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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: MELVIN L. SCHWEITZER Justice PART 45

SYNCORA GUARANTEE INC

-v-

ALINDA CAPITAL PARTNERS LLC et al

INDEX NO. 651258/2012

MOTION DATE

MOTION SEQ. NO. 002

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits ____ | No(s). ____

Answering Affidavits — Exhibits ____ | No(s). ____

Replying Affidavits ____ | No(s). ____

Upon the foregoing papers, it is ordered that this motion is by defendant Macquarie Securities (USA) Inc. to dismiss the complaint is DENIED per the attached Decision and Order.

A Preliminary Conference is scheduled for 8-23-13 at 10:30 AM at 26 Broadway 10th Floor

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

Dated: July 1, 2013

J.S.C.
MELVIN L. SCHWEITZER

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 45

SYNCORA GUARANTEE INC.

Plaintiff,

-against-

ALINDA CAPITAL PARTNERS LLC, AMERICAN ROADS LLC, MACQUARIE SECURITIES (USA) INC., and JOHN S. LAXMI,

Defendants.

Index No. 651258/2012

DECISION AND ORDER

Motion Seq. No. 002

MELVIN L. SCHWEITZER, J.:

This case involves causes of action for fraud, aid and abetting fraud, and negligent misrepresentation in connection with an approximately $500 million bond and interest rate swap financing. Macquarie Securities (USA) Inc. (Macquarie) moves to dismiss for failure to state a claim pursuant to CPLR 3211(a)(7) and for failure to plead fraud with particularity pursuant to CPLR 3016(b).

Background

The following facts are drawn from the complaint, and are accepted as true along with all reasonable inferences drawn from those facts. *See Skillgames, LLC v Brody,* 1 AD3d 247, 250 (1st Dept 2003).

Syncora Guarantee Inc. (Syncora) is a monoline financial guaranty insurance company that provides credit enhancement and protection for the obligations of debt issuers through the issuance of financial guaranty insurance policies. Macquarie is an advisory services arm of the

Macquarie Group, which consists of Macquarie Bank Limited (Macquarie Bank) and affiliates. Macquarie Bank is a diversified international financial services organization.

In November 2005, Syncora was approached by Macquarie. At the time, Maquarie Bank was in advanced negotiations to create a new entity, now known as American Roads, LLC (American Roads) that would acquire and operate five toll road facilities in North America and refinance them on a consolidated basis. Macquarie, a self-described "recognized global leader" "at the forefront of the infrastructure and project finance industries" with "a decade of experience managing toll road assets [including] over 30 toll road investments globally," requested Syncora to provide insurance in connection with the refinancing. Macquarie repeatedly emphasized to Syncora its expertise as a sponsor for public infrastructure and transportation projects, such as American Roads. To refinance those assets, Macquarie planned to issue approximately $500 million in senior secured bonds (the Bonds), which would be hedged through corresponding interest-rate swaps (the Swaps), the payment obligations on all of which were to be insured by Syncora. A feature of the proposed debt structure was the use of an accreting swap, in which the payments due on one of the interest rate swaps started out low and increased over time, much like the interest rates used in subprime mortgages. This helped to back-load much of the debt used to acquire the toll facilities.

Syncora's issuance of insurance was critical to the Bonds achieving an Aaa rating from the rating agencies, without which they could not be successfully marketed and sold. Macquarie repeatedly assured Syncora that the revenues from the five toll road assets would be more than sufficient to comfortably service the debt. In that regard, Macquarie procured for Syncora several traffic and revenue forecasts (the Maunsell Forecasts) from Maunsell Australia Pty Ltd. (Maunsell), a purportedly neutral traffic advisor and touted Maunsell's "track record of

forecasting accuracy." Macquarie also assured Syncora that Maunsell "devoted normal professional efforts" to the traffic and revenue forecasts and that these forecasts were consistent with its reasonable business judgment. The Maunsell Forecasts showed that the toll roads in American Roads' portfolio would experience high volumes of traffic growth that would result in an increasing stream of revenue to service the debt. Macquarie also used these projections to support sensitivity analyses that it provided to Syncora to further bolster the appearance of a safe and reliable transaction.

In October 2006, following its debt-funded acquisition of the toll road facilities, American Roads was purchased from the Macquarie Group by an affiliate of Alinda Capital Partners, LLC (Alinda), a private investment firm with more than $7.4 billion in equity commitments to infrastructure investments worldwide. Macquarie, through a financial advisor agreement, committed to provide advisory services to American Roads in connection with the upcoming Bond issuance. Alinda swiftly installed three of its partners on American Roads' four-member Board of Directors and moved to complete the refinancing of American Roads' debt through the Bond issuance. As part of this effort, Alinda used its significant expertise in familiarizing itself with the underlying toll assets and with the Maunsell Forecasts.

To market the bonds and induce Syncora's participation, Alinda followed Macquarie's lead and procured an updated analysis from Maunsell; that analysis (the November 2006 Report), which was incorporated into the Bond offering materials (the Offering Memorandum), was based on and reaffirmed Maunsell's prior findings, and once again showed growth in traffic and revenue at the facilities comprising American Roads' portfolio. Through Alinda's substantial direct dealings with Maunsell, they were aware of Maunsell's payment terms, including its long history of receiving undisclosed success fees from Macquarie.

In December 2006, American Roads completed the Bond issuance and closed the two Swaps with a diversified financial institution. Syncora guaranteed the Bonds and Swaps, and in connection with these transactions entered into an Agreement as to Certain Undertakings, Common Representations, Warranties, Covenants and Other Terms (the Common Agreement) with American Roads. In the Common Agreement, American Roads represented to Syncora, among other things, that the Offering Memorandum did not "contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading." The Common Agreement narrowly exempted from this representation and warranty the Maunsell Forecasts themselves, but did not exempt the other portions of the Offering Memorandum that described Maunsell's engagement and the process through which the November 2006 Report was prepared.

In the Offering Memorandum, which was covered by the representation and warranty, American Roads repeatedly stressed the experience and expertise of its traffic advisor, Maunsell, and encouraged Syncora to rely on Maunsell's traffic and revenue findings as independent assurance that the toll road facilities in American Roads' portfolio were of high quality.

Far from being an independent third-party, Syncora alleges that Maunsell had a clear economic incentive to provide unrealistically optimistic projections designed solely to help defendants sell the transaction. Despite the presentation of Maunsell as an independent authority on which Syncora could rely, and unbeknownst to Syncora, Maunsell was routinely paid *undisclosed* success fees by Macquarie, on top of Maunsell's standard engagement fees, for projects that Macquarie successfully acquired as a result of Maunsell's forecasts. These under-the-table success fees amounted to additional millions of dollars per transaction, and were paid

in connection with the American Roads transaction as well as many others. None of this was disclosed to Syncora, which was instead led to believe that Maunsell was an objective advisor on whom it could, and did, rely.

Syncora claims that, contrary to what had been represented to it, Macquarie knew from its long-time collaboration with Maunsell that Maunsell's forecasts were not the product of a neutral and independent evaluation process but instead were specifically engineered to ensure that the Macquarie Group could justify the overpriced bids it placed in acquiring infrastructure assets, such as American Roads'. Alinda (and thus American Roads), through its direct dealings with Maunsell, including the procurement of the November 2006 Report, also knew that Maunsell was conflicted based upon its hidden success fees and that its projections were prepared primarily for acquisition purposes. Like Macquarie before it, Alinda stood to earn a continuous stream of fees by having an interest in American Roads and keeping it afloat through the Bond offering, the success of which was dependent on Maunsell's forecasts. It was easy to consciously overlook the fact that Maunsell's projections were used to support bids on toll roads that were $1 billion more than the next highest bid and more than 50 times the roads' historic cash flows. Defendants never disclosed to Syncora that the projections were anything other than reliable and objective, nor did they disclose the conflicts of interest tainting Maunsell's work.

Syncora commenced this action asserting three causes of action. First, fraud; in order to induce Syncora's participation in the deal, Macquarie allegedly made several false and misleading representations and material omissions, upon which Syncora reasonably relied. Second, Syncora alleges an aiding and abetting fraud claim against Macquarie based on the underlying fraud. Finally, Syncora brings a negligent misrepresentation claim against

Macquarie, claiming that Macquarie's superior knowledge of facts that were not available or discoverable with reasonable diligence by Syncora gave rise to an affirmative duty to disclose.

Macquarie moves to dismiss all three claims. It urges that Syncora fails to plead the elements of fraud with the specificity required under CPLR 3016(b). Regarding Syncora's fraud claim, it argues that Syncora fails to allege any misstatement of material existing fact, that the allegations in the complaint do not establish justifiable reliance, and that Syncora has failed to allege an actual injury sufficient to support a claim for fraud. Macquarie contends that Syncora's aiding and abetting fraud claim must also fail in the absence of an adequately pled claim for an underlying fraud. It argues that Syncora's negligent misrepresentation claim must be dismissed because it fails to plead the requisite "special relationship" with Macquarie necessary to establish a negligent misrepresentation claim under New York Law. *See Mandarin Trading Ltd. v Wildenstein,* 16 NY3d 173, 180 (2011).

Discussion

In considering a motion to dismiss for failure to state a cause of action, the court must accept all allegations set forth in the complaint as true, with all reasonable inferences drawn in favor of the plaintiff. CPLR 3211(a)(7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court is not authorized to assess the merits of the complaint or any of its factual allegations, but only to determine if, assuming the truth of the facts alleged, the complaint states the elements of a legally cognizable cause of action. *See Guggenheimer v Ginzburg,* 43 N.Y.2d 268, 275 (Ct App 1977).

Fraud

The essential elements of a cause of action for fraud include a material misrepresentation or omission of fact, knowledge of its falsity, reasonable reliance upon such misrepresentation or

omission, and resulting damages. *See Eurycleia Partners, LP v Seward & Kissel, LLP,* 12 N.Y.3d 553, 559 (2009). Each element of a cause of action for fraud must be pled with particularity as required under CPLR 3016(b). *Id.* CPLR 3016(b) is satisfied when the facts in the complaint "permit a reasonable inference of the alleged conduct." *Pludeman v Northern Leasing Sys., Inc.,* 10 N.Y.3d 486, 491 (2008). The Court finds that Syncora has pled each element of its fraud claim with the requisite particularity needed to permit such a reasonable inference. Each element will be addressed separately.

Material misrepresentation or omission of fact

Syncora alleges that by misleading representations and material omissions on the part of Macquarie, it was led to believe that Maunsell was an objective and independent third-party who would provide realistic projections of future revenue anticipated by the toll roads. As alleged in the complaint, Macquarie's primary purpose in hiring Maunsell to provide traffic projections for the infrastructure assets, such as those underlying the American Roads transaction, was to obtain inflated estimates concerning the assets' ability to generate cash flows. Syncora alleges that presenting Maunsell as an independent consultant and concealing the fact that it was routinely paid millions of dollars in undisclosed success fees amounts to a material misrepresentation and omission of fact.

In response, Macquarie presents two flawed arguments. First, Macquarie argues that Syncora's fraud claim fails because the Maunsell Forecasts were merely projections, which are not actionable as representations of present fact that can support a fraud claim. Macquarie argues that the "misrepresentations" that Syncora alleges are merely predictions of future revenues that *may* be generated based on certain assumptions, and which are subject to numerous contingencies and uncertainties. Such predictions or projections, it argues, are simply not

actionable as a present misrepresentation of fact. Macquarie argues that the Offering Memorandum expressly enumerated certain risks that could adversely impact the potential revenue generated by the Toll Road Facilities, including: "[d]elays in real estate development in the areas surrounding the FBX Bridge," "[a] natural disaster or other catastrophe," and "demographic changes, economic growth, increasing fuel prices, government macroeconomic policies, competition from untolled or public transportation." For these reasons, Macquarie argues, the predictions from the Maunsell Report are not actionable as a material misrepresentation of fact.

It is well settled that "speculation and expressions of hope for the future do not constitute actionable representations of fact" sufficient to support a claim for fraud and that "a party does not make an actionable representation of fact when predicting a future event with no knowledge of whether or not the event may occur." *Albert Apartment Corp. v Corbro Co.,* 182 AD2d 500, 500 (1st Dept 1992); *see also Quasha v Am. Natural Beverage Corp.*, 171 AD2d 537, 567 (1991). In *Albert*, the First Department dismissed plaintiff's fraud claims because plaintiffs failed to plead an actionable misrepresentation of a material fact. *Id.* at 500-01, 410-11. Plaintiffs alleged misrepresentations in the offering plan of a cooperative conversion concerning estimated tax exemption and abatement benefits that would be available in specified amounts and for a specified period of time. *Id.* at 500, 410. These "estimates," however, were subject to express assumptions set forth in the offering plan, which also included warnings that "no assurance can be given that the tax benefits as described will not be adversely affected by subsequent changes in . . . the applicable legislation." *Id.* at 502, 411. They were held not actionable as "representation[s] of a material existing fact." *Id.* at 500, 410.

Syncora does not dispute that predictions such as the Maunsell Forecasts do not constitute a material misrepresentation of fact for the purposes of stating a claim for fraud. If Syncora's claim were in fact based on the inaccuracy of the Maunsell Forecasts as Macquarie says, then there would be no misrepresentation of material fact and Syncora's fraud claim would inevitably fail. Syncora's fraud claim does not turn on the mere fact that the traffic volume proved to be dramatically lower than the projections. Their misrepresentation claim is based on *how* those projections were obtained.

Syncora alleges that Macquarie repeatedly stressed the experience and expertise of its traffic advisor, Maunsell, and encouraged Syncora to rely on Maunsell's traffic and revenue findings as independent assurance that the toll road facilities in American Roads' portfolio were of high quality. Far from being an independent third-party, Maunsell was allegedly paid undisclosed success fees by Macquarie, on top of Maunsell's standard engagement fees, for projects that Macquarie successfully acquired as a result of Maunsell's forecasts. As noted, these undisclosed success fees amounted to additional millions of dollars per transaction, and were paid in connection with the American Roads transaction as well as many others. These facts were hidden from Syncora, and they, not the mere fact that the projections were wrong, form the basis of Syncora's fraud claim.

A number of recent decisions hold that the concealment of consultation fees, conflict of interest, or potential bias of research analysts or consultants is sufficient to constitute a material misrepresentation or omission to support a claim for fraud. *See Huang v Sy,* 2008 WL 553646, at *6 (finding actionable concealment of "the fact that [the defendant], or the co-defendant corporations which he controlled, would receive a substantial 'consultation fee'" in connection with the transaction), *affd*, 62 AD3d 660 (2d Dept 2009); *Richman v Goldman Sachs Group,*

Inc., 868 F Supp 2d 261, 278-79 (SD NY 2012) (finding that investors pled that corporation made omissions about potential conflicts of interest in selection of CDO assets); *Lapin v Goldman Sachs Group, Inc.* 506 F Supp 2d 221, 236-41 (SDNY 2006) (concluding that misrepresentations and omissions concerning bias of research analysts were actionable as securities fraud); *Fogarazzo v Lehman Brothers, Inc.*, 341 F Supp 2d 274, 293-95 (SDNY 2004) (finding there was "no question" that concealment of analyst conflicts of interest gave rise to securities fraud).

Syncora argues, and the court agrees, that the undisclosed conflict of interest under which Maunsell operated, in addition to the secret success fees that Maunsell was paid in connection with the transaction, do amount to a material misrepresentation or omission of fact. The alleged misrepresentations and omissions concerning how Macquarie obtained their traffic projections in connection with the transaction and that they paid for them through undisclosed success fees is sufficient to constitute a misrepresentation or omission of material fact that is plainly actionable as fraud.

Macquarie next argues that the nondisclosure of success fees paid to Maunsell cannot constitute fraud because it is a factual allegation based solely upon "information and belief." Macquarie points out that allegations based upon "information and belief," without disclosure of the source of alleged information, are insufficient to support a cause of action and cannot be accepted as true. *Kanbar v Aronow,* 260 AD2d 182, 182 (1st Dept. 1999) (affirming dismissal of claims because facts "asserted on information and belief, without disclosure of sources of information that form the basis of the belief" are "insufficient"); *U.S. Underwriters Ins. Co. v Greenwald,* No. 111375/08, 31 Misc 3d 1206(A), 2010 WL 6422981, at *4 (Sup. Ct. N.Y. Cnty. 2010) ("Factual allegations of fraud based entirely upon 'information and belief,' without any

indication of the sources of the allegations, are insufficient to fulfill the statutory pleading requirements [of CPLR § 3016(b)].

The court finds this argument to be without merit. While it is true that allegations based solely on information and belief cannot support a claim for fraud, the defendant has mischaracterized the allegations set forth in the complaint. It is not the allegation that Maunsell was paid success fees by Macquarie that is based on information and belief, but rather the *amount* of those success fees. The relevant language is:

> "To ensure that Maunsell was properly incentivized to continue providing unrealistic and rosy projections, without which the Macquarie model would not be successful, Macquarie routinely paid undisclosed success fees to Maunsell, on top of Maunsell's standard fees, for the projects that it successfully acquired. These success fees, on information and belief, amounted to additional millions of dollars per transaction and were paid in connection with American Roads as well." (Compl. ¶ 57.)

Macquarie's theory regarding the deficiency of the allegations is misguided, because it was not the existence of the success fees themselves that were alleged upon information and belief, but only the exact sum of those fees, asserted by Syncora (on information and belief) to be in the millions of dollars, but according to Macquarie, to be in the hundred thousands.

The court concludes that Syncora has pled facts sufficient to establish a material misrepresentation or material omission of fact.

Knowing participation in fraud

To plead a claim of fraud, a plaintiff must allege that the defendant knowingly made false statements with the intent to deceive. *See Friedman v Anderson,* 23 AD3d 163, 166 (1st Dept 2005). Recognizing that fraudulent intent is a matter peculiarly within the knowledge of the defendant courts do not require direct proof of intent. *See Houbigant, Inc. v Deloitte & Touche, LLP,* 303 AD2d 92, 98, 100 (1st Dept 2003). The plaintiff need only plead facts that are

"sufficient to permit a reasonable inference of the alleged conduct." *Pludeman v Leasing Sys., Inc.*, 10 NY3d 486, 492 (2008). New York's "[CPLR 3106(b)] is a more lenient test than the Second Circuit's 'strong inference of fraud' test," in that it requires only that the complaint include "facts from which it is possible to infer defendant's knowledge of the falsity of its statements." *Houbigant Inc. v Deloitte & Touche LLP*, 303 AD2d 92, 99 (1st Dept 2003).

Macquarie argues that Syncora fails to plead any facts sufficient to establish that Macquarie knowingly participated in fraud. Macquarie argues that Syncora's allegations that it procured "fraudulent" traffic forecasts to earn lucrative investment advisory fees is "legally insufficient to establish scienter because the desire for higher compensation . . . is found in virtually all commercial transactions, making it an ill-suited motive from which to draw an inference of intent to defraud." *Zutty v Rye Select Broad Mkt. Prime Fund, L.P.*, 33 Misc 3d 1226(A), 2011 WL 5962804, *11 (Sup. Ct. N.Y. Cty. Apr. 15, 2011). In other words, Macquarie's motive to earn fees in and of itself does not support an inference of fraud.

Macquarie's characterization of the allegations grossly understate the allegations contained in the complaint. The complaint does not simply allege that defendant's misconduct was in the pursuit of "advisory fees;" it alleges that, by promoting inflated projections that Maunsell had prepared (on the promise of undisclosed success fees), Macquarie could quickly acquire assets around which to build an entire business model that generated a cascade of fees, so long as they could keep the assets afloat through the issuance of debt. This scheme is far from the mere pursuit of "higher compensation" that is found in "virtually all commercial transactions" that was deemed insufficient in Macquarie's cited authority.

It is the court's opinion that Syncora alleged more than sufficient facts from which to infer that Macquarie acted with knowing fraudulent intent. The complaint alleges that, far from

the objective consultant that Macquarie made it out to be, Maunsell had a long (and concealed) history of collaboration with the Macquarie Group that was based on Maunsell supplying overstated traffic projections, which were then used to justify the acquisition of public infrastructure assets at hefty premiums. The complaint also alleges that Macquarie had an incentive to grow assets under management quickly so it could move them from one Macquarie company to another and earn a cornucopia of advisory, banking, and success fees, which are generated each time the assets are transferred. Most importantly, the complaint alleges that, unbeknownst to Syncora, Maunsell was paid undisclosed success fees to incentivize it to provide these unrealistic projections.

It is eminently reasonable to infer from this collection of facts that Macquarie knew but intentionally concealed from Syncora the fact that Maunsell was not an impartial consultant, that the undisclosed success fees which Maunsell received incentivized Maunsell to inflate its projections, that those projections thus were not prepared in good faith, nor could they be relied upon as an objective assessment, and that Macquarie had a strong motive to present them as otherwise. Syncora has adequately alleged scienter because the complaint satisfies the requirement that there be a rational basis for inferring that the alleged misrepresentations were made knowingly.

Given that Syncora has pled facts sufficient to establish that Macquarie participated in knowing fraud, the court does not reach the issue of whether Insurance Law Sections 3105 and 3106 apply.

Reliance

Sophisticated investors have an affirmative duty to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions. *Global Minerals & Metals Corp. v Holme,* 35 AD3d 93, 100 (1st Dept. 2006). *See e.g. Abrahami v UPC Const. Co., Inc.,* 224 AD2d 231, 234 (1st Dept 1996) (sophisticated businessmen had a duty to exercise ordinary diligence and conduct an independent appraisal of the risk they were assuming).

When the party to whom a misrepresentation is made has been alerted to hints of its falsity, a heightened degree of diligence is required of it. *Banque Franco-Hellinique de Commerce Intl. et Mar., S.A. v Christophides,* 106 F3d 22, 27 [2d Cir 1997]. If a plaintiff was aware of information that rendered its reliance unreasonable, or if it had enough information to create a duty to investigate further, then the requisite reliance necessary to assert a fraud claim cannot be established. *Permasteelisa, S.p.A. v Lincolnshire Mgt., Inc.,* 16 AD3d 352, 352 (1st Dept 2005); *see also Keywell Corp. v Weinstein,* 33 F.3d 159, 164 (2d Cir 1994). When a party fails to make further inquiry or to insert appropriate language into the agreement for its protection in such a case, then it is said to have "willingly assumed the business risk that the facts may not be as represented," and reasonable reliance cannot be established. *Rodas v Manitaras,* 159 AD2d 341, 343 (1st Dept. 1990). *See also Centro Empresarial Cempresa S.A.* (76 AD3d 310, 320-321 (1st Dept. 2010).

Two recent decisions of the First Department in cases involving monoline insurers—*CIFG Assurance North America, Inc. v Goldman, Sachs & Co.* and *ACA Financial Guaranty Corp. v Goldman, Sachs & Co.*—reinforce the principle that a plaintiff that conducts

its customary due diligence is precluded from showing reasonable reliance only if it was alerted to, but then failed to investigate, the misrepresentation on which it sues.

In *CIFG Assurance v Goldman, Sachs & Co.*, the First Department reversed the trial court's dismissal of the plaintiff's fraud claim. *CIFG Assurance N. Am., Inc. v Goldman, Sachs & Co.*, 2013 WL 1876243 (1st Dept 2013). There, the plaintiff claimed that the defendants fraudulently induced it to provide guaranty insurance in connection with a securitization by misleading the plaintiff as to the quality and origination of the mortgage loans backing the securitization. The lower court dismissed the fraud claims, reasoning that the plaintiff could not demonstrate justifiable reliance because it had failed to review the underlying loan files. *See CIFG Assur. N. Am., Inc. v Goldman, Sachs & Co.*, 2012 WL 1562718, Op. at 15-16. In reinstating the fraud claim, the First Department noted that the defendants had made representations to the plaintiff concerning the characteristics of the underlying loans that "were not demonstrably known by plaintiff to be false when made." *CIFG II,* 2013 WL1876243, at *1. It concluded that the plaintiff "was not required, as a matter of law, to audit or sample the underlying loan files" and the issue of plaintiff's reasonable reliance was a question of fact that could not be resolved at the motion to dismiss phase.

In *ACA Financial,* the First Department reversed the lower court and dismissed a claim for fraud, holding that where a sophisticated plaintiff fails to obtain a written "prophylactic provision to ensure against the possibility of misrepresentation," there can be no justifiable reliance. *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 2013 WL 1953751, at *1 (1st Dept. May 14, 2013). The plaintiff alleged that it was fraudulently induced to issue a financial guaranty on certain tranches of a collateralized debt obligation (CDO) on the basis of the defendant's misrepresentation that a nonparty hedge fund was taking a long position in the CDO.

The plaintiff alleged that, contrary to that representation, the hedge fund in fact planned to take a short position, betting against the quality of the CDO.

The First Department dismissed the plaintiff's complaint. Its conclusion was based on the fact that the offering circular for the deal, which the plaintiff had, "should have alerted plaintiff that contrary to the representations made," the hedge fund was not taking a long position in the CDO. *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.*, 2013 WL 1953751, at *3 (1st Dept. 2013). The court concluded that, because the plaintiff was aware of contradictory information, for it to have relied on the defendant's misrepresentation was unreasonable.

Macquarie argues that Syncora cannot establish reasonable reliance due to its failure to obtain a written representation and warranty and its failure to exercise due diligence as to the Maunsell Forecasts and as to Maunsell's fee arrangement. It argues that Syncora could have independently evaluated the data on which Maunsell's projections were based, and could have investigated further into Maunsell's connection with Macquarie, but chose not to, barring their claim for fraud.

Failure to obtain a written warranty

As to the failure to obtain a written representation and warranty, Macquarie argues that Syncora's fraud claim should fail because "plaintiffs who choose to rely upon unverified representations," as Syncora chose to rely upon the Maunsell Forecasts "without inserting into the agreement a prophylactic provision . . . may be truly said to have willingly assumed the business risk that the facts may not be as represented." *Centro Empresarial Cempresa S.A. v America Movil S.A.B.*, 76 AD3d 310, 320 (1st Dept 2010). Macquarie argues that Syncora obtained no such representation and warranty with respect to either the Maunsell Forecasts or Maunsell's fee arrangement with Macquarie.

Syncora argues that it is not precluded from showing reasonable reliance unless it was alerted to contradictory representations. Syncora argues that Macquarie's reliance on *ACA* is misplaced because Syncora was never alerted to any contrary representations that would have put them on notice as to the alleged fraud. Unlike in *ACA*, Syncora had no reason to believe that Maunsell's work was the result of a broad scheme by Macquarie to stockpile infrastructure assets on the basis of overstated projections. Thus, Syncora argues, it was not required to obtain a prophylactic provision to ensure against the possibility of misrepresentations.

We agree that *ACA* should not be read to say that a plaintiff must obtain a written warranty with respect to every fact that, in hindsight, may appear to be material to the plaintiff. In project finance bond purchase agreements, the issuer will customarily represent and warrant that there are no material misstatements in the bond prospectus. That was the case here. That is the prophylactic provision provided by the comprehensive financing schemes of these infrastructure projects. Under the Common Agreement, American Roads represented to Syncora that the Offering Memorandum did not "contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading."

The Offering Memorandum contained a detailed description of Maunsell and the work that it did for Macquarie. The Offering Memorandum stated that Maunsell "devoted normal professional efforts compatible with the time and budget available in the acquisition process." It also said that Maunsell's findings were consistent with its reasonable business judgment. Since Syncora was not alerted to any discrepancies regarding this information, even an expansive reading of *ACA* would not suggest that it could not rely on the prophylactic representation provided by the issuer in a project finance bond offering or that Syncora take the unprecedented

step of obtaining a representation and warranty from a consultant such as Maunsell. The court reads *ACA* as requiring prophylactic representations from transactors, sellers of securities or assets, not as revising customary project finance documentation protocol to require representations from consultants, accountants, or other experts.

Due diligence as to the Maunsell Forecasts

In order to establish justifiable reliance, plaintiffs who are sophisticated businessmen have a duty to exercise ordinary diligence and conduct an independent appraisal of the risk they were assuming. *First Nationwide Bank v 965 Amsterdam,* 212 AD2d 469, 471 (1995). "[W]here a party has means available to him for discovering," by the exercise of ordinary intelligence, "the true nature of a transaction he is about to enter into," he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations." *Schumaker v Mather,* 133 NY 590, 596 [1892].

Macquarie argues that Syncora's failure to exercise due diligence with respect to the Maunsell Forecasts precludes justifiable reliance because, "as a matter of law, a sophisticated plaintiff cannot establish that it entered into an arm's length transaction in justifiable reliance . . . if that plaintiff failed to make use of the means of verification that were available to it, such as reviewing the files of the other parties." *UST Private Equity Investors Fund v Salomon Smith Barney,* 288 AD2d 87, 88 (1st Dept 2001). Macquarie claims that Syncora had access to all relevant information regarding the toll roads, including the Maunsell Forecasts, which expressly disclosed the sources of data and assumptions on which the traffic forecasts were based, as well as the Wilbur Associates Audit, which analyzed Maunsell's methodology and set forth alternative traffic forecasts. Macquarie points out that Syncora also had access to census data, public information, and physical access to the locations of the five Toll Road Facilities.

Macquarie urges that reliance cannot be established because Syncora is a sophisticated insurance company that could have independently reviewed the same data on which the Maunsell Forecasts were based.[1]

Syncora argues that the Macquarie's position is based on the incorrect assumption that due diligence would have uncovered defendant's fraud. Even if they did have the ability to assess the risks relating to the performance of American Roads' toll facilities, Syncora argues, it would have made no difference because those risks would not have included the risk that Macquarie had compromised the objectivity of the projections supporting the Bond offering by paying for them through undisclosed success fees. Syncora argues that it had no reason to question Macquarie's relationship with Maunsell so as to enlarge the scope of its customary reasonable due diligence to audit their past collaborations.

Syncora's fraud claim is not based on the inaccuracy of Maunsell's projections, but rather the conflict of interest under which it operated. Whether or not Syncora performed due diligence with regard to the Maunsell Forecasts is irrelevant whether it reasonably relied on representations that Maunsell was a neutral consultant. The court finds that Macquarie's second argument to be without merit.

[1] The court does not accept Macquarie's position that one can not rely on the report of an expert, whether it be an accountant, engineer or other consultant, without performing due diligence on its work product. New York law does not require it. *See CIFG II,* 106 AD3d 437 (1st Dept 2013). To do so would increase transaction costs by judicial fiat. Taken to its extreme, it would require sophisticated institutional purchasers of assets or securities to go behind a transactor's audited financial statements in order to preserve their rights to assert fraud claims.

Due diligence as to Maunsell's fee arrangement

Macquarie argues that Syncora's fraud claim is precluded by the fact that Syncora made no inquiry into Maunsell's fee arrangement at the time, despite the fact that this detail was apparently critical to its decision to enter into the transaction. Macquarie argues that Syncora easily could have asked Alinda, Macquarie, or Maunsell for information regarding Maunsell's fees, yet admits that it failed to do so, thus barring justifiable reliance.

Syncora contends that reasonable due diligence does not mean that Syncora was required to ask about Macquarie's fee arrangement with Maunsell for the American Roads project. Syncora argues it had no reason to believe that Maunsell's work was the result of a broad scheme by Macquarie to stockpile infrastructure assets on the basis of overstated projections. In Macquarie's cited authority, it argues, the plaintiff was only precluded from pleading justifiable reliance where it failed to investigate the very assets backing its investments, despite knowledge that certain representations were contradictory or otherwise unreliable. They were not accused of failing to detect a broader fraudulent scheme involving those investments, as is the case here.

The scheme in question, Syncora argues, was particularly within Macquarie's knowledge and was concealed from Syncora. It was only after the Bond offering closed that reports calling into question Macquarie's relationship with Maunsell began to surface. Nothing at the time, Syncora insists, alerted it to this scheme so as to cause it to perform additional due diligence into Macquarie's relationship with Maunsell. It is for this reason, Syncora argues, that it was never put on notice that Maunsell's projections were not prepared in good faith, and it is not barred from pleading reasonable reliance.

Customarily, in project finance bond financings, the status of auditors, engineers, consultants, and other experts is covered by the representation made by the bond issuer in the

bond purchase agreement with respect to there being no material misstatements in the bond prospectus, in which the work of an auditor or other expert is presented.

Reasonable commercial due diligence has never required bond purchasers who are not on notice of reason to believe that the statements in a prospectus with respect to the auditors, engineers, consultants, and other experts, are not true and correct, to conduct due diligence into their relationship with the issuer or its investment banker. If an issuer's auditor failed the test for independence, and this was a material fact in connection with a suit for fraud relating to the issuer's bonds, it is hard to imagine a court would find that a plaintiff did not justifiably rely on whatever misstatements may have been made because it did not conduct a pre-closing due diligence interview session with the auditor to confirm that it satisfied the tests for independence. The same reasoning applies with respect to statements made in a bond prospectus regarding engineers, consultants, and other experts.

It is the content of auditors' opinions, and engineers, consultants, and other experts' reports that draw the focus of investors or bond insurers. Macquarie cites no cases which suggest that investors have on their due diligence checklists inquiry into undisclosed relationships between these parties and issuers or their financial intermediaries, or the propriety of the fees that are being paid to them. The focus, to the extent it is not on the content of the opinion or report, is on the reputation of the party delivering it. Due diligence with respect to that point, if any is thought necessary, is conducted outside the framework of the transaction by examining the professional history of the party.

Customary financing due diligence procedures, both in underwritten and privately placed debt offerings, have been in place for a very long time. They have never included a granular

inspection of the relationship of auditors, engineers, consultants, or other experts to the issuer or a financial intermediary.

The court will not unwarrantedly expand the holding of *ACA* and numerous other New York cases requiring due diligence in connection with alleging justifiable reliance to require one now. It will not erect another hurdle that must be cleared in order to properly plead a cause of action for fraud.

Injury

To establish a common law fraud claim, plaintiffs must allege an injury. *Small v Lorillard Tobacco Co., Inc.*, 94 NY2d 43, 57, 698 NYS2d 615, 621 (1999). The injury must be actual, not merely speculative. *Dress Shirt Sales, Inc. v Hotel Martinique Assocs.*, 12 NY2d 339, 343, 239 NY2d 660, 663 (1963) ("[I]n an action for damages for fraud actual pecuniary loss must be shown"); *Urtz v N.Y. Cent. & Hudson River R.R. Co.*, 202 N.Y. 170, 174, 95 N.E. 711, 712 (1911) (noting that plaintiff could not be defrauded unless "she lost something of value.").

Macquarie contends that Syncora fails to allege it has suffered any actual losses. There is no allegation that there has been any default on the Bonds, and Syncora admits that it would not be required to make any payments, in the event of a future default by American Roads, until at least 2016. According to Macquarie, Syncora's claims of increased exposure to risk of loss are insufficient to sustain a claim for damages.

Macquarie relies on a number of decisions where the courts have rejected claims that plaintiffs suffered "additional risk of loss as a consequence of . . . fraud" or that plaintiffs were "damaged simply by being undersecured" as insufficient to demonstrate actual injury. *See First Nationwide Bank v Gelt Funding Corp.*, 27 F3d 763, 768 (2d Cir 1994); *Sager v Friedman*, 270 NY 472 482, 1 NE2d 971, 974 (1936) (plaintiffs failed to adequately allege injury because

"[p]roof of deficiency in the value of . . . collateral would not show that the plaintiff suffered a loss through the fraudulent inducement to make the contract for a loan"); *Jackson Nat'l Life Ins. Co. v Ligator,* 949 F Supp 200, 207-208 (SDNY 1996) (plaintiff's claims that certain notes that were due six years in the future had been "rendered valueless . . . due to the unlikelihood of full repayment" lacked merit because such damages were non-provable and speculative).

This argument, according to Syncora, wholly ignores the fact that recission (or rescissory damages) is an appropriate remedy where an insurer has been fraudulently induced to enter into an insurance contract that it would not have entered into, or would have entered into on different terms, if not for the misrepresentation. According to Syncora, the complaint indisputably alleges that the misrepresentations and omissions at the core of this case, the riskiness of the toll road assets underlying the Bonds insured by Syncora, was material to Syncora's decision as to whether and on what terms it would issue the policies.

The law is clear that a party is entitled to rescission of a contract if it was induced by a fraud to enter the agreement. *See Gosmile, Inc. v Levine,* 81 AD3d 77, 82 (1st Dept 2010); *Soklow, Dunaud, Marcadier & Carreras v Lacher,* 299 AD2d 64, 70-71 (1st Dept 2002). This is particularly true in the case of an insurance agreement. "Both New York common law and Insurance Law are clear that a material misrepresentation made at a time an insurance policy is being procured may lead to a policy being rescinded and/or avoided. . . . This corresponds to a standard claim for fraud, in which fraud is complete when a misrepresentation is made that induces a party to take action and that party suffers damage as a result." *MBIA Ins. Corp. v Countrywide Home Loans, Inc.,* 34 Misc 3d 895, 906 (Sup Ct NY Cty 2012); *see also Sun Ins. Co. of N.Y. v Hercules Sec. Unlimited, Inc.,* 195 AD2d 24, 30 (2d Dept 1993) ("A policy of insurance will be voided where it is proved that in applying for the insurance coverage the

insured fraudulently concealed [or misrepresented] a material fact.") (citing *Sebring v Fidelity-Phenix Fire Ins. Co. of N.Y.*, 255 NY 382 (1931)). "A fact is material so as to avoid *ab initio* an insurance contract if, had it been revealed, the insurer or reinsurer would either not have issued the policy or would have only at a higher premium." *Interested Underwriters at Lloyd's v H.D.I. III Assoc.*, 213 AD2d 246, 247 (1st Dept 1995); *Mut. Ben. Life Ins. Co. v JMR Elec Corp.*, 848 F2d 30, 32-33 (2d Cir 1988).

Where rescission of the contract itself is impracticable due to obligations to third parties or otherwise, rescissory damages are available to compensate the defrauded party. *See Syncora Guarantee*, 36 Misc 3d at 343 (citing *Gotham Partners, L.P. v Hallwood Realty Patners, L.P.*, 855 A2d 1059, 1072 (Del. Ch. 2003)); *see also St. Clair Shores General Employees Retirement System v Eibeler*, 2010 WL 3958803, at *9 (SDNY Sept. 8, 2010) ("Rescissory damages 'restore a plaintiff to the position occupied before the defendant's wrongful acts," and are "designed to be the economic equivalent of rescission in a circumstance in which rescission is warranted, but not impracticable.'" (citations omitted)); *Ambac Assur. Corp. v EMC Mortg. Corp.*, 2009 WL 734073, at *2 (SDNY Mar. 16, 2009) (refusing to strike claim by financial guaranty insurer seeking rescissory damages against sponsor of mortgage-backed securitizations).

The New York Supreme Court has held, on almost precisely these same facts, that rescissory damages are appropriate in these circumstances. In *Syncora Guarantee, Inc. v Countrywide Home Loans, Inc.*, as here, Syncora alleged that it was induced into issuing guarantee insurance policies on a series of bonds based on material misrepresentations by Countrywide as to the quality of the assets (there, residential mortgage loans) underlying the bonds. 36 Misc 3d at 330-331. Syncora moved on summary judgment for a declaration that rescissory damages were an appropriate basis for damages, and the court agreed. Informed by

New York Insurance Law sections 3105 and 3106, the court said that rescission was "warranted, but impractical" because rescinding the policies would harm the policies' direct beneficiaries, the noteholders, and in light of a clause contained in the insurance agreement there (similar to one contained in the Insurance Agreements here) that Syncora "shall unconditionally and irrevocably pay" under the policies. *Id.* at 344. The court concluded that "rescissory damages are appropriate in this instance under the persuasive case law and this court's power to award relief." *Id.* (citing CPLR 3017(a)).

In that case, Syncora also argued that it was not required in proving its claim to show that ". . . any loans have defaulted, any connection between a misrepresentation and a subsequent loan default, or provide any evidence of any event subsequent to the misrepresentation." *Id.* at 336-337. The court again agreed, declaring that Syncora need not demonstrate that the misrepresentations at issue caused any payments under the policies in order to recover such damages. *Id.* at 340-42. (noting that Syncora "seeks damages for all payments it has or *will make* pursuant to the insurance policies" (emphasis added)). Contrary to Macquarie's contention, the Bonds need not have defaulted and Syncora need not have made any payments under the policies in order to proceed at this stage with its claims. *See generally F.D.I.C. v Countrywide Fin. Corp.*, 2012 WL 5900973, at *7 (C.D. Cal. Nov 21, 2011) (noting that "many Countrywide investors brought lawsuits based on misrepresentations before any downgrade in their securities, because their 'injury accrued at the same time the alleged misrepresentations came to light, not at the time the risk actually materialized in the form of defaults or lower market values.'" (quoting *Stitching Pensioenfonds ABP v Countrywide Financial Corp.*, 802 F Supp 2d 1125, 1135 (C.D. Cal. 2011)).

Rescissory damages provide an appropriate remedy.

Aiding and abetting

To state a claim for aiding and abetting fraud, a plaintiff must allege "(1) the existence of an underlying fraud; (2) knowledge of this fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud." *Stanfield Offshore Leveraged Assets, Ltd. v Metro Life Ins. Co.*, 64 AD3d 472, 476, 883 NYS2d 486, 489 (1st Dept 2009).

Syncora has pled the elements of the underlying fraud, which satisfies the first element of Syncora's aiding and abetting fraud claim. Because Syncora has pled that Macquarie knew, or consciously disregarded knowledge, of the fraud and substantially assisted the fraud, the aiding and abetting claim stands.

While the knowledge element of an aiding and abetting fraud claim requires "actual knowledge" of the underlying fraud, it "does not have to be based on defendant's explicit acknowledgment of the fraud." *Nathan v Siegal,* 592 F Supp 2d 452, 468 (SDNY 2008). This is particularly apt given that guilty knowledge is a fact that is often particularly within the defendant's possession and is not susceptible to direct proof, but must instead be inferred from the circumstantial evidence. *See Pludeman,* 10 NY3d at 491-492. Macquarie's argument that Syncora's failure to identify "specific communications" between itself and Maunsell precludes relief therefore fails—indeed, such "specific communications" are precisely the type of evidence expected to be within defendants' possession and control, and Syncora has pled facts sufficient to infer that Macquarie knew of (or, at the least, consciously disregarded) the fraudulent misrepresentations and omissions made to Syncora. Such knowledge (or conscious disregard) satisfies the first element of Syncora's aiding and abetting claim.

The element of substantial assistance can be inferred from the circumstances alleged in the complaint. It is axiomatic that "[m]isrepresenters have not been known to keep elaborate diaries of their fraud for the use of the defrauded in court." *Pludeman,* 10 NY3d at 492 (quoting *Siegel,* 2003 Supp. Practice Commentary, McKinney's Cons. Laws of N.Y., Book 7B CPLR C3016:3, 2008 Pocket Part, at 17). Thus, at this stage of the pleadings, Syncora need only allege sufficient facts regarding the fraudulent scheme "to permit a reasonable inference of the alleged conduct." *Id.* It necessarily follows that to the extent Syncora has adequately alleged Macquarie's direct participation in the fraud, at a minimum, it has also met the lesser standard for pleading that defendant's substantial assistance of the fraud. *See Nigerian Nat'l Petroleum Corp. v Citibank, N.A.,* 1999 WL 558141, at *8 (SDNY July 30, 1999) (a plaintiff sufficiently pleads substantial assistance by showing that the defendant "affirmatively assist[ed], help[ed] conceal, or by virtue of failing to act when required to do so enabl[ed] [the fraud] to proceed.").

Negligent misrepresentation

To establish a claim for negligent misrepresentation, a plaintiff must 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." *Mandarin Trading Ltd. v Wildenstein,* 16 NY3d 173, 180, 919 NYS2d 465, 470 (2011). A special relationship "does not arise out of an ordinary arm's-length business transaction between two parties." *US Express Leasing, Inc. v Elite Tech.,* 87 AD3d 494, 497, 928 NYS2d 696, 700 (1st Dept 2011). "[T]he special relationship must have existed prior to the transaction giving rise to the alleged wrong, and not as a result of it." *Emigrant Bank v UBS Real Estate Secs.,* 49 AD3d 382, 385 (2008).

Macquarie argues that Syncora cannot allege a negligent misrepresentation claim against it because it did not owe any duty of disclosure to Syncora. The court finds this argument to be without merit.

A duty to speak with care exists for purposes of a negligent misrepresentation claim when "the relationship of the parties, arising out of contract or otherwise, [is] such that in morals and good conscience the one has the right to rely upon the other for information." *Kimmel v Schaefer,* 89 NY2d 257, 263 (1996) (quoting *International Prods. Co. v Erie R. R. Co.,* 244 NY 331, 338 (1927)) (alteration in *Kimmell*). Such a duty arises where "there is a need to complete or clarify one party's partial or ambiguous statement," or where "one party has superior knowledge of facts which are not available or discoverable with reasonable diligence by the other party and the first party knows that the second party is acting on the basis of mistaken or inadequate knowledge." *Huang v Sy,* 2008 WL 553646, at *6; *accord Williams v Sidley Austin Brown & Wood, LLP,* 38 AD3d 219, 220 (1st Dept 2007) (finding actionable omission where defendant's failure to disclose the true role of other defendants "was a misleading partial disclosure").

Syncora has adequately alleged the existence of a duty to disclose full and complete information arising from the partial, incomplete disclosures made by Macquarie, and from it's superior knowledge and access to information regarding Maunsell's gross conflict of interest. *See e.g. Kimmell,* 89 NY2d at 264-65 (finding a duty to speak with care where defendant was "uniquely situated to evaluate the economics" of the investment opportunity, supplied plaintiffs with projections that misrepresented the potential rate of return on the investment with the expectation that plaintiffs would rely on them in deciding to invest, and personally received a large commission for his efforts); *E*Trade Fin. Corp. v Deutsche Bank AG,* 420 F Supp 2d 273,

290-91 (SDNY 2006) (finding special relationship where plaintiff claimed defendant "held unique knowledge" of a deferred tax asset, was aware of how plaintiff would make use of that information, and supplied the information for that purpose); *Basis Yield,* 2012 WL 5187653, at *9 (alleg[ations] that the information that would have revealed that Goldman was making a misrepresentation was in Goldman's exclusive control, such as Goldman's internal marks and the details of the collateral" raised "question of fact" sufficient to preclude dismissal of negligent misrepresentation claim).

This opinion has already addressed why the information contained in the Maunsell Forecasts and the Offering Memorandum are actionable as misrepresentations and omissions of fact, as well as Syncora's reasonable reliance on these false statements and omissions. It follows that Syncora has alleged a claim for negligent misrepresentation.

Conclusion

Accordingly, it is

ORDERED that Macquarie's Motion to Dismiss is denied.

Dated: July 1, 2013

ENTER:

J.S.C.

MELVIN L. SCHWEITZER