STATE OF NEW YORK
SUPREME COURT : COUNTY OF ERIE

M&T BANK CORP.

Plaintiff

MEMORANDUM DECISION

vs.

Index No. 7064/08

GEMSTONE CDO VII, LTD., GEMSTONE CDO VII CORP., DEUTSCHE BANK SECURITIES, INC., DEUTSCHE BANK TRUST COMPANY AMERICAS, DEUTSCHE BANK AG, HBK INVESTMENTS, LP, HBK PARTNERS II, LP, and HBK MANAGEMENT LLC

Defendants

BEFORE: **HON. JOHN M. CURRAN, J.S.C.**

APPEARANCES:

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CURRAN, J.

Defendants have moved to dismiss Plaintiff's Complaint ("Complaint") on a pre-answer basis pursuant to CPLR §§ 3013, 3014, 3016 (b), 3211 (a) (1) and 3211 (a) (7). The parties have stipulated to the submission of a Joint Appendix containing the following documents referred to in the Complaint: (1) the Preliminary Offering Circular dated February 14, 2007 ("Preliminary Circular"); (2) the Debt Investor Presentation dated February 8, 2007 ("Investor Presentation"); and (3) the Indenture Agreement, as of March 15, 2007 ("Indenture"). In support of the motions, Defendants have submitted various evidentiary material, including the Final Offering Circular dated March 15, 2007 ("Final Circular"); the Collateral Management Agreement dated March 15, 2007 ("Management Agreement"); a schedule of collateral annexed to the Indenture; various filings by the Plaintiff with the United States Securities and Exchange Commission ("SEC"); certain of Plaintiff's annual reports; and various newspaper articles and media advisories. In opposition to the motions, Plaintiff has submitted an SEC filing by one of the Defendants and various newspaper articles.

Introduction

This action was commenced with the filing of the Complaint on June 16, 2008. It seeks recovery of more than $82 million of losses allegedly suffered by Plaintiff through the "fraud and other wrongful conduct" of the Defendants (Complaint, ¶ 10). These allegations arise out of the purchase by Plaintiff, on February 21, 2007, from defendant, Deutsche Bank Securities, Inc. ("DBSI"), of two promissory notes ("Notes") which were part of the "collateralized debt obligation" ("CDO") issued by defendant, Gemstone CDO VII, Ltd. and its co-issuer, Gemstone CDO VII Corp. (hereinafter referred to together as the "Gemstone Defendants"). According to the Complaint, the Notes were marketed by Defendants as "providing a higher interest rate than Treasury Bills or high-grade corporate bonds, with a risk level lower than high-grade bonds and approaching the risk-free level of Treasury Bills" (Complaint, ¶ 10).

Plaintiff alleges that it relied upon various written and oral representations about the Notes made by the Defendants, particularly DBSI, who sold the Notes to Plaintiff, and by defendant, HBK Investments, LP ("HBK"), the Collateral Manager for the assets underlying the CDO. Plaintiff further alleges that these representations were false when made and that the Defendants were aware they were false when made. Additionally, Plaintiff claims that the Defendants had an affirmative duty to disclose the special facts they had regarding the collateral underlying the CDO and the credit ratings pertaining to them. These claims are premised on the assertion that Defendants knowingly concealed material information from Plaintiff, the knowledge of which would have caused Plaintiff not to purchase the Notes.

The Parties

Plaintiff is a banking corporation which Defendants allege is one of the nation's twenty (20) largest banks.

Defendant, Gemstone CDO VII, Ltd. ("Gemstone Ltd."), is a limited partnership and is the issuer of the Notes sold to Plaintiff. Defendant, Gemstone CDO VII Corp. ("Gemstone Corp."), is a corporation and is the co-issuer of the Notes sold to Plaintiff.

The Gemstone Defendants issued the Notes which pay interest at a stipulated rate. The purchaser of the Notes (i.e., Plaintiff) is entitled to that income stream. The Gemstone Defendants also acquire, hold and pledge the assets which serve as collateral for the repayment of the Notes. The assets are pledged to a trustee which performs pursuant to the terms of the Indenture. The Gemstone Defendants do not own any material assets other than the collateral pledged to the trustee. The Gemstone Defendants receive structuring fees and closing expenses in connection with the transaction.

DBSI is a corporation and a registered broker-dealer. DBSI was the "initial purchaser" of the entire principal amount of the notes issued by the Gemstone Defendants, including the Notes purchased by Plaintiff. DBSI purchased all of the notes for the purpose of privately placing them with eligible investors. DBSI was the direct seller of the Notes to the Plaintiff. DBSI earns commissions on the sales.

Defendant, Deutsche Bank Trust Company Americas ("Deutsche Bank Trust"), is a banking corporation and serves as the trustee of the trust formed to hold and administer the collateral underlying the CDO. Deutsche Bank Trust undertook to perform the duties set forth

in the Indenture. The trustee is entitled to collect compensation for its services, including custodial services.

Defendant, Deutsche Bank AG ("DBAG"), is a corporation which acted as a counterparty on the credit default swaps which comprise a portion of the collateral for the notes issued by the Gemstone Defendants.

HBK is a limited partnership which serves as Collateral Manager for the collateral which is held by Deutsche Bank Trust pursuant to the Indenture by virtue of the pledge given by the Gemstone Defendants. HBK also is the holder of a lesser class of notes involved in this transaction. HBK's duties are defined by the Management Agreement entered into with Gemstone Ltd. Pursuant to that agreement, HBK provides management services, including the acquisition and disposal of the assets which serve as collateral for the CDO. In exchange for its services, HBK receives a management fee.

Defendant, HBK Partners II, LP ("HBK Partners"), is a limited partnership and is the general partner of HBK. Defendant, HBK Management, LLC ("HBK Management"), is a limited liability company and is the general partner of HBK Partners. HBK Partners and HBK Management have been joined in order to ensure that HBK is properly named in this litigation (together these defendants are hereinafter referred to as the "HBK Defendants").

The Complaint

The Complaint asserts twelve (12) causes of action. The following is a chart outlining the causes of action alleged against each defendant:

Cause of Action #	Defendants	Cause of Action Theory
First	DBSI, HBK, Gemstone Defendants and HBK Defendants	Common Law Fraud
Second	Deutsche Bank Trust and DBAG	Aiding and Abetting Common Law Fraud
Third	DBSI, HBK, Gemstone Defendants and HBK Defendants	Negligent Misrepresentation
Fourth	Deutsche Bank Trust, HBK and HBK Defendants	Breach of Fiduciary Duty
Fifth	DBSI and DBAG	Aiding and Abetting Breach of Fiduciary Duty
Sixth	DBSI and Deutsche Bank Trust	Breach of Contract
Seventh and Eighth	DBSI, HBK and Gemstone Defendants	Violations of General Business Law §§ 349 and 350
Ninth, Tenth and Eleventh	DBSI	Rescission of Contract (fraud, mistake and illegality)
Twelfth	All Defendants	Unjust Enrichment

The relief sought in the Complaint is compensatory and punitive damages, rescission, an accounting, a constructive trust and disgorgement. The compensatory damages are alleged to exceed $82 million.

The Transaction

The Gemstone Defendants are special purpose entities formed on a limited liability basis to serve as issuers of the notes constituting the CDO. A CDO is a structured financial product sold through the issuance of debt securities (i.e., notes). Entities such as the Gemstone Defendants are formed for the limited purpose of serving as the conduit through

which that financial product is sold. The Gemstone Defendants are both alleged to be "Deutsche Bank affiliates" (Complaint, ¶ 23).

The CDO is collateralized by other debt instruments, the repayment of which is the sole recourse for purchasers of the notes issued by the CDO. The debt instruments securing the amounts paid under the notes issued by a CDO are typically residential mortgage-backed securities ("RMBS"), commercial mortgage-backed securities ("CMBS"), and synthetic securities such as credit default swaps. "The purchase of securities issued by the CDO is essentially the purchase of a right to participate in the cash flows from the collateral portfolio owned by the CDO" (Complaint, ¶ 16).

The CDO was secured largely by RMBS (88.7%). Most of the collateral consisted of sub-prime mortgages[1] (53.1%) and mid-prime mortgages (35.2%), while a small portion (1.4%) were prime mortgages. The other collateral consisted of synthetic securities, CMBS and student loans.

The synthetic securities were a series of credit default swaps with DBAG, known as the counterparty. Each such security "relates to a Reference Obligation whereby the Issuer sells credit protection to the . . . counterparty on such Reference Obligation" (Final

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[1] Sub-prime mortgages are those furnished to borrowers with low credit ratings either because they have damaged credit or no credit history. Because the default risk is greater for these mortgages, they bear a higher interest rate.

Circular, p. 122).[2] The basic concept is similar to the purchase of insurance whereby, in this context, DBAG purchased credit insurance against the default of certain asset-backed securities serving as the "Reference Obligation" (Complaint, ¶¶ 19-20, 110).[3] Gemstone Ltd., as seller of the credit default protection to DBAG, receives premiums which in turn serve as collateral and/or a source of liquidity for the CDO (Final Circular, pp. 122-130). Plaintiff alleges that DBAG "acted as counterparty on the credit default swaps which constituted $600 million of the collateral for the Gemstone VII notes" (Complaint, ¶ 6).

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[2] Only a few court decisions have described credit default swaps (*see, e.g.*, *Eternity Global Master Fund, Ltd. v Morgan Guar. Trust Co.*, 375 F3d 168, 171-173 [2d Cir 2004] ["Simply put, a credit default swap is a bilateral financial contract in which '[a] protection buyer makes [ ] periodic payments to . . . the protection seller, in return for a contingent payment if a predefined credit event occurs in the reference credit,' i.e., the obligation on which the contract is written"] [citation omitted]; *Merrill Lynch Intl. v XL Capital Assur. Inc.*, 564 F Supp 2d 298 [SD NY 2008] ["A credit default swap is an arrangement similar to an insurance contract. The buyer of protection pays a periodic fee, like an insurance premium, to the seller of protection, in exchange for compensation in the event that the insured security experiences default"]; *In re World Com, Inc. Sec. Litig.*, 346 F Supp 2d 628 [SD NY 2004] ["A credit default swap enables a lender to hedge its exposure to a borrower. The lender enters into a swap contract and pays a premium for credit default protection to the swap seller. In the event of a failure to pay, the swap seller agrees to pay the lender the value of the loan. If there is no failure to pay, the lender has lost only the premium"]; *Deutsche Bank, AG v Ambac Credit Prods., LLC*, 2006 WL 1867497, 2006 US Dist LEXIS 45322 [SD NY 2006] [A credit default swap is a "species of [a] credit derivative" which is "akin to insurance policies . . . transferring credit risk from a 'protection buyer' to a 'protection seller'"]).

[3] The New York State Insurance Department has recently addressed whether credit default swaps should be treated as a regulated insurance product (see, Venokur, Magidson & Singer, *Comparing Credit Default Swaps to Insurance Contracts: Did the New York State Insurance Department Get it Right?*, Futures and Derivatives Law Report, Vol 28, Issue 11 [Dec. 2008]). One of the issues in this regard is whether the counterparty owns the Reference Obligation. The record here does not disclose the nature of the Reference Obligation or whether DBAG owns it.

The Gemstone Defendants issued notes and "preference shares" valued at approximately $1.1 billion. Preference shares are essentially equity interests in the issuers. The CDO was structured according to a mezzanine of seven (7) classes, plus the preference shares. Each class, also referred to as a "tranch," is referred to by an alphabetical and/or numerical designation. The classes are organized sequentially such that each class is subordinated in right of payment to other classes with an earlier alphabetical/numerical designation. The Class A-1 Notes are the highest and most secure while Class E Notes are the lowest and least secure class with only the preference shares behind the Class E Notes. The higher and more secure classes receive a lesser interest rate. In short, the greater the risk, the greater the potential reward.

Each class of notes received ratings from Moody's and Standard & Poor's ("S&P").[4] The most senior and secure classes in the CDO, Class A-1 Notes and Class A-2 Notes, were required as a condition of the issuance of the notes to be rated "Aaa" by Moody's and "AAA" by S&P. A further condition of the issuance for the notes was that the Class B Notes be rated at least "Aa2" by Moody's and "AA" by S&P (Final Circular, cover page). The remaining classes received lesser ratings in descending order. The "AAA" and "AA" ratings by S&P are the two highest issued by S&P (Complaint, ¶ 26). Plaintiff purchased $42 million dollars of Class A-2 notes (rated "AAA") and $40 million dollars of Class B notes (rated "AA").

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[4] These two credit rating agencies are among the most prominent in the business. "These private agencies form opinions regarding an issuer's risk of default . . . Due to the market's faith in the credit agencies, an issuer must typically offer higher rates of interest when it has received a lower credit rating . . . Investors consider credit rating agencies' opinions important . . ." (*J&R Mktg., SEP v General Motors Corp.*, 549 F3d 384, 388-393 [6th Cir 2008]).

The CDO notes have a maximum legal life of forty (40) years (Investor Presentation, p. 7). Such notes are typically redeemed in a much shorter "average life" through the various redemption mechanisms outlined in the Final Circular (Investor Presentation, p. 7; Final Circular, pp. 74-80).

Plaintiff began investigating the possibility of investing in RMBS-backed CDO's in "early 2007." Plaintiff contacted DBSI and was provided with "general information" regarding the CDO (Complaint, ¶ 22).

Plaintiff also met with HBK in early February 2007 at which time Plaintiff was provided the Preliminary Circular and Investor Presentation (hereinafter together referred to as the "Gemstone Offering Materials") (Complaint, ¶ 24). Plaintiff placed its order for the $82 million in Notes on February 21, 2007 (Complaint, ¶ 25). The CDO offering closed on March 15, 2007, at which time Plaintiff's purchase became complete (Complaint, ¶ 37).

The parties agree that the sub-prime mortgage crisis gained prominence in the first half of 2007, largely due to the recognition of housing devaluation and increased mortgage defaults tied at least in part to adjustable rate mortgages. By early July of 2007, the Notes were placed on negative "credit watch" for possible downgrade by S&P (Complaint, ¶ 38). By October of 2007, much of the collateral supporting the CDO had been downgraded and, in November of 2007, the Notes held by Plaintiff were likewise downgraded (Complaint, ¶¶ 49

and 51). In December of 2007, Plaintiff sought to establish a market value for the Notes[5] and determined that the Notes had lost 95% of their original value (Complaint, ¶ 52). The Notes were further downgraded in February of 2008 (Complaint, ¶ 53). As of April 30, 2008, Plaintiff carried the Notes on its books at a value of $1.031 million (Complaint, ¶ 53), a reduction from the initial cost of more than 98%.

Procedural Standards

The crux of these motions is Defendants' claim that the Complaint fails to state any cause of action and therefore must be dismissed under CPLR § 3211 (a) (7). The Court of Appeals has held: "Under modern pleading theory, a complaint should not be dismissed on a pleading motion so long as, when the plaintiff is given the benefit of every possible favorable inference, a cause of action exists . . . Modern pleading rules are designed to focus attention on whether the pleader has a cause of action rather than on whether he has properly stated one (*Rovello v Orofino Realty Co., Inc.*, 40 NY2d 633, 634-636 [1976], citing 6 Carmody-Wait 2d § 38.19; *Kelly v Bank of Buffalo*, 32 AD2d 875 [4th Dept 1969]).[6] Initially, the sole criterion is

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[5] This process is typically a result of what is known as "mark-to-market" accounting required by Statement No. 157 of the Federal Accounting Standards Board. This rule (which has been recently relaxed) requires banks to value securities at current market prices even if they plan to hold the securities for awhile and therefore may recoup market loss over time. Accordingly, some or all of Plaintiff's alleged losses may be lessened over time by an increase in market value.

[6] The *Rovello* decision has been criticized by Professor David D. Siegel as having "unfortunately reduced" the "utility of the CPLR 3211 (a) (7) motion" (Siegel, NY Prac § 265, at 446 [4th ed]).

whether the pleading states a cause of action, and if from the four corners of the complaint "factual allegations are discerned which taken together manifest any cause of action cognizable at law, a motion for dismissal will fail" (*Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977], citing *Foley v D'Agostino*, 21 AD2d 60, 64-65 [1st Dept 1964]; Siegel, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C3211:24; Weinstein-Korn-Miller, NY Civ Prac ¶ 3211.36). "On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction. We accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory" (*Leon v Martinez*, 84 NY2d 83, 87-88 [1994] [citation omitted]). The Court of Appeals has further applied *Rovello* to mean that a plaintiff's complaint and additional affidavits submitted by plaintiffs on a CPLR 3211 (a) (7) motion "must be given their most favorable intendment" (*Arrington v New York Times Co.*, 55 NY2d 433, 442 [1982]; *see also Pharmhealth Infusion, Inc. v Rohm Servs. Corp.*, 249 AD2d 950 [4th Dept 1998]).

The Appellate Division has held that even facts alleged "upon information and belief" must be considered as true upon a motion pursuant to CPLR 3211 (a) (7) (*Roldan v Allstate Ins. Co.*, 149 AD2d 20, 40 [2d Dept 1989]). Nevertheless, the Appellate Division also has held that "mere conclusory assertions" are not enough to defend against a motion to dismiss (*Spallina v Giannoccaro*, 98 AD2d 103, 108 [4th Dept 1983]), and that "allegations consisting of bare legal conclusions, as well as factual claims either inherently incredible or flatly

contradicted by documentary evidence" are likewise insufficient (*Sud v Sud*, 211 AD2d 423, 424 [1st Dept 1995]).

The *Rovello* decision has given birth to a conflict over whether a court may read a defendant's factual affidavits submitted in support of a CPLR 3211 (a) (7) motion (*see* 97 Siegel's Practice Review, at 4 [July 2000]). In *Rovello*, the Court of Appeals stated that "affidavits received on a unconverted motion to dismiss for failure to state a cause of action are not to be examined for the purpose of determining whether there is evidentiary support for the pleading" and that "affidavits may be received for a limited purpose only, serving normally to remedy defects in the complaint . . ." (40 NY2d at 635-636). The conflict has arisen because the *Rovello* court completed the immediately-preceding quoted sentence as follows: ". . ., although there may be instances in which a submission by a plaintiff will conclusively establish that he has no cause of action" (40 NY2d at 636). Further, the very next sentence states: ". . . affidavits submitted by the defendant will seldom if ever warrant the relief he seeks unless too the affidavits establish conclusively that plaintiff has no cause of action" (40 NY2d at 636).[7]

The greater weight of Appellate Division authority permits consideration of evidentiary material received from defendants on a CPLR 3211 (a) (7) motion, but only if it

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[7] The Third Department sometimes has held that trial courts must "ignore" factual affidavits submitted by defendants on a CPLR 3211 (a) (7) motion (*Henbest & Morrisey, Inc. v W.H. Ins. Agency, Inc.*, 259 AD2d 829, 830 [3d Dept 1999]; *Valentino v County of Tompkins*, 284 AD2d 898, 899 [3d Dept 2001]), although it has not done so consistently (*Marraccini v Bertelsmann Music Group, Inc.*, 221 AD2d 95, 97 [3d Dept 1996], *lv denied* 89 NY2d 809 [1997]; *Allen v City of New York*, 49 AD3d 1126, 1127 [3d Dept 2008], *lv denied* 11 NY3d 705 [2008]).

"conclusively establishes" that plaintiff has no cause of action (Weinstein-Korn-Miller, NY Civ Prac, § 21.03 [Matthew Bender Chase ed] [and cases cited therein]; *Fields v Leeponis*, 95 AD2d 822 [2d Dept 1983]; *Town of North Hempstead v Sea Crest Constr. Corp.*, 119 AD2d 744, 746 [2d Dept 1986]); *M&L Provisions, Inc. v Dominick's Italian Delights, Inc.*, 141 AD2d 616 [2d Dept 1988]; *Rhode v Port Washington Cinema Corp.*, 267 AD2d 444 [2d Dept 1999]; *Gerson v Enter. Rent-A-Car Co.*, 286 AD2d 475 [2d Dept 2001]). Accordingly, this Court has reviewed Defendants' evidentiary material but has only relied upon it if it conclusively establishes that Plaintiff does not have a cause of action (*Albert v Solimon*, 252 AD2d 139, 140-141 [4th Dept 1998], *affd* 94 NY2d 771 [1999]; *Watts v Champion Home Bldrs. Co.*, 15 AD3d 850, 851 [4th Dept 2005]).

Defendants also have moved to dismiss under CPLR 3211 (a) (1) alleging that documentary evidence refutes Plaintiff's claims. Defendants have submitted affidavits and exhibits alleging that such "documentary evidence" warrants dismissal of the Complaint. It is the same evidentiary material Defendants assert "conclusively establishes" that Plaintiff does not have a cause of action and mandates dismissal under CPLR 3211 (a) (7). The standard under CPLR 3211 (a) (1), however, is different than under CPLR 3211 (a) (7). Dismissal under CPLR 3211 (a) (1) "may be appropriately granted only where the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law" (*Goshen v Mut. Life Ins. Co.*, 98 NY2d 314, 326 [2002], citing *Leon*, 84 NY2d at 88). Dismissals under this section are rare and typically involve "a paper whose content is

essentially undeniable and which, assuming the verity of its contents and the validity of its execution, will itself support the ground on which the motion is based" (Siegel, Practice Commentaries, McKinney's Cons Laws of NY, Book 7B, CPLR C3211:10). Most of the grounds eligible to support a motion under this subsection are set forth in CPLR 3211 (a) (5) (Siegel, NY Prac § 259, at 441 [4th ed]). None of those grounds is involved here. Moreover, Defendants have not identified any specific document, such as a note, mortgage or judgment, which, in and of itself, requires dismissal (*See, e.g. Heaney v Purdy*, 29 NY2d 157 [1971]; *Bronxville Knolls, Inc. v Webster Town Ctr. Partnership*, 221 AD2d 248 [1st Dept 1995]).

Defendants also premise their dismissal motions on CPLR 3013, 3014 and 3016 (b). Particularly in light of the legislative policy set forth in CPLR 3026 that "pleadings shall be liberally construed," it cannot be seriously doubted that the Complaint, comprised of one hundred forty-one (141) separate paragraphs and twelve (12) separately stated causes of action, complies with the directives of CPLR 3013 and CPLR 3014 to set forth particular, plain and concise statements.[8]

Defendants' reliance upon these sections appears to supplement their arguments that the Complaint violates CPLR 3016 (b) requiring that circumstances constituting misrepresentation, fraud and breach of trust be "stated in detail." More than thirty (30) years ago, the Court of Appeals interpreted this provision to require "only that the misconduct complained of be set forth in sufficient detail to clearly inform a defendant with respect to the

[8] Defendants did not move for a more definite statement under CPLR 3024 (a).

incidents complained of and is not to be interpreted so strictly as to prevent an otherwise valid cause of action in situations where it may be 'impossible to state in detail the circumstances constituting a fraud'" (*Lanzi v Brooks*, 43 NY2d 778, 780 [1977], citing *Jared Contr. Corp. v New York City Tr. Auth.*, 22 NY2d 187, 194 [1968]). More recently, the Court of Appeals has held that the requirement of CPLR 3016 (b) "should not be confused with unassailable proof of fraud" and that the requirement "may be met when the facts are sufficient to permit a reasonable inference of the alleged conduct" (*Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491-92 [2008]). In *Pludeman*, the court cautioned against dismissing a fraud claim at the pleading stage if facts "are unavailable prior to discovery," again, so long as the Complaint alleges a scheme giving rise to a reasonable inference of fraud (10 NY3d at 493).

Based on these standards, the Court must evaluate whether: (1) the Complaint alleges the necessary elements of each cause of action; (2) the allegations of fact in the Complaint are sufficiently clear as opposed to conclusory; (3) the allegations of fact are "inherently incredible" or flatly contradicted by documentary evidence such that Defendants have conclusively established Plaintiff has no causes of action; and (4) the allegations involving misrepresentations, fraud and breach of trust are set forth in sufficient detail to clearly inform Defendants of the incidents complained of and allow a reasonable inference of the alleged misconduct.

First Cause of Action: Common Law Fraud

1. Nature of the duty breached

While the relationships among the parties are largely founded on written agreements voluntarily undertaken, and the relationships should therefore be governed by those writings, the law also imposes a more general duty on the parties to avoid injury to others (Prosser and Keeton, Torts § 92, at 655 [5th Ed]). This duty forms the basis of the law of torts (*Id.*). It is a duty existing "apart from and independent of promises made and therefore apart from any manifested intention of parties to a contract or other bargaining transaction" (*Id.,* at 656).

A cause of action for fraud lies in tort (*Channel Master Corp. v Aluminum Ltd. Sales, Inc.*, 4 NY2d 403 [1958]). Liability in fraud is incurred for a violation of the duty of honesty and fair dealing which the law enjoins upon parties engaged in transactions with one another (37 Am Jur 2d, Fraud and Deceit, § 15; *Lipkind v Ward*, 256 AD 74 [3d Dept 1939]). Accordingly, when alleging fraud, a plaintiff must allege facts demonstrating a breach of this duty existing under tort law, separate and apart from any duty voluntarily undertaken through the exchange of contractual promises (*Rich v N.Y. Cent. & Hudson Riv. R.R. Co.*, 87 NY 382 [1882]; *North Shore Bottling Co., Inc. v C. Schmidt & Sons, Inc.*, 22 NY2d 171 [1968]; *Steigerwald v Dean Witter Reynolds, Inc.*, 107 AD2d 1026 [4th Dept 1985]).

It is well-settled that it is not enough for a plaintiff to base allegations of fraud solely on facts which give rise to nothing more than an alleged breach of a duty undertaken through a promise in a contract (*Clark-Fitzpatrick, Inc. v Long Island R.R. Co.*, 70 NY2d 382 [1987]; *Sommer v Federal Signal Corp.*, 79 NY2d 540 [1992]; *Rocanova v Equitable Life*

Assur. Socy., 83 NY2d 603 [1994]; *New York Univ. v Continental Ins. Co.*, 87 NY2d 308 [1995]; *Albemarle Theatre, Inc. v Bayberry Realty* Corp., 27 AD2d 172 [1st Dept 1967]; *Wegman v Dairylea Coop, Inc.*, 50 AD2d 108 [4th Dept 1975]). The Appellate Division has routinely held that "a cause of action for fraud will not arise when the only fraud charged relates to a breach of contract" (*Wegman*, 50 AD2d at 113; *Miller v Volk & Huxley, Inc.*, 44 AD2d 810 [1st Dept 1974]; *McKernin v Fanny Farmer Candy Shops, Inc.*, 176 AD2d 233 [2d Dept 1991]; *Shlang v Bear's Estates Dev.*, 194 AD2d 914 [3d Dept 1993]). More recently, our new Chief Judge has observed: "Fraud, a wrong bordering on criminality is, by design, not easily asserted . . ." (*Braddock v Braddock*, ___ AD3d ___, 2009 NY Slip Op 39, *12 [1st Dept 2009] [Lippman, J., dissenting], citing *Gaidon v Guardian Life Ins. Co. of Am.*, 94 NY2d 330, 348 [1999]).

Within this legal framework, the courts must analyze the origin of the duty allegedly breached. If it originates solely from promises freely and mutually exchanged, the breach of duty is governed by the law of contracts. If the duty arises solely from the obligation to conduct one's affairs with honesty and fair dealing, the breach of duty is governed by the law of torts. As the Court of Appeals recognized long ago, these concepts are not always easily separated:

> Between actions plainly *ex contractu* and those as clearly *ex delicto* there exists what has been termed a border-land, where the lines of distinction are shadowy and obscure, and the tort and the contract so approach each other, and become so nearly coincident as to make their practical separation somewhat difficult.

Rich, 87 NY at 390. Because the Complaint alleges both fraud and breach of contract, and fraud based on written misrepresentations apparently contained in contracts, this Court will need to evaluate the nature of the duties Defendants allegedly breached.

2. Different types of fraud

Hornbook law in New York recognizes the distinction between "actual fraud" and "constructive fraud" (60A NY Jur 2d, Fraud and Deceit § 2). The former is predicated on an "intentional deception" while the latter generally requires "a confidential fiduciary relationship between the parties, or one having superior knowledge over the other" (*Id.*). The elements for both are the same except that, with constructive fraud, the need to prove knowledge of the falsity of a representation is replaced by the need to establish the existence of a fiduciary/confidential relationship, or superior knowledge (*Id.*).

New York also recognizes that fraud may be effectuated through affirmative representations or concealment (60A NY Jur 2d, Fraud and Deceit § 91). With concealment, a plaintiff generally must demonstrate more than mere silence but also must show a "purpose or design" in suppressing the truth (60A NY Jur 2d, Fraud and Deceit § 92). When mere silence is alleged, a plaintiff must establish a duty to speak (60A NY Jur 2d, Fraud and Deceit § 91).

The Complaint purports to allege theories sounding in both actual and constructive fraud, as well as based on affirmative representations and concealment.

3. Elements of cause of action

The elements of fraudulent misrepresentation are a representation of material fact, falsity, scienter, reasonable reliance and injury (*Small v Lorillard Tobacco Co., Inc.*, 94 NY2d 43 [1999]; *Kline v Taukpoint Realty Corp.*, 302 AD2d 433 [2d Dept 2003]). When

fraudulent concealment is alleged, plaintiff must plead that the defendant had a duty to disclose because the defendant had special or superior knowledge of the facts not available to the other party, or where the defendant has communicated a half-truth or made some other misleading, partial disclosure (*Dembeck v 220 Cent. Park S., LLC*, 33 AD3d 491 [1st Dept 2006]; *Donovan v Aeolian*, 270 NY 267 [1936]; *Williams v Sidley Austin Brown & Wood, LLP*, 38 AD3d 219 [1st Dept 2007]).

4. <u>The alleged misrepresentation/omissions</u>

The first cause of action alleges that DBSI, HBK and the Gemstone Defendants made "material misrepresentations and omissions" (Complaint, ¶¶ 80 and 81). With respect to DBSI and HBK, the Complaint alleges that these misrepresentations were in writing contained in the Gemstone Offering Materials and/or made orally to the Plaintiff. With respect to the Gemstone Defendants, Plaintiff alleges only that the Gemstone Offering Materials contained material misrepresentations. All of these Defendants are alleged to have omitted communicating the truth to Plaintiff.

According to the Complaint, the written representations upon which Plaintiff relied are contained in the Preliminary Circular and the Investor Presentation. The Preliminary Circular is relied upon to assert that "the Gemstone VII notes were marketed with an overwhelming emphasis on the S&P and Moody's ratings of the Notes and the representations of safety and low risk conveyed by those writings" (Complaint, ¶ 33). The alleged written

misrepresentations contained in the Investor Presentation are particularized in paragraph 34 of the Complaint and relate solely to representations made by and pertaining to HBK.[9]

The oral misrepresentations upon which the fraud cause of action is based are alleged to be made only by DBSI and HBK. They are alleged to have been made by DBSI salesman Sean Whelan and HBK's senior collateral manager, Kevin Jenks. In February of 2007, Mr. Whelan of DBSI allegedly represented that HBK "does constant maintenance and surveillance on the market" and that the "underlying structures in these bonds are built to withstand adverse conditions" because they are "fully rock solid" (Complaint, ¶ 36). In July of 2007, Mr. Jenks of HBK allegedly represented that the Notes were not "at risk of losing principal or becoming delinquent in interest payments" and that HBK had the power to force still-viable originators to re-purchase the underlying loans (Complaint, ¶ 41).

5. Gemstone Defendants' alleged misrepresentations

The Complaint alleges that the Gemstone Offering Materials were drafted by DBSI and HBK (Complaint, ¶ 81). The Complaint fails to allege any written misrepresentation drafted or prepared by the Gemstone Defendants. The Complaint further fails to allege any oral misrepresentation made by any representative of the Gemstone Defendants. Rather, the Complaint in conclusory fashion alleges that the Gemstone Defendants "are directly responsible and liable for these misrepresentations . . ." (Complaint, ¶ 81). The Complaint, however, does

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[9] For example, Plaintiff alleges that the Investor Presentation contains representations that HBK "conducts due diligence of underlying collateral;" "aggressively pursues exit strategies when investments underperform, expressly where fraud is a factor;" and "works with dealers and originators to customize pools by kicking out problem loans" by analyzing underlying loans using "our own loan level surveillance systems" (Complaint, ¶ 34; Investor Presentation, pp. 30-32, 41).

not allege how or why this is so. Therefore, as to any misrepresentations, the Complaint against the Gemstone Defendants must be dismissed.

6. DBSI/HBK alleged misrepresentations

With respect to DBSI and HBK, the Complaint alleges that they used the Preliminary Circular to overemphasize the ratings procured from Moody's and S&P. Specifically, Plaintiff alleges that the "ratings were misleading and inflated because defendants withheld from the rating agencies material information about the quality and default problems defendants were experiencing with subprime collateral under their control in late 2006 and early 2007" (Complaint, ¶ 12). Defendants also allegedly withheld information from the rating agencies concerning "subprime originators (who) were refusing to stand behind their contractual warranties relating to such loans" (Complaint, ¶ 12). Plaintiff allegedly learned the truth in September of 2007 when Mr. Jenks' replacement at HBK revealed that HBK had been fighting with one of its largest subprime mortgage originators for nine (9) months and that there had been disputes with a total of five (5) such originators dating back to loans defaulting in 2006 (Complaint, ¶¶ 44-45). Plaintiff alleges that Defendants knew of these disputes and defaults in late 2006 and early 2007, and did not disclose them to Plaintiff or the ratings agencies (Complaint, ¶¶ 46-48). Plaintiff thereupon alleges, on information and belief, that if this information had been disclosed to the ratings agencies, the Notes would have received lower ratings and Plaintiff would not have purchased them (Complaint, ¶ 48).

Because these ratings were based on false information provided by HBK and DBSI, the use of the Preliminary Circular for this purpose was allegedly part of the fraudulent scheme. Additionally, using the Investor Presentation to tout HBK's expertise and to otherwise

reassure Plaintiff about the collateral underlying the CDO, DBSI and HBK purportedly used the Preliminary Circular and Investor Presentation to falsely represent the quality and condition of the CDO.

In addition to common law fraud, Plaintiff has alleged against DBSI a breach of contract cause of action incorporating by reference the representations made in the Gemstone Offering Materials (Complaint, ¶ 113). Plaintiff alleges that the representations in these documents were material terms of its contract with DBSI.[10] Thus, on this record as to DBSI, the written misrepresentations underlying the fraud cause of action are duplicative of and relate solely to promises contained in the contract alleged to exist between the parties. By Plaintiff's own allegations, therefore, the duty allegedly breached by DBSI in terms of written misrepresentations arise solely out of contract law. Accordingly, with respect to the portion of the first cause of action relying on written misrepresentations by DBSI, it must be dismissed (*Charles v Onondaga Community Coll.*, 69 AD2d 144 [4th Dept 1979]; *Burlew v Am. Mut. Ins. Co.*, 99 AD2d 11 [4th Dept 1984], *affd* 63 NY2d 412 [1984]; *Giambrone v Owens*, 167 AD2d 841 [4th Dept 1990]; *Garwood v Sheen & Shine, Inc.*, 175 AD2d 569 [4th Dept 1991]), *lv denied* 78 NY2d 864 [1991]; *Makuch v NY Cent. Mut. Fire Ins. Co.*, 12 AD3d 1110 [4th Dept 2004]; *Paragon Restoration Group, Inc. v Cambridge Sq. Condominiums*, 42 AD3d 905 [4th Dept 2007]).

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[10] The record does not contain the contract referred to in the breach of contract cause of action and the only terms of that purported contract before the Court are in the Gemstone Offering Materials.

Plaintiff does not allege any breach of contract with HBK. Plaintiff instead alleges that HBK used the written statements contained in the Gemstone Offering Materials to mislead Plaintiff because those statements materially misrepresented the quality of the collateral underlying the CDO (including statements made to procure the ratings from Moody's and S&P) and the reliability of the models used to evaluate the creditworthiness of the collateral. Plaintiff has therefore sufficiently alleged written misrepresentations made by HBK which were not solely related to a contract between Plaintiff and HBK. The duty allegedly breached therefore arises out of tort law. In this light, the Complaint adequately alleges the elements of a fraud cause of action based on the use of written misrepresentations allegedly made by HBK.

The oral representations alleged in the Complaint were made solely by HBK and DBSI. The specific representations attributed to Mr. Whelan in paragraphs 35 and 36 of the Complaint (described above) are particularized and are alleged to have been spoken with knowledge of their falsity. Therefore, the Complaint adequately alleges fraudulent oral misrepresentations by DBSI.

The Complaint further alleges that there were oral representations made by HBK's Mr. Jenks. Plaintiff was thereby purportedly induced to continue holding the Notes despite the fact that, as of the time Mr. Jenks spoke with the Plaintiff, "the sub-prime mortgage crisis was in full bloom" (Complaint, ¶ 40). The allegations of the Complaint alleging that Mr. Jenks made misrepresentations are stated with sufficient specificity and are alleged to have been made while knowing they were false. As a result, the Complaint adequately alleges fraudulent oral misrepresentations by HBK.

DBSI argues that its alleged misrepresentations, including the credit ratings, the statements by Mr. Whelan and the representations as to HBK's skills, were all opinions and/or predictions and are therefore not actionable. The Court disagrees. The ratings by Moody's and S&P are facts constituting the actual evaluation by reputable independent entities concerning the creditworthiness of the Notes. Plaintiff alleges that these ratings were false because the Defendants provided false information to the ratings agencies. The ratings by Moody's and S&P are not just predictions of future valuation but a present analysis of current valuation. Such ratings have been highly regarded and eagerly sought for years. To characterize them merely as predictions or opinions would undercut the necessary reliability such ratings furnish in the world of credit. Further, the representations by Mr. Whelan are in part "puffing" but on the whole his alleged oral representations are based on facts he was asserting which then allegedly existed in terms of the security of the investment. The representations with respect to HBK's skills also were characterized in terms of facts based on HBK's prior history and present expertise.

HBK argues that the disclaimers in the Gemstone Offering Materials negate any claim by Plaintiff that it justifiably relied on the alleged misrepresentations. However, the disclaimers contained in the Gemstone Offering Materials are not specific enough to address the type of fraud allegedly perpetrated by the Defendants. In the absence of specific language addressing the representations made both orally and in writing, and specifically addressing the complaints by Plaintiff with respect to the quality of the collateral and the adequacy of HBK's underwriting, the disclaimers in the documents do not negate the reliance factor as a matter of law (*Steinhardt Group, Inc. v Citicorp*, 272 AD2d 255 [1st Dept 2000]; *Swersky v Dreyer &*

Traub, 219 AD2d 321 [1st Dept 1996]; *Superior Tech. Resources, Inc. v Lawson Software, Inc.*, 17 Misc 3d 1137[A], 2007 NY Slip Op 52319[U] [Sup Ct, Erie County 2007]).

7. Concealment

The Complaint also adequately states a cause of action for fraudulent concealment as against HBK and DBSI. The Complaint specifically alleges that these Defendants had knowledge of the false information provided to the rating agencies and of the inadequacy of the underwriting used to evaluate the creditworthiness of the Notes, and that this information could not have been detected by Plaintiff even through the exercise of due diligence. Such allegations are sufficient as a matter of law (*Steinhardt*, 272 AD2d at 255; *Swersky,* 219 AD2d at 321*; George Cohen Agency, Inc. v Donald S. Perlman Agency, Inc.*, 114 AD2d 930 [2d Dept 1985], *lv denied* 68 NY2d 603 [1986]; *The Hamlet on Olde Oyster Bay Home Owners Assoc., Inc. v The Holiday Org., Inc.*, 12 Misc 3d 1182[A], 2006 NY Slip Op 51378[U] [App Term, 1st Dept 2006], *affd in part, mod in part* __ AD3d ___, 2009 NY Slip Op 1443 [2d Dept 2009]).

HBK and DBSI argue that Plaintiff is a sophisticated investor and must have been aware of the risks involved in the transaction, particularly in light of the admonitions about risk contained in the Gemstone Offering Materials. Defendants' argument invites the Court to weigh the evidentiary material they submitted to determine the level of sophistication possessed by Plaintiff with respect to CDO's against the special knowledge allegedly possessed by HBK and DBSI. On a motion to dismiss, the Court cannot evaluate the credibility of these competing allegations as the Complaint's allegations are not inherently incredible or flatly contradicted by Defendants' evidentiary material. In essence, Defendants have urged the Court

to make a factual determination as to the level of Plaintiff's sophistication concerning this type of transaction. This the Court cannot do at this stage of the action.[11]

Defendants have recently submitted for consideration the First Department's decision in *DDJ Management, LLC v Rhone Group, LLC* (___ AD3d ___, 2009 NY Slip Op 1575 [1st Dept 2009]). There, the court reversed denial of a CPLR 3211 (a) (7) motion to dismiss the fraud cause of action. The court concluded that plaintiff, as a sophisticated investor/lender, could not establish reasonable reliance because it had failed to use the means available to it of determining the truth. While there is no question Plaintiff is a sophisticated investor, the Complaint here alleges that Plaintiff investigated several different CDO offerings, received information from DBSI about the CDO, met with HBK and reviewed the Gemstone Offering Materials and the Investor Presentation. In *DDJ Management*, the First Department noted that the plaintiff never looked at the debtor's books and records (despite the contractual right to do so) and "failed to make any such effort to evaluate the risk themselves" (2009 NY Slip Op 1575, at *3). Moreover, unlike the more traditional loan arrangement in *DDJ Management*, this action involves a highly complex derivative form of investment. As a result, the means by which Plaintiff could have learned the truth about the alleged deficient collateral, inadequate underwriting standards and the independent credit ratings purportedly procured based on false information are far from evident on this record.

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[11] This is not to say the fraud allegations in the Complaint will survive a summary judgment motion submitted after discovery is conducted. Even if Plaintiff survives such a motion, its proof as to the fraud will be governed at trial by a "clear and convincing" evidentiary standard (requiring a showing of a "high degree of probability" that the elements of fraud have been established) (PJI 1:64).

With respect to the first cause of action, the motions to dismiss are GRANTED as follows: (a) as against the Gemstone Defendants in its entirety; and (b) as against DBSI with respect to fraud based on the written misrepresentations allegedly contained in the Gemstone Offering Materials. The motions to dismiss the first cause of action are otherwise DENIED.

Third Cause of Action: Negligent Misrepresentation

The elements of a cause of action for negligent misrepresentation are: (1) awareness by the maker of a statement that the statement is to be used for a particular purpose; (2) reliance by a known party on the statement in furtherance of that purpose; and (3) some conduct by the maker of the statement linking it to the relying party and evincing its understanding of that reliance (*Credit Alliance Corp. v Arthur Andersen & Co.*, 65 NY2d 536, 551 [1985]; *Ford v Sivilli*, 2 AD3d 773, 774 [2d Dept 2003]). A plaintiff may recover for negligent misrepresentation "only where there is a special relationship of trust or confidence, which creates a duty for one party to impart correct information to another . . . The special relationship requires a closer degree of trust than that in an ordinary business relationship" (*Wright v Selle*, 27 AD3d 1065, 1066-67 [4th Dept 2006]; *Auble v Doyle*, 38 AD3d 1264, 1266 [4th Dept 2007]).

While Plaintiff acknowledges that it did not use the precise phrase "special relationship" in its Complaint, it nevertheless maintains that the factual allegations in the Complaint make out such a relationship. Plaintiff relies most heavily on its allegations that Defendants "appear to hold unique or special expertise" (*Kimmell v Schaefer*, 89 NY2d 257, 264 [1996]). This is very similar to Plaintiff's argument with respect to the fraud cause of action and, in fact, the courts have recognized that "the tort of negligent misrepresentation

involves most of the same elements as fraud, with a negligence standard substituted for the scienter requirement" (*Mia Shoes, Inc. v Republic Factors Corp.*, 1997 WL 525401, *3, 1997 US Dist Lexis 12571, *6 [SD NY 1997]; *Rotterdam Ventures, Inc. v Ernst & Young, LLP*, 300 AD2d 963 [3d Dept 2002]; *Ambassador Factors v Kandel & Co.*, 215 AD2d 305 [1st Dept 1995]). Thus, as in the analysis of the fraud cause of action, the Court concludes that the allegations in the Complaint against DBSI and HBK for negligent misrepresentation are sufficiently based on the purported "unique or special expertise" these parties had in the relationship with Plaintiff. At a minimum, the allegations of the Complaint as to DBSI and HBK raise an issue of fact which cannot be resolved on this motion (*Kimmell*, 89 NY2d at 264).

The Complaint is devoid of any factual allegations upon which to premise Plaintiff's argument that the Gemstone Defendants held "unique or special expertise." HBK selected the collateral to be part of the CDO and, according to the Complaint, the Gemstone Defendants' sole role in this transaction is as the issuer of the Notes. Plaintiff seems to acknowledge this by premising its negligent misrepresentation claim on the allegation that there was a "direct contractual relationship between the parties" (Complaint, ¶ 95). The relationship between the Plaintiff and the Gemstone Defendants is solely a debtor and creditor relationship because it is based on the Notes held by Plaintiff. This is nothing more than an "ordinary business relationship" upon which a negligent misrepresentation claim may not be based (*Auble v Doyle*, 38 AD3d at 1266; *Wright v Selle*, 27 AD3d at 1067; *H&R Project Assocs., Inc. v City of Syracuse*, 289 AD2d 967, 969 [4th Dept 2001]; *Banque Nationale de Paris v 1567 Broadway Ownership Assocs.*, 214 AD2d 359, 360 [1st Dept 1995]; *Bank Leumi*

Trust Co. v Block 3102 Corp., 180 AD2d 588 [1st Dept 1992], *lv denied* 80 NY2d 754 [1992]). The motions to dismiss by HBK and DBSI as to the third cause of action for negligent misrepresentations are in all respects DENIED and the motion to dismiss the third cause of action by the Gemstone Defendants is in all respects GRANTED.

Fourth Cause of Action: Breach of Fiduciary Duty

The analysis for the fiduciary duty cause of action is very similar to the one for the fraud and negligent misrepresentation causes of action. Again, Plaintiff relies upon the "superior expertise or knowledge" of the Defendants (*see Wiener v Lazard Freres & Co.*, 241 AD2d 114, 122 [1st Dept 1998]). As noted above, there are sufficient factual allegations in the Complaint upon which to sustain this cause of action as to HBK.[12] However, as to Deutsche Bank Trust, the rights and remedies between the parties are defined in the Indenture (*AG Capital Funding Partners, LP v State St. Bank & Trust Co.*, 11 NY3d 146, 156 [2008]). Accordingly, unless Plaintiff has alleged facts sufficient to conclude a breach of a duty separate and apart from the promises in the Indenture, Plaintiff's cause of action against Deutsche Bank Trust cannot survive (*William Kaufman Org., Ltd. v Graham & James, LLP*, 269 AD2d 171 [1st Dept 2000]).

Plaintiff argues that Deutsche Bank Trust had "superior expertise and knowledge" similar to that possessed by HBK. The only such allegations, upon information and belief, against Deutsche Bank Trust appear in paragraph 47 of the Complaint. These

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[12] HBK Partners and HBK Management are included in this conclusion based solely on their alleged legal relationship to HBK (which is the only basis upon which they have been joined [Complaint, ¶¶ 8-9, 103]).

conclusory allegations cannot be accepted as true for purposes of this motion because they are specifically contradicted by the terms of the Indenture (Exhibit A-2, Section 6.1 [a], pp. 81-89; Section 6.3 [f], pp. 90-91; Section 6.3 [i], p. 91; Section 6.3 [j], p. 91). Accordingly, it has been conclusively established that the conclusory allegations against Deutsche Bank Trust concerning its "superior expertise or knowledge" are directly contradicted by the documentary evidence in the record.

For these reasons, the motion to dismiss the fourth cause of action for breach of fiduciary duty against HBK is DENIED and the motion to dismiss by Deutsche Bank Trust is in all respects GRANTED.

Second and Fifth Causes of Action: Aiding and Abetting Fraud and Breach of Fiduciary Duty

The second cause of action alleges that Deutsche Bank Trust and DBAG aided and abetted the fraud alleged in the first cause of action. The fifth cause of action alleges that DBSI and DBAG aided and abetted the breaches of fiduciary duty alleged in the fourth cause of action.

The elements of aiding and abetting fraud are: "(1) the existence of a fraud; (2) a defendant's knowledge of the fraud; and (3) that the defendant provided substantial assistance to advance the fraud's commission" (*JP Morgan Chase Bank v Winnick*, 406 F Supp 2d 247, 252 [SD NY 2005] [internal quotation marks omitted]).

Plaintiff alleges in conclusory fashion that Deutsche Bank Trust and DBAG were aware of the fraudulent concealment by HBK (Complaint, ¶¶ 47-48). The only factual allegations substantiating this purported knowledge of the fraud are set forth in paragraph 49 of

the Complaint in which Plaintiff alleges that Deutsche Bank Trust and DBAG had a close ongoing business relationship with HBK. Plaintiff asserts that, under *Pludeman*, this is enough to satisfy the CPLR's pleading requirements.

In the absence of *Pludeman*, this Court would have no doubt that the allegations against Deutsche Bank Trust and DBAG are insufficient as a matter of law because mere allegations of "knowledge" based on an affiliation or business relationship, absent more, are insufficient (*In re Terrorist Attacks on September 11, 2001*, 349 F Supp 2d 765, 835-36 [SD NY 2005]; *Kolbeck v LIT Am., Inc.*, 939 F Supp 240, 246 [SD NY 1996], *affd* 152 F3d 918 [2d Cir 1998]). In *Pludeman*, the Court of Appeals affirmed an order denying a motion to dismiss a fraud cause of action against corporate officers based solely on their high level position in the defendant's corporate structure. Plaintiff equates the position of the corporate officers in *Pludeman* to the affiliated business relationship here. The Court concludes that *Pludeman* is inapplicable. At best, the *Pludeman* rationale is premised on the agency relationship between the high level officers and the corporate defendant. There is no such agency relationship here. Instead, Plaintiff alleges a close ongoing business relationship with the alleged perpetrators of the fraud. Such facts cannot in themselves be enough to overcome a motion to dismiss. Indeed, such allegations could be made in a myriad of business transactions involving multiple commercial entities and should not expose such entities to routine accusations of aiding and abetting.

Because this action will continue at least as against some Defendants, the discovery process will move forward. If during the course of discovery Plaintiff discovers facts supporting any of the causes of action being dismissed pursuant to this decision, leave to amend could be sought as Plaintiff is well within its statute of limitations.

The aiding and abetting breach of fiduciary duty cause of action is alleged against DBSI and DBAG. To sustain this cause of action, Plaintiff must allege: "(1) a breach by a fiduciary of obligations to another; (2) that the defendant knowingly induced or participated in the breach; and (3) that Plaintiff suffered damage as a result of the breach" (*Kaufman v Cohen*, 307 AD2d 113, 125 [1st Dept 2003]). "A person knowingly participates in a breach of fiduciary duty only when he or she provides 'substantial assistance' to the primary violator" (*Kaufman*, 307 AD2d at 126). To meet this standard, the Complaint must allege that the Defendants affirmatively assisted, helped conceal or otherwise failed to act when required to do so, and thereby enabled the breach of fiduciary duty to occur (*Kaufman*, 307 AD2d at 126).

While the Complaint alleges that DBAG had knowledge of the misrepresentations allegedly made by its co-Defendants, the only facts alleged supporting the conclusion that DBAG "substantially assisted" the breach of fiduciary duty is that DBAG fulfilled its role as counterparty to the credit default swaps which served as collateral for the CDO. Service as a counterparty to a credit default swap cannot, in itself, be deemed sufficient to substantiate an allegation that the counterparty has "substantially assisted" a breach of fiduciary duty. Otherwise, the mysterious sounding moniker of serving as a "counterparty" to a

"credit default swap" would overwhelm the business world reality of the relationship between parties to such swaps which, in themselves, are ordinary arms' length business relationships.

With respect to DBSI, however, the Complaint as described above is replete with allegations that DBSI actively participated in the fraud and in the concealment of its superior knowledge of the collateral and the underwriting standards. These allegations are sufficient to support an aiding and abetting breach of fiduciary duty cause of action because such concealment, if proven, would constitute substantial assistance to the breach.

The motions to dismiss the second cause of action for aiding and abetting fraud by Deutsche Bank Trust and DBAG are in all respects GRANTED. The motion to dismiss the fifth cause of action for aiding and abetting breach of fiduciary duty made by DBAG is in all respects GRANTED. The motion to dismiss the fifth cause of action for aiding and abetting breach of fiduciary duty by DBSI is in all respects DENIED.

Sixth Cause of Action: Breach of Contract

The Complaint alleges that DBSI breached the contract whereby it sold the Notes to Plaintiff. This cause of action also seeks to allege a breach by Deutsche Bank Trust of the Indenture under which Plaintiff alleges it was a third-party beneficiary.

The allegations of breach by DBSI are sufficiently alleged in paragraph 113 of the Complaint. While the Defendants argue that the provisions of the contract allegedly breached should be set forth specifically (*Valley Cadillac Corp. v Dick*, 238 AD2d 894 [4th Dept 1997]), there is no requirement that the specific section numbers of the contract be identified. Rather, in taking a liberal construction of the Complaint, and in view of the factual

allegations elsewhere in the Complaint (¶¶ 11-14, 30-32, 35-36), the Court concludes a breach of contract cause of action is properly stated against DBSI.

The allegations of breach of contract by Deutsche Bank Trust with Plaintiff as the purported third-party beneficiary of the Indenture are vague and conclusory. Further, as recounted above, the obligations Plaintiff ascribes to Deutsche Bank Trust are conclusively refuted by the language of the Indenture. Even assuming that Plaintiff is a third-party beneficiary under the Indenture, the documentary evidence conclusively establishes that Deutsche Bank Trust owed no such contractual obligations to the Plaintiff.

For these reasons, DBSI's motion to dismiss the sixth cause of action for breach of contract is DENIED. The motion to dismiss by Deutsche Bank Trust is GRANTED.

Seventh and Eighth Causes of Action:
General Business Law §§ 349 and 350

Article 22-A of New York's General Business Law ("GBL") provides consumer protection from deceptive acts and practices. GBL § 349 declares deceptive acts and practices unlawful and § 350 declares false advertising unlawful. "The standard for recovery under General Business Law Section 350, while specific to false advertising, is otherwise identical to Section 349" (*Goshen v Mut. Life Ins. Co. of New York*, 98 NY2d 314, 324 n 1 [2002]). The elements of a cause of action under these statutes are that: (1) the challenged transaction was "consumer-oriented;" (2) defendant engaged in deceptive or materially misleading acts or practices; and (3) plaintiff was injured by reason of defendant's deceptive or misleading conduct (*Oswego Laborers' Local 214 Pension Fund v Marine Midland Bank, NA*, 85 NY2d 20, 25 [1995]; *DeAngelis v Timberpeg East, Inc.*, 51 AD3d 1175, 1177 [3d Dept 2008]; *Lynch*

v McQueen, 309 AD2d 790 [2d Dept 2003]; *McGill v General Motors Corp.*, 231 AD2d 449 [1st Dept 1996]).

The Court of Appeals has held that parties claiming the benefit of these consumer protection statutes "must, at the threshold, charge conduct that is consumer oriented" and that has a "broad impact on consumers at large" (*New York Univ.,* 87 NY2d at 320-21). The statute was not intended to reach "private contract disputes unique to the parties" (*New York Univ.*, 87 NY2d at 321).

In support of these causes of action, Plaintiff urges the Court to "take judicial notice that massive defaults in CDO obligations like Gemstone VII have caused losses in the billions of dollars to those who bought securities backed by these mortgages" (Memorandum of Law, p. 108). Plaintiff therefore seeks to have the Court view this transaction as part of a "vicious cycle" which traps "consumers between falling home prices and the tightening credit market" (Memorandum of Law, p. 109).

To allow this litigation to become some sort of *cause celeb* regarding the meltdown of the credit markets and the current severe recession would be to abdicate the Court's sole responsibility to adjudicate the dispute between these parties. All of the parties to this litigation are sophisticated participants in the commercial arena. All of the parties elected to voluntarily enter into a private transaction. This litigation simply does not give rise to anything other than a private dispute lacking allegations of any wrongs directed against the consuming public (*see, e.g., New York Univ.*, 87 NY2d at 321 ["each side was knowledgeable and received expert representation advice"]).

For these reasons, the motions to dismiss the seventh and eighth causes of action predicated on the consumer protection statutes are in all respects GRANTED.

Ninth, Tenth and Eleventh Causes of Action: Equitable Relief

These three causes of action seek rescission of the sales contract between DBSI and the Plaintiff on the grounds of fraud, illegality and mutual mistake. As noted throughout, there are particular allegations in the Complaint, all of which must be accepted as true, which support the rescission cause of action based on fraud. Plaintiff has therefore adequately alleged a claim for rescission based on fraud (*Albany Motor Inn & Rest., Inc. v Watkins*, 85 AD2d 797, 798 [3d Dept 1981], *lv denied* 56 NY2d 508 [1982]; *D'Angelo v Bob Hastings Oldsmobile, Inc.*, 89 AD2d 785 [4th Dept 1982], *affd* 59 NY2d 773 [1983]). Similarly, the claim for rescission based on mutual mistake should be sustained as an alternative theory to the rescission through fraud cause of action. If DBSI did not intentionally defraud Plaintiff, Plaintiff is entitled to argue that the Notes should be rescinded based on mutual mistake. Should HBK be found to have defrauded Plaintiff and DBSI unaware of that fraud, the mutual mistake of DBSI and Plaintiff might substantiate an alternative basis for relief. The trier of fact also might consider the mistake to be substantial enough to permit Plaintiff to rescind the contract (*Koffman v Smith*, 191 AD2d 776, 777 [3d Dept 1993]; *Rekis v Lake Minnewaska Mtn. Houses, Inc.*, 170 AD2d 124, 130 [3d Dept 1991]).

As to the claim of illegality, the Court has already decided to dismiss the causes of action premised on GBL §§ 349 and 350. Therefore, those statutes cannot be the basis of the claimed illegality. Furthermore, to the extent Plaintiff seeks to rely on the Martin Act and Securities Act of 1993, such reliance is misplaced. Neither of these statutes provides for a

private right of action (*CPC Intl., Inc. v McKesson Corp.*, 70 NY2d 268, 276-77 [1987]; *Finkel v Stratton Corp.*, 962 F2d 169, 175 [2d Cir 1992]). Moreover, Plaintiff cannot be permitted to convert these statutes to a private right of action by artful pleading (*see, e.g., Granite Partners, LP v Bear, Stearns & Co., Inc.*, 17 F Supp 2d 275, 291 [SD NY 1998]).

For these reasons, the motions to dismiss the equitable claims underlying the ninth and eleventh causes of action are in all respects DENIED. The motions to dismiss the tenth cause of action based on illegality are GRANTED.

Twelfth Cause of Action: Unjust Enrichment

This last cause of action in the Complaint is asserted against all of the Defendants based on their "fraud and other wrongful conduct" (Complaint, ¶ 140). On this basis, Plaintiff claims to be entitled to judgment directing "Defendants to disclose all amounts received" in this transaction (Complaint, ¶ 141).

HBK properly points out that Plaintiff has no "possessory interest" in the management fees charged by HBK and for which Plaintiff apparently seeks disgorgement. Plaintiff also has no "possessory interest" in any fees or premiums received by DBAG. In the absence of any such "possessory interest," Plaintiff cannot maintain a cause of action for unjust enrichment (*SNS Bank, NV v Citibank, NA*, Sup Ct, New York County, July 31, 2003, Freedman, J., index No. 601989/02, *affd* 7 AD3d 352 [1st Dept 2004]; *IDT Corp. v Morgan Stanley Dean Witter & Co.*, ___ NY3d ___, 2009 NY Slip Op 2262, *6 [2009]).

DBSI correctly points out that Plaintiff's unjust enrichment claim is barred by the breach of contract cause of action which the Court has allowed to proceed (*Clark-Fitzpatrick, Inc. v Long Island R.R. Co.*, 70 NY2d 382, 388 [1987]). For the same reason,

because Deutsche Bank Trust's duties and obligations are defined through the terms of the Indenture, even if Plaintiff is deemed as a third-party beneficiary of that contract, the terms of that contract preclude this unjust enrichment claim.

Lastly, in terms of the Gemstone Defendants, because Plaintiff has no viable claim of fraud or negligent misrepresentation against them, or any other basis for relief in this action, Plaintiff cannot plead the "unjustness" element of the claim for unjust enrichment (*Mandarin Trading Ltd. v Wildenstein*, 17 Misc 3d 1118[A], 2007 NY Slip Op 52059[U] [Sup Ct, New York County, 2007]).

For all of these reasons, the motions to dismiss the twelfth cause of action for unjust enrichment are in all respects GRANTED.

Leave to Amend

Plaintiff has sought leave to amend if the Court were to grant any part of the motions to dismiss. Plaintiff's request is granted and any such Amended Complaint conforming with this Decision shall be served within thirty (30) days of service of the Order entered upon this Decision with notice of entry. The Court will establish a scheduling order for the further proceedings in this action at a conference to be conducted on **May 26, 2009 at 2:00 p.m.**

Settle Order.

DATED: April 7, 2009

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HON. JOHN M. CURRAN, J.S.C.