaint ¶ 20. Phoenix asserts its claims against defendants as assignee of four distressed or defunct entities that purchased RMBS from Deutsche Bank: (1) Harrier Finance Limited (Harrier), a limited liability company incorporated in the Cayman Islands; (2) Kestrel Funding P.L.C. (Kestrel), a limited liability company incorporated in the Cayman Islands; (3) WestLB AG (WestLB), a German corporation; and (4) Greyhawk Funding LLC (Greyhawk), a Delaware limited liability company (collectively, the Assignors). *Id.* Plaintiffs Silver Elms CDO PLC, Silver Elms II CDO PLC (Silver Elms II) (collectively, Silver) and Kleros Preferred Funding V PLC (Kleros) are limited liability companies incorporated in Ireland that purchased RMBS from Deutsche Bank. ¶¶ 22-24. Plaintiff Blue Heron Funding V Ltd. (Heron) is a Cayman Islands company that purchased RMBS from Deutsche Bank. ¶ 25.

Defendant DBAG is a German company that is headquartered in New York. ¶ 27. The other defendants, DBSI, DBSP, DAAS, and ACE, are Delaware corporations and wholly-owned subsidiaries of DBAG. ¶¶ 28-31. DBSI is the investment banking and securities division of DBAG and underwrote all of the RMBS at issue in this case. ¶ 28. DBSP acquired the mortgage loans for most of the RMBS at issue. ¶ 29. DAAS and ACE purchased the mortgage loans from DBSP, deposited them into trusts, and sold the corresponding trust certificates to DBSI – which certificates were ultimately purchased by plaintiffs. ¶¶ 30-31.

B. The RMBS

Between January 25, 2006 and February 8, 2007, plaintiffs (including the Assignors) purchased 24 certificates in tranches of 14 RMBS. *See* ¶ 81. Plaintiffs contend that Deutsche Bank made fraudulent misrepresentations in the RMBS offering materials that made the RMBS appear to be far less risky than they were. Those alleged include: (1) misrepresentations concerning the mortgage originators' underwriting standards [¶¶ 84-227]; (2) misrepresentations concerning mortgage pool data, such as the borrowers' credit scores, occupancy rates, default rates, loan-to-value ratios, and property values [¶¶ 228-244]; and (3) misrepresentations concerning the credit ratings of the RMBS [¶¶ 245-251]. At its core, plaintiffs' allegation is that Deutsche Bank defrauded plaintiffs by selling them ostensibly low-risk RMBS that Deutsche Bank knew were risky investments. Deutsche Bank purportedly concealed the true risk of the RMBS by engaging in fraudulent conduct in the underwriting of mortgages, packaging these risky mortgages into securities, obtaining an investment grade rating from the credit agencies by providing them with false or misleading data, and, finally, marketing the RMBS to plaintiffs as low-risk investments, knowing full well that the RMBS were toxic.

The majority of the mortgage loans in this action did not originate with Deutsche Bank. ¶ 4. Instead, Deutsche Bank purchased the loans from the originators. *Id.* Before they did so, Deutsche Bank hired non-party Clayton Holdings, Inc. (Clayton) to conduct due diligence on the loans to determine if they complied with their underwriting guidelines and to ascertain if the property valuations were accurate. ¶ 10. The complaint alleges that Clayton tested a sample of the loans and determined that approximately 35% of the tested loans did not comply with the stated underwriting guidelines and/or were supported by false or inflated appraisals. *Id.* Plaintiffs contend that Deutsche Bank did not inform plaintiffs of these findings and did not disclose them in the offering materials. Instead, according to the complaint, Deutsche Bank used

this information to negotiate a lower purchase price for itself from the originators. *Id.* Plaintiffs contend that Deutsche Bank profited by obtaining millions of dollars in fees from the sale of these RMBS and also made billions of dollars by shorting other RMBS through credit default swaps. ¶¶ 18-19. Plaintiffs, on the other hand, lost virtually their entire $150 million investment in the subject RMBS.

Plaintiffs commenced this action on February 14, 2012, by serving a Summons with Notice. A Supplemental Summons (the SS) was filed and purportedly served on March 7, 2012. On May 14, 2012, plaintiffs filed the Complaint, asserting seven causes of action: (1) fraud; (2) fraudulent inducement; (3) aiding and abetting fraud; (4) negligent misrepresentation; (5) violations of § 11 of the United States Securities Act of 1933 (the 1933 Act); (6) violations of § 12(a)(2) of the 1933 Act; and (7) violations of § 15 of the 1933 Act.

II. Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty* Corp., 60 NY3d 491 (2009); *Skillgames, L.L.C. v Brody*, 1 AD3d 247, 250 (1st Dept 2003) (citing *McGill v Parker*, 179 AD2d 98, 105 (1992)); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.* (citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such

consideration." *Skillgames*, 1 AD3d at 250 (citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994)). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law [citation omitted]." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

As a preliminary matter, defendants contend that Phoenix does not have standing to sue for the losses allegedly suffered by the Assignors. However, defendants have not submitted documentary evidence that refutes Phoenix's contention that its acquisition of "all title, rights and causes of action" from the Assignors includes fraud claims. Indeed, where, as here, such language is used by a *defunct* entity to assign rights under a contract, the right to sue for fraud is presumed to have been included. *See Banque Arabe et Internationale D'Investissement v Md. Nat'l Bank*, 57 F3d 146, 151-53 (2d Cir 1995); *see also Abu Dhabi Comm. Bank v Morgan Stanley & Co.*, 888 F Supp 2d 431, 446 (SDNY 2012) (transferring "all rights, title and interest" in given transaction is "sufficient to effect the assignment of tort claims based on fraud"). For the purposes of this motion to dismiss, where the truth of allegations in the complaint must be accepted, the court assumes that Phoenix has the right to assert its fraud claims. Defendants' motion to dismiss Phoenix's claims for lack of standing, therefore, is denied without prejudice and with leave to renew if documents produced in discovery demonstrate that the right to assert such claims was never conferred upon Phoenix.

Next, defendants argue that Silver Elms II's claims must be dismissed because the SS, which unlike the original Summons, names Silver Elms II as a plaintiff for the first time and was not properly served. The court will not dismiss Silver Elms II's claims on this basis, since the

contention was raised for the first time in defendants' reply brief. The substantive allegations in the SS are substantially the same as in the Summons. Moreover, the Complaint, which was filed on May 14, 2012, names Silver Elms II as a plaintiff. Defendants have suffered no prejudice due to the manner in which the SS was served, and defendants were all on actual notice of the SS because it was filed on the NYSCEF system. That being said, even if service was improper, the court would grant plaintiffs an extension of time to effectuate service "in the interest of justice" pursuant to CPLR 306-b.

A. Fraud, Fraudulent Inducement, & Aiding and Abetting Fraud

To properly plead a cause of action for fraud, the complaint must contain allegations of a representation of material fact, falsity, scienter, reliance, and injury. *Small v Lorillard Tobacco Co.*, 94 NY2d 43, 57 (1999). Pursuant to CPLR 3016(b), the circumstances constituting the fraud must be stated in detail. *Id.* To establish a claim for fraudulent inducement, the plaintiff must allege that the elements of fraud occurred prior to the execution of the subject contract. *Centro Empresarial Cempresa S.A. v America Movil, S.A.B. de C.V.*, 17 NY3d 269, 276 (2011). To allege aiding and abetting fraud, the plaintiff "must allege the existence of the underlying fraud, actual knowledge, and substantial assistance." *Oster v Kirschner*, 77 AD3d 51, 55 (1st Dept 2010).

At the outset, the court notes that plaintiffs' fraud allegations are virtually identical to those asserted in *Dexia SA/NV v Bear, Stearns & Co.*, 2013 WL 856499 (SDNY Feb. 27, 2013) (Rakoff, J.). Defendants correctly contend that the heightened pleading standard under CPLR 3016(b) and FRCP 9(b) "are effectively the same." *See* Trans., p. 4. Moreover, "the elements of [New York] common law fraud essentially mirror those involved in [federal securities law] claims." *In re Merrill Lynch*, 2012 WL 1994707, at *3 (SDNY 2012). For the reasons discussed

infra, part II.A.2, plaintiffs adequately pled a claim for common law fraud. Nonetheless, before the court considers the merits of plaintiffs' fraud claims, the court will first address defendants' arguments that such claims are barred by the applicable statutes of limitation.

1. Statutes of Limitation

"When a nonresident sues on a cause of action accruing outside New York, CPLR 202 requires the cause of action to be timely under the limitation periods of both New York and the jurisdiction where the cause of action accrued." *Global Fin. Corp. v Triarc Corp.*, 93 NY2d 525, 528 (1999). "When an alleged injury is purely economic, the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss." *Id.* at 529. "[A] securities fraud claim arising outside this State is subject to the limitations periods of . . . the place where the investors resided." *Smith Barney, Harris Upham & Co. v Luckie*, 85 NY2d 193, 207 (1995). Thus, each plaintiff's fraud claim is governed by the statute of limitations of the jurisdiction in which it is incorporated. *See Global Fin. Corp.,* 93 NY2d at 530.

The fraud claims based on the purchases of RMBS by Harrier, Kestrel, Silver, Kleros, and Heron are subject to a 6-year statute of limitations, which is the time limit to bring a fraud claim under Irish and Cayman Island Law. *See* Dec. of Suzanne Kingston, dated Sept. 7, 2012, and Aff. of Anthony Akiwumi, dated Sept. 10, 2012. Moreover, the statute of limitations does not begin to run until the plaintiff is on notice of the fraud. *See id.* These claims are timely because defendants did not produce evidence that plaintiffs were on notice of facts giving rise to the alleged fraud prior to 2008, approximately four years before this action was commenced.

However, the fraud claims based on the purchases of RMBS by WestLB and Greyhawk are subject to the 3-year statute of limitations of Germany and Delaware, which also do not begin to run until the plaintiff is on notice of the fraud. *See* Dec. of Juergen Johannes Witte, dated July

12, 2012; *see also* 10 Del. Code § 8106. Under German law, the statute of limitations does not begin to run until December 31 of the year in which the plaintiff obtained notice of the fraud. *See id.* Thus, WestLB's and Greyhawk's claims would be barred by the statute of limitations if they were on notice of the fraud prior to December 31, 2008.

Defendants argue that plaintiffs were on notice of the fraud in 2008 because information concerning the falsity of the underlying loan data was widely reported by numerous major newspapers. For instance, in January 2008, the *New York Times* ran an article on an investigation into Clayton which stated that "[r]eports commissioned by the banks raised red flags about high-risk loans." *See* Def. Mem., p. 7, quoting Vikas Bajaj & Jenny Anderson, *Inquiry Focuses on Withholding of Data on Loans*, N.Y. TIMES, Jan. 12, 2008. However, while such public reporting might put plaintiff on notice that the RMBS offering materials contained misrepresentations, the statute of limitations does not begin to run until plaintiff is on notice of every element of the claim, which, in the case of fraud, includes scienter. As Justice Bransten recently held, information reported in newspapers about the possible falsity of loan data is insufficient to put plaintiffs on notice of a defendant's intent to defraud. *See Allstate Ins. Co. v Morgan Stanley*, Index No. 651840/2011, NYSCEF Dkt. No. 48, at *14-15 (Sup Ct, NY County, Mar. 14, 2013), citing *Merck & Co. v Reynolds*, 559 US 633, 130 S Ct 1784, 1796 (2010) ("A plaintiff cannot recover without proving that a defendant made a material misstatement *with an intent to deceive* . . . [i]t would therefore frustrate the very purpose of the discovery rule . . . if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter") (emphasis in original; internal citations omitted). Justice Bransten further noted that "courts have denied limitations-based motions in RMBS fraud actions despite objections similar to those raised by defendants" because "even where facts are 'widely-

reported' their knowledge cannot be imputed to a plaintiff absent actual notice." *Allstate*, *supra*, at *16-18, citing *In re Countrywide Fin. Corp. Mortgage-Backed Sec. Litig.*, 2012 WL 1322884, at *4 (CD Cal 2012); *Mass. Mut. Life Ins. Co. v Residential Funding Co.*, 843 F Supp 2d 191, 208-09 (D Mass 2012); *Capital Ventures Int'l v J.P. Morgan Mortg. Acquisition Corp.*, 2013 WL 535320, at *7 (D Mass 2013).

Here, as in *Allstate*, the newspaper articles cited by defendants did not put plaintiffs on notice of defendants' alleged intent to defraud them by marketing RMBS comprised of dubious loans as investment grade assets. Moreover, had plaintiffs sued defendants in 2008 based on the cited newspaper reports, this court would likely have dismissed the complaint for failure to plead scienter. The requirement, pursuant to CPLR 3016(b), that a plaintiff alleging fraud must plead scienter with particularity is meant to protect defendants, such as Deutsche Bank, from lawsuits based on mere conjecture that serve as fishing expeditions where the plaintiff rummages thought defendants' records hoping to uncover a smoking gun. Defendants cannot turn that protection on its head by contending that the time to bring a fraud claim begins to run before a viable complaint can be filed. Thus, the statute of limitations for WestLB's and Greyhawk's claims did not begin to run in 2008. Ergo, their claims are timely.

2. The Misrepresentations

The misrepresentations alleged in the Complaint and the parties' arguments regarding whether such representations can form the basis for a fraud claim were considered at length by Judge Rakoff in *Dexia*, *supra*, at *4-9,[1] where he noted that "the 'central issue' in determining

[1] In an Order dated April 2, 2013, Judge Rakoff granted defendants' motion for summary judgment in part and dismissed most of the claims asserted by plaintiffs, indicating that "an opinion explaining the reasons for these rulings will issue in due course." *See* 2013 WL 1320803. The court will not speculate about the basis for the decision, which might have been based on either standing or the merits (though his order dated April 22, 2013 suggests that the decision might be "null and void" for lack of subject matter jurisdiction). At this time, there is

whether material misrepresentations have been sufficiently pleaded 'is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, *would have mis[led] a reasonable investor about the nature of the [securities].*'" *Id.* at *4, quoting *Olkey v Hyperion 1999 Term Trust,* 98 F3d 2, 5 (2d Cir 1996) (emphasis added); *see also MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 294-96 (1st Dept 2011) (plaintiff must prove that the representations were material to its decision to enter into the transaction).

Plaintiffs have properly alleged that the subject misrepresentations were the proximate cause of their losses because defendants allegedly gave false loan data to the ratings agencies with the intent to procure an investment grade rating, knowing that such a rating was necessary to induce investors, such as plaintiffs, to invest in the RMBS. Had defendants disclosed Clayton's findings to the ratings agencies, the RMBS could not have been rated as investment grade. Hence, without defendants' misrepresentations, there would be no suitably rated RMBS for plaintiffs to invest in and plaintiffs (or any reasonable investor) would not have invested. The nexus between what defendants knew about the mortgage loans, the information given to the ratings agencies, and the information given to plaintiffs demonstrates a scheme that, if true, is fraudulent on its face.

Finally, Deutsche Bank sets forth the uncompelling argument (commonly made by similarly situated banks) that a financial institution lacks scienter when the institution's interests are not aligned with the interests of a rogue or dissenting trader. If this were the case, so long as a bank's net position on a transaction deviated from the trader's position, the bank could not be

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no way to know if the similarities between *Dexia* and this case are limited to the pleadings or also extend to the facts. That is the subject of discovery. The only relevance of *Dexia* to the instant decision is that it involved similar pleadings and claims, which, as discussed herein, warrants denial of defendants' motion to dismiss the fraud claims.

sued for fraud because it supposedly stood to lose from the very fraud alleged. This argument ignores the realities of the financial industry. First, a trader, such as Greg Lippman, may execute trading strategies that do not reflect the bank's net position on a security or a particular market for myriad reasons, such as hedging. Second, and more importantly, by 2006 and 2007, most major banks had amassed long positions on the housing market that could not be completely unwound, through selling securities, entering into credit default swaps, or otherwise. However, once the banks realized the problems in the housing market, they sought to amass large short positions to attempt to minimize their losses, and, if possible, profit from the impending market crash. *See, e.g.*, *Dodona I, LLC v Goldman, Sachs & Co.*, 847 FSupp2d 624, 632-33 (SDNY 2012). Consequently, for a bank to contend that it did not act with scienter with respect to touting the safety of RMBS because the bank stood to sustain a net loss if the RMBS were bad investments, defies the reality of the situation. Many banks were going to lose money no matter what. The operative question, however, is *how* much, and the *how* was often linked to what the bank could market to clients before the toxicity of the housing market could no longer hide behind the shroud of complex asset backed securities.

In sum, the allegations that Deutsche Bank made false representations in the RMBS offering materials that flatly contradict the reality depicted in Clayton's report to induce plaintiffs to purchase RMBS are sufficient to state a claim for fraud and fraudulent inducement. Additionally, plaintiffs have properly alleged a claim for aiding and abetting fraud because the Complaint explains how each of Deutsche Bank's subsidiaries played a role in the lifecycle of the RMBS and how they substantially assisted in the alleged fraud that led to plaintiffs purchasing the RMBS.

B. Negligent Misrepresentation

"A claim for negligent misrepresentation requires the plaintiff to demonstrate (1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information." *J.A.O. Acquisition Corp. v Stavitsky,* 8 NY3d 144, 148 (2007). Where, as here, the parties entered into an arms' length transaction to purchase RMBS, no special relationship exists. *See Allstate*, *supra*, at *33; *see also MBIA*, 87 AD3d at 297.

C. Claims Under the 1933 Act

The United States Supreme Court has held that the federal securities laws only apply to "transactions in securities listed on domestic exchanges[] and domestic transactions in other securities." *Morrison v Nat'l Australia Bank Ltd.*, 130 S Ct 2869, 2884 (2010). However, the Supreme Court did not define "domestic transaction." Here, the RMBS were not listed on a domestic exchange. As a result, the relevant inquiry is whether the sale of the subject RMBS to plaintiffs was a domestic transaction.

Plaintiffs argue that the subject transactions are domestic because the RMBS were registered with the SEC. However, the United States Court of Appeals for the Second Circuit has rejected this argument. *See Absolute Activist Value Master Fund Ltd. v Ficeto*, 677 F3d 60, 68-69 (2d Cir 2012). Instead, the Second Circuit has held that "plaintiffs must allege facts indicating that irrevocable liability was incurred or that title was transferred within the United States." *Id.* at 62. All of the plaintiffs are foreign companies (including the Assignors) and the Complaint does not allege facts sufficient to determine if the subject transactions meet the standard set forth by the Second Circuit. Given the relative uncertainty surrounding this area of federal law, the court will not make a determination of whether the transactions are subject to federal securities law without a more complete record. Therefore, plaintiffs' claims under the

1933 Act are dismissed, without prejudice, with leave to re-plead after discovery. Accordingly, it is

ORDERED that the motion to dismiss by defendants ACE Securities Corp., Deutsche Alt-A Securities, Inc., DB Structured Products, Inc., Deutsche Bank Securities Inc., and Deutsche Bank AG against plaintiffs Phoenix Light SF Limited, Silver Elms CDO PLC, Silver Elms II CDO PLC, Kleros Preferred Funding V PLC, and Blue Heron Funding V Ltd. is granted in part as follows: (1) the fourth cause of action (negligent misrepresentation) is dismissed with prejudice; (2) the fifth, sixth, and seventh causes of action (claims under the 1933 Act) are dismissed without prejudice; (3) the motion is denied, without prejudice, as to Phoenix Light SF Limited's standing; and (4) the motion is otherwise denied; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre St., rm. 228, New York, N.Y., for a status conference on May 7, 2013 at 11:00 in the forenoon.

Dated: April 24, 2013

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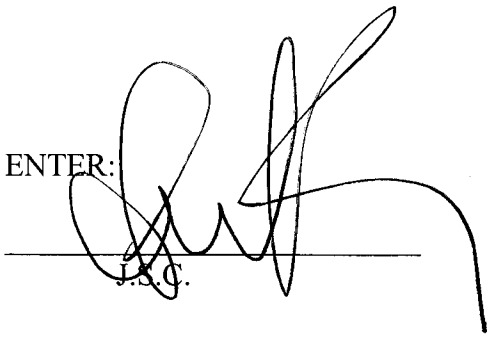

J.S.C.