

Allstate Ins. Co. v Ace Sec. Corp.

2013 NY Slip Op 31844(U)

March 14, 2013

Sup Ct, New York County

Docket Number: 650431/2011

Judge: Eileen Bransten

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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

HON. EILEEN BRANSTEN
J.S.C.

PRESENT: Justice

PART 3

Index Number : 650431/2011
ALLSTATE INSURANCE COMPANY
vs
ACE SECURITIES CORP.
Sequence Number : 001
DISMISS ACTION

INDEX NO. 650431/2011
MOTION DATE 4/30/12
MOTION SEQ. NO. 1

The following papers, numbered 1 to 3, were read on this motion to/for dismiss

Notice of Motion/Order to Show Cause -- Affidavits -- Exhibits No(s) 1
Answering Affidavits -- Exhibits No(s) 2
Replying Affidavits No(s) 3

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

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 3-14-13

EILEEN BRANSTEN
J.S.C.

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

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

-----X
ALLSTATE INSURANCE COMPANY, ALLSTATE
LIFE INSURANCE COMPANY, ALLSTATE BANK
(F/K/A ALLSTATE FEDERAL SAVINGS BANK),
ALLSTATE LIFE INSURANCE COMPANY OF NEW
YORK, and ALLSTATE RETIREMENT PLAN, AND
AGENTS PENSION PLAN,

Index No. 650431/2011
Motion Seq. No. 001
Motion Date: 4/30/12

Plaintiffs,

-against-

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

Defendants.

-----X

BRANSTEN, J.:

This fraud action arises from the Allstate plaintiffs' purchase of more than \$185 million of residential mortgage backed securities ("RMBS") from the Deutsche Bank defendants. Defendants move to dismiss the Amended Complaint as time-barred and for failure to state a claim under CPLR 3211(a)(5) and (7). For the reasons that follow, Defendants' motion is granted in part and denied in part.

Background / The Amended Complaint

Plaintiff's Allstate Insurance Company ("Allstate Insurance") and Allstate Life Insurance Company ("Allstate Life") are insurance companies domiciled in, and with their principal places of business in, Illinois. Plaintiff Allstate Life Insurance Company of New York ("Allstate New York") is an insurance company domiciled in and with its principal place of business in New York. Allstate Life is a wholly-owned subsidiary of Allstate Insurance, and Allstate New York is a wholly-owned subsidiary of Allstate Life. Plaintiffs Agents Pension Plan and Allstate Retirement Plan are Employee Retirement Income Security Act ("ERISA") plans sponsored by Allstate Insurance. (Am. Compl. ¶¶ 10-25.) For the purposes of this motion the plaintiff entities will be referred to as "Allstate," unless a distinction between them needs to be made.

Between July 15, 2005 and July 13, 2007, Allstate purchased \$185,182,809.33 in RMBS (the "Certificates") from defendants Deutsche Bank AG New York Branch ("Deutsche NY") and DB Structured Products, Inc. ("DB Products") as follows:

ACE 2005-WF1, M1	(\$5,000,000.00 on July 15, 2005)
ACE 2005-WF1, M2	(\$3,000,000.00 on July 15, 2005)
ACE 2005-WF1, M3	(\$4,530,000.00 on July 15, 2005)
DBALT 2005-AR1, 1A1	(\$10,024,764.90 on January 27, 2006)
ACE 2006-GP1, A	(\$25,000,000.00 on May 23, 2006)
ACE 2006-SL4, A-1	(\$20,000,000.00 on August 14, 2006)
ACE 2006-HE4, A2C	(\$25,000,000.00 on September 15, 2006)
ACE 2006-HE4, A2D	(\$20,000,000.00 on September 15, 2006)
ACE 2006-OP2, A2B	(\$8,000,000.00 on October 13, 2006)
ACE 2006-OP2, A2C	(\$18,740,000.00 on October 13, 2006)

ACE 2004-RM2, M2	(\$11,660,325 on February 2, 2007)
ACE 2004-OP1, M2	(\$17,718,724.06 on April 4, 2007)
ACE 2004-HE4, M1	(\$16,508,995.37 on July 13, 2007)

(Am. Compl. ¶ 7 and Ex. B.) The Certificates represent interests in a pool of mortgage loans. They entitle the holder to payment of principal and interest as payments are made by the underlying mortgage borrowers. (Am. Compl. ¶ 27).

RMBS certificates are created in a multi-step process. The first step is the generation of loan by the initial originator, which are then pooled into groups by a “sponsor” or “seller.” In this case the sponsors were Deutsche NY and DB Products. To insure the original originators would be able to generate sufficient loans, Deutsche provided them with a warehouse line of credit to provide the funds to be loaned to the ultimate borrower. (Am. Compl. ¶ 28.)

After pooling the loans, the sponsor transfers them to a “depositor.” The depositor is typically a special-purpose affiliate of the sponsor, and exists solely to receive and pass on the rights to the pools of loans. It is also often controlled directly by the same officers and directors who run the sponsor. Here Deutsche Alt-A Securities, Inc. (“DB Alt-A”) and Ace Securities Corp. (“Ace”) acted as “depositors.” (Am. Compl. ¶ 29.)

Upon acquisition of the loans, the depositor transfers, or “deposits,” the acquired loan pool to an “issuing trust.” The depositor then securitizes the loan pool in the issuing trust so that the rights to the cash flows from the pool can be sold to investors. RMBS securitization transactions are structured so that the risk of loss is divided among different levels of investment, or “tranches,” with each having a different level of risk and reward. (Am. Compl. ¶ 30.) Once the tranches are established, the issuing trust passes the securities back to the depositor, which becomes the issuer of the RMBS. The depositor then passes the RMBS to the underwriter, which here was Deutsche Bank Securities, Inc. (“DBSI”). (Am. Compl. ¶¶ 31-32.)

The collateral pool for each securitization usually contains thousands of loans. The underwriter provides information about the loans and securities to investors. Information about those mortgages is included in the “loan files” that the mortgage originators developed while making the loans. A loan file typically contains documents including the borrower’s application for the loan; documents relating to verification of the borrower’s income, assets, and employment; references; credit reports on the borrower; an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as loan-to-value ratios; and a statement of the occupancy status of the property. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as

well as detailed notes of the underwriter setting forth the rationale for the making of each loan. (Am. Compl. ¶¶ 34-35.)

Investors, like Allstate, were not given access to the loan files. (Am. Compl. ¶ 34.) Instead, they relied on the representations made by Morgan Stanley in registration statements, prospectuses, draft prospectus supplements, prospectus supplements and term sheets (the "Offering Materials") about the quality and nature of the loans forming the security for the RMBS. (Am. Compl. ¶¶ 2, 35-36.) The Offering Materials represented that the loans were originated according to certain guidelines; that loans that did not meet certain criteria would be approved only if compensating factors made up for their defects; that a specific percentage of properties in each loan pool were owner-occupied; and that the loans had specific loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios. (Am. Compl. ¶¶ 2.) They further represented that the loan originators would consider each applicants credit history, repayment ability and debt service income ratio, and the value, type and use of the mortgaged property. Each loan would be evaluated after review of the loan application and other documentation submitted by the borrower, including the applicant's liabilities, income, credit history, employment history and personal information. (Am. Compl. ¶¶ 60, 64, 95, 109.)

Allstate alleges that with defendants' knowledge, the various companies which originated the loans routinely violated or abandoned their stated underwriting guidelines

by disregarding or failing to obtain information regarding the borrowers' ability to repay, allowing exceptions to underwriting guidelines without sufficient compensating factors; and manipulating the appraisal process in order to inflate the values of the underlying mortgaged properties to originate and sell as many loans as possible. (Am. Compl. ¶ 134.)

The originators included Wells Fargo Bank (Am. Compl. ¶¶ 150-73), American Home Mortgage Corporation (Am. Compl. ¶¶ 174-85), IndyMac Bank (Am. Compl. ¶¶ 186-20), Fremont Investment and Loan (Am. Compl. ¶¶ 203-14), Greenpoint Mortgage Funding (Am. Compl. ¶¶ 215-29), Option One Mortgage Corp. (Am. Compl. ¶¶ 230-39), First NLC Financial Services (Am. Compl. ¶¶ 241-42), National City Mortgage Co. (Am. Compl. ¶¶ 243-47), People Choice Home Loans (Am. Compl. ¶¶ 248-52), Quicken Loans (Am. Compl. ¶¶ 253-54) and ResMAE Mortgage (Am. Compl. ¶¶ 255-58). A number of these companies subsequently closed down their operations, filed for bankruptcy or became the subject of governmental investigations and private lawsuits alleging misconduct arising out of pervasive illegal and improper mortgage lending practices and other violations of law..

Plaintiffs assert that the Offering Materials misrepresented or concealed material facts regarding underwriting and quality of the loans, including the loan originators' underwriting guidelines (Am. Compl. ¶¶ 65-68), defendants' due diligence in selecting loans to securitize (Am. Compl. ¶¶ 69-72), the owner-occupancy rates (Am. Compl. ¶¶

73-77), the LTV and CLTV ratios (Am. Compl. ¶¶ 78-80), the accuracy of the credit ratings assigned to the Certificates (Am. Compl. ¶¶ 81-83) and the existing credit enhancements (excess interest, over-collateralization, subordination). (Am. Compl. ¶¶ 84-87.) Defendants allegedly made exceptions for borrower on a wholesale rather than case-by-case basis, and waived in a large number of deficient loans. (Am. Compl. ¶¶ 70, 88-90.)

The complaint alleges that defendants knew of the defects in the loans and the underwriting process because of their own relationships with the originators, and in view of their retention of an independent third-party due diligence provider, Clayton Holdings, Inc. (“Clayton”) which uncovered the problems. (Am. Compl. ¶¶ 280-84.) Instead of taking remedial measures, defendants used the information to negotiate lower prices with the loan originators. (Am. Compl. ¶ 285.)

The loans underlying plaintiffs’ Certificates began experiencing high default rates. By 2011, between 10% and 38% of the loans in each pool had been removed as delinquent. (Am. Compl. ¶ 91.) The remaining loans were also performing poorly, with between 10% and 52% of the loans in each pool becoming delinquent. (Am. Compl. ¶ 92.). The credit ratings for the Certificates deteriorated, with a significant percentage falling from AAA to non-investment grade. (Am. Compl. ¶¶ 93-95.)

The original complaint was filed on February 17, 2011. The Amended Complaint sets forth four causes of action, each asserted against all of the defendants: common law fraud (Am. Compl. ¶¶ 346-52) (as against DBSI, ACE and DB Alt-A), negligent misrepresentation (Am. Compl. ¶¶ 353-65) (as against DBSI, ACE and DB Alt-A), fraudulent inducement (Am. Compl. ¶¶ 366-62) (as against DBSI, ACE and DB Alt-A) and aiding and abetting fraud. (Am. Compl. ¶¶ 273-89.)

Discussion

Defendants move to dismiss the claims as time-barred under New York and Illinois law. Additionally, defendants argue that plaintiffs have not pleaded scienter, loss causation, justifiable reliance or damages, or alleged material misrepresentations with respect to underwriting guidelines, adherence to due diligence standards, LTV/CLTV ratios, owner-occupancy statistics or credit enhancements. Defendants further assert that plaintiffs have not pleaded the special relationship required to state a claim for negligent misrepresentation, or particularized their aiding and abetting claim. For the following reasons, the motion is granted as to the claims relating to the Certificates purchased before February 17, 2006, and as to the claim for negligent misrepresentation, but is otherwise denied.

I. Statute of Limitations

In moving to dismiss, defendants invoke New York's borrowing statute, CPLR 202, which "requires the cause of action to be timely under the limitations period of both New York and the jurisdiction where the cause of action accrued." *Global Fin. Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 528 (1999). The purpose of the statute is to "prevent[] nonresidents from shopping in New York for a favorable Statute of Limitations." *Id.* at 528. Furthermore, "[w]hen an alleged injury is purely economic, the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss." *Id.* at 529. The parties agree that in view of the Allstate plaintiffs' residence, their claims must satisfy the limitations provided by both New York and Illinois law.¹ Furthermore, "in 'borrowing' a Statute of Limitations of another State, a New York court will also 'borrow' the other State's rules as to tolling," *Antone v. General Motors Corp.*, 64 N.Y.2d 20, 31 (1984).

All of plaintiffs' claims would be timely under the six-year New York statute of limitations for fraud, CPLR 213, so the parties agree that the critical analysis implicates the shorter statute of limitations under the Illinois Securities Law of 1953. That statute, 815 Ill. Comp. Stat. ("ILS") 5/13, provides:

¹ One plaintiff, Allstate Life Insurance Company Of New York, is alleged to be a New York resident. Accordingly, that party's claims are timely under CPLR 213. The court rejects defendants' unelaborated suggestion that its status as a wholly-owned subsidiary of one of the Illinois plaintiffs somehow extinguishes its identity as a New York resident.

D. No action shall be brought for relief under this Section or upon or because of any of the matters for which relief is granted by this Section after 3 years from the date of sale; provided, that if the party bringing the action neither knew nor in the exercise of reasonable diligence should have known of any alleged violation of . . . of this Act which is the basis for the action, the 3 year period provided herein shall begin to run upon the earlier of:

(1) the date upon which the party bringing the action has actual knowledge of the alleged violation of this Act; or

(2) the date upon which the party bringing the action has notice of facts which in the exercise of reasonable diligence would lead to actual knowledge of the alleged violation of this Act; but in no event shall the period of limitation so extended be more than 2 years beyond the expiration of the 3 year period otherwise applicable.

The limitations provisions of this section applies not merely to statutory securities claims, but to common law fraud and negligent misrepresentations claims arising from the purchase of a security. *See Tregenza v. Lehman Bros., Inc.*, 287 Ill. App. 3d 108, 109-10 (1st Dist. 1997) (general five-year limitations period ordinarily governing common law fraud claims under 735 Ill. Comp. Stat. 5/13-205 superseded by more specific provisions of ISL 5/13(D), which imposes a shorter period for both statutory securities law violations and “any of the matters for which relief is granted” under the securities law).²

² Plaintiffs argue that the five-year statute of limitation for common law fraud must apply because “Defendants cannot meet their burden of demonstrating that Allstate could maintain an action under the Illinois Securities Law, because the analogous New York “blue sky” law—the Martin Act—does not provide for any private right of action.” (Plaintiffs’ Memorandum in Opposition to Motion to Dismiss at 32-33.) However, even assuming that plaintiffs, under choice of law principles, would be relegated to some sort of common law action that was not

Accordingly, absent tolling, all of plaintiffs' claims arising out of RMBS purchases prior to February 17, 2008 would be time-barred under the statute's base three-year limitations period accruing from the "date of sale." Moreover, recovery relating to any RMBS purchases prior to February 17, 2006 are barred regardless of tolling under the ultimate five-year deadline imposed by ILCS 5/13(D)(2). Plaintiffs thus concede that claims under the ACE 2005-WF1 and DBALT 2005-AR1 Certificates are untimely.

Moreover, as plaintiffs plead that they purchased all of the securities before February 17, 2008, no claim can survive absent tolling. In that connection, defendants argue that the complaint is fatally flawed because it fails to affirmatively plead that the three year sale-based limitations period was tolled. However, neither the statute nor *Rein v. David A. Noyes and Co.*, 230 Ill. App. 3d 12 (2d Dist. 1992), upon which defendants rely, impose such a rule. Although the *Rein* court did state that the effect of ILS 5/13(D) was "to lengthen the time in which such a suit may be filed, provided that plaintiffs properly *allege* and demonstrate the requisite grounds," *Id.* at 15 (emphasis supplied), there is no indication that the court was announcing a formal pleading requirement. Moreover, the plaintiffs in *Rein* did not even invoke the discovery rule set forth in ILS 5/13(D) or contest that their security purchases fell outside the longer five-year limitations period, so the case has little application to the issues at bar. The statute itself

preempted by the Martin Act, they would still be subject to the ISL's statute of limitations because it governs all security-related common law claims.

does not declare a pleading rule, but merely sets forth alternatives to the sale-based accrual period, *i.e.*, the earlier of three years from either actual knowledge of the violation or notice of facts that would with reasonable diligence lead to such knowledge.

Nevertheless, in their reply memorandum defendants argue that it can be determined from the face of the complaint, and the documents referenced therein, that plaintiffs had sufficient “notice of facts” prior to February 2008 which should have led to discovery of their claims. Specifically, defendants rely on the following chronology of allegations extracted from the Amended Complaint:

August 2006: Mortgage borrowers file a class action lawsuit against IndyMac Bancorp., Inc.—the corporate parent of IndyMac F.S.B., an originator in the DBALT 2005-AR1 offering (Am. Compl. ¶ 149)—alleging a “systematic and continued failure . . . to provide independent and effective appraisals and evaluations.” (Affirmation of Andrew Rhys Davies (“Davis Affirm.”) Ex. B ¶ 22.)

February 2007: Reuters reports that ResMae Mortgage Corporation, an originator in the ACE 2004-RM2 offering (Am. Compl. ¶ 149), had filed for Chapter 11 bankruptcy, citing the “lowering [of] underwriting standards” and “weak underwriting on 2006 loans.” (Davies Affirm. Ex. C.)

March 2007: The FDIC issues a cease and desist order to Fremont Investment & Loan, an originator in the ACE 2004-HE4 offering (Am. Compl. ¶ 149), for “operating without effective risk management policies and procedures in place in relation to its subprime mortgage and commercial real estate lending” and “operating without adequate subprime mortgage loan underwriting criteria.” (Davies Affirm. Ex. D)

March 2007: A class action lawsuit is filed against IndyMac Financial, Inc.—an affiliate of IndyMac F.S.B., which was an originator in the DBALT 2005-AR1 offering (Am. Compl. ¶ 149)—asserting that IndyMac

had misrepresented the adequacy of its underwriting guidelines. (Davies Affirm. Ex. E.)

March 2007: Allstate's outside counsel in in *Allstate Ins. Co. v Morgan Stanley*, No. 651840/2011 (N.Y. Sup. Ct.), announces that it was "conducting an extensive investigation into the conduct of numerous subprime lenders" and that "many sub-prime lenders responded to the rising interest rates that increased competition among mortgage lenders in 2005 and 2006 by abandoning their underwriting standards." (Davies Affirm. Ex. F) (emphasis added).

March 2007: Bloomberg reports that People's Choice Home Loan, Inc., an originator in the ACE 2006-SL4 and ACE 2004-HE4 offerings (Am. Compl. ¶ 149), has filed for Chapter 11 bankruptcy (Davies Affirm. Ex. G), and the next day The New York Times reports that "more than two dozen home financiers . . . have sought Chapter 11 status since the crisis involving subprime lenders came to national attention last year." (*Id.* Ex. H.). The latter article also noted that Senator Christopher J. Dodd had launched an investigation, asking five subprime mortgage originators to "to explain their lending practices." (*Id.*)

August 2007: The New York Times reports the closing of AHM, an originator in the ACE 2006-SL4 offering (Am. Compl. ¶ 149), "in light of liquidity issues resulting from disruptions in the secondary mortgage market." (Davies Affirm. Ex. J.)

August 2007: The Wall Street Journal reports that Greenpoint Mortgage Funding, Inc., an originator in the ACE 2006-GP1 and DBALT 2005-AR1 offerings, was being shut down for incurring severe losses. The article noted that Greenpoint specialized in non-conforming loans, which do not meet the standards set by Fannie Mae and Freddie Mac, and that it specialized in "jumbo" and "Alt-A" loans. (Davies Affirm. Ex. K.)

November 2007 and January 2008: Standard & Poor's marked ACE 2006-SL4 A-1, ACE 2006-HE4 A2C, ACE 2006-HE4 A2D, ACE 2006-OP2 A2B, ACE 2006-OP2 A2C, as "AAA*-" meaning that sixteen—more than half of the Certificates Allstate allegedly purchased (see Am. Compl. Ex. B)—were rated "credit watch negative" for a possible downgrade

within 90 days. (Affirmation of Andrew H. Reynard (“Reynard Affirm.”), Ex. 26).

(Defendants’ Reply Memorandum in Further Support of Motion to Dismiss at 5-6.)

Defendants also point to other allegations in the complaint relating to financial difficulties, bankruptcies and investigations of other loan originators (Wells Fargo, American Home Mortgage, Greenpoint, National City, People’s Choice) between 2005 and early 2008. (Am. Compl. ¶¶ 153, 172, 180, 218, 242, 245, 249.)

However, defendants must demonstrate not merely that plaintiffs could have known that certain statements in the Offering Materials were false, but also that plaintiffs could have known that Morgan Stanley knew and thus acted with intent to deceive. *Baron v. Chrans*, 2008 WL 2796948, at *21 (C.D. Ill. 2008) (“In a securities fraud context, an injured person knows sufficient facts on the date on which the person learned, or should have learned, both that the representations were untrue and that the misrepresentations were knowingly false”); see *Merck & Co. v. Reynolds*, 130 S.Ct. 1784, 1796 (2010) (“A plaintiff cannot recover without proving that a defendant made a material misstatement *with an intent to deceive* . . . [i]t would therefore frustrate the very purpose of the discovery rule . . . if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter”).

In *In re Countrywide Fin. Corp. Mortgage-Backed Securities*, 860 F. Supp. 2d 1062 (C.D. Cal. 2012) (*Countrywide I*), the Court denied a motion to dismiss under ILS 5/13(D), noting that the “reasonable diligence” requirement of the statute only required diligence in obtaining knowledge of the violation once plaintiff had obtained actual notice of the facts, but did not require diligence in obtaining the facts triggering the inquiry. The court concluded that “[i]nformation that was sent to [plaintiff] or that [plaintiff] was aware of will constitute notice, whereas information that was widely reported in the press but never seen by [plaintiff] will not suffice.” *Countrywide I*, 860 F. Supp. 2d at 1076.

A number of courts have denied limitations-based motions in RMBS fraud actions despite objections similar to those raised by defendants here. For example, in *In re Countrywide Fin. Corp. Mortgage-Backed Securities*, 2012 WL 1322884 (C.D. Cal. 2012) (*Countrywide II*), the court held:

Defendants have cited a number of articles from 2007 that either make or hint at this same connection. As in *Allstate* it is possible, perhaps probable, that Defendants will ultimately demonstrate that a reasonable investor was on inquiry notice by August 31, 2007. However, 2007 was a turbulent time during which the causes, consequences, and interrelated natures of the housing downturn and subprime crisis were still being worked out. The Court cannot, based solely on the [complaint] and judicially noticeable documents, conclude that by August 31, 2007 a reasonably diligent investor should have linked increased defaults and delinquencies in the loan pools underlying the Certificates with both a failure to follow the underwriting and appraisal guidelines specified in the Offering Documents and the possibility that the tranches purchased by [plaintiff] would suffer losses.

That is the link that a reasonable investor would have needed to make in order to know that something material was amiss with the Offering Documents for the particular tranches that are at issue in this case. Accordingly, the Court DENIES Defendants' motions to dismiss based on the statute of limitations.

Countrywide II, 2012 WL 1322884, at *4. See also *Massachusetts Mut. Life Ins. Co. v Residential Funding Co., LLC*, 843 F. Supp. 2d 191, 208-09 (D. Mass. 2012) (“At this point in the litigation, Defendants have not met the relatively high burden to demonstrate that Plaintiff was on inquiry notice in 2007 . . . [i]ndeed, courts have been reluctant to conclude that purchasers of mortgage-backed securities were on inquiry notice of similar claims as late as mid-2008, let alone as early as 2007”); *Capital Ventures Intern. v J.P. Morgan Mortgage. Acquisition Corp.*, 2013 WL 535320, at *7 (D. Mass. 2013) (finding that defendants failed to carry “heavy burden” of demonstrating that plaintiff was on notice of its claims by October 2007, despite defendants’ citation to newspaper articles, government publications, and media reports noting the widespread erosion of underwriting guidelines in the mortgage market, the pressure on appraisers to generate inflated property values, pervasive misrepresentation of owner occupancy and associating the erosion of underwriting guidelines and increased default rates with the primary originators whose loans backed plaintiffs’ certificates insufficient to constitute knowledge of securities fraud).

None of the allegations or facts which defendants contend should impute notice to plaintiffs directly implicate misrepresentation or scienter on the part of defendants. The collapse of the various loan originators, or even plaintiffs' counsel's accusations of wrongdoing against one of them, would not necessarily apprise plaintiffs that defendants were complicit in their wrongdoing. The link becomes more attenuated insofar as most of the originators were responsible for only a percentage of the loans placed in various combinations of the RMBS. Nor do general allegations of misconduct in the subprime industry suggest misconduct or knowledge thereof by Morgan Stanley, much less misconduct with respect to the particular tranches representing plaintiffs' investments.

Accordingly, for the foregoing reasons, defendants' motion to dismiss plaintiffs' claims as untimely is granted only as to the ACE 2005-WF1 and DBALT 2005-AR1 certificates, and is otherwise denied.

II. Common Law Fraud and Fraudulent Inducement Claims

As noted, defendants challenge several aspects of plaintiffs' fraud and fraudulent inducement claims. To plead fraud, the plaintiff must allege "(1) a material misrepresentation of a fact, (2) knowledge of its falsity, (3) an intent to induce reliance, (4) justifiable reliance by the plaintiff, and (5) damages." *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009). The elements of a fraudulent

inducement claim are substantially the same. *See Perrotti v. Becker, Glynn, Melamed & Muffly LLP*, 82 A.D.3d 495, 498 (1st Dep't 2011).

A. *Scienter*

Defendants first dispute the adequacy of plaintiffs' allegations of scienter. To satisfy that element, the pleading need only "contain[] some rational basis for inferring that the alleged misrepresentation was knowingly made." *Houbigant, Inc. v. Deloitte & Touche LLP*, 303 A.D.2d 92, 98 (1st Dep't 2003); *see also Seaview Mezzanine Fund, LP v. Ramson*, 77 A.D.3d 567, 568 (1st Dep't 2010). However, this "requirement should not be confused with unassailable proof of fraud." *Pludeman v. N. Leasing Sys., Inc.*, 10 N.Y.3d 486, 492 (2008).

In a case involving RMBS, "the allegations of the mortgage loans material and pervasive non-compliance with the Seller's underwriting Guide and the mortgage loan representations are sufficient non-compliance from which Defendant's scienter can be inferred." *MBIA Ins. Co. v. Morgan Stanley, et al*, 2011 WL 2118336, at 4-5 (Sup. Ct. Westchester Co. May 26, 2011); *see China Dev. Indus. Bank v. Morgan Stanley & Co. Inc.*, 86 A.D.3d 435, 436 (1st Dep't 2011) ("[t]he element of scienter can be reasonably inferred from the facts alleged . . . including e-mails, which support a motive by Morgan, at the time of the subject transaction, to quickly dispose of troubled collateral [i.e.,

predominantly residential mortgage-backed securities] which it owned at the time”); *Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A), at *10 (Sup. Ct. N.Y. Cty. Nov. 30, 2012) (scienter requirement satisfied where complaint alleged that defendants “were involved in every step of the complex process that eventually resulted in the Certificates, including making the mortgage loans, selecting the loans for securitization, commissioning diligence reviews of the loans, servicing the loans, monitoring loan performance, bundling the loans into RMBS, and selling the RMBS Certificates to investors . . . [d]efendants’ knowledge of the poor quality of the loans can be inferred from its interactions with its due diligence vendor . . . and through its use of the ‘repricing’ program, which involved demanding extra compensation from third party originators for poor quality loans . . . [t]aken together, [plaintiff’s] allegations make it rational to infer that [defendants] knew that many of the representations in its Offering Documents were false”).

As described above, the Amended Complaint alleges, *inter alia*, that defendants knew about and ignored deficiencies in the loan pools, deliberately manipulated the due diligence process and ratings procedures to conceal the deficiencies, participated in a variety of other questionable practices to procure a high volume of loans, and used its knowledge to negotiate cheaper prices for loans. This is sufficient to forestall a motion to dismiss.

B. *Loss Causation*

Defendants next assert that plaintiffs cannot establish that the decline in the value of the six RMBS was proximately caused by their alleged misrepresentations. In particular, defendants contend that plaintiffs have impermissibly ignored non-fraudulent explanations for their losses, such as whether the economic downturn was an intervening cause. This type of argument must be repeatedly rejected as premature. “[I]t is the job of the fact-finder to determine which losses were proximately caused by misrepresentations and which are due to extrinsic forces . . . [i]t cannot be said, on this pre-answer motion to dismiss, that [plaintiffs’] losses were caused, as a matter of law, by the 2007 housing and credit crisis.” *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 295 (1st Dep’t 2011) (internal citations and quotations omitted); see *MBIA Ins. Co. v. Morgan Stanley*, 2011 WL 2118336, at 5 (Sup. Ct. Westchester Co. May 26, 2011) (“whether MBIA's losses were caused by Morgan Stanley’s representations or the economic down is a question of fact for trial”); *In re Sadia*, 269 F.R.D. 298, 317 (S.D.N.Y. 2010) (“For the third time in as many months, the Court finds itself presented with the defense: ‘don't blame me, blame the financial crisis.’ For the same reasons I rejected this argument in prior cases, I reject it once again”).

Defendants’ argument also ignores the Amended Complaint’s pleading that the housing market collapse was not necessarily an independent event, but was rather in part

caused by the securitization practices of industry participants like Morgan Stanley. *See* Am. Compl. ¶¶ 41-49; *see also In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1174 (C.D. Cal. 2008) (defendant's "deteriorating lending standards were causally linked to at least some of the macroeconomic shifts of the past year"). For this reason, defendants' reference to Allstate's statement in its 2009 annual report that its losses were "largely due to the macroeconomic conditions and credit market deterioration, including the impact of real estate valuations" is not a dispositive admission. Plaintiffs' failure to blame defendants in that particular report does not negate the possibility that defendants were culpable for the conditions which led to plaintiffs' damages.

While the plaintiff must plead some facts supporting its theory that defendants' conduct was responsible for its losses, "[i]t is not . . . necessary to allege that the entirety of the loss was caused by the alleged misstatements and none was caused by the more general market decline." *Stichting*, 38 Misc.3d 1214(A), at *11. Thus, "[w]here the plaintiff pleads some causation between the defendant's misstatements and the loss, and the defendant claims some other mechanism of causation such as a market downturn, causation is a matter of proof at trial and not to be decided on a . . . motion to dismiss." *Id.* (internal quotations and citations omitted). It is sufficient to allege a "chain of causation leading from the alleged abandonment of underwriting standards, to higher rates of default and delinquency in the underlying mortgages, to the Certificates' ratings

downgrades, finally to the Certificates' decline in market value,” and once that is done, “[t]he validity of this chain of causation, and the apportionment of [plaintiff’s] loss between this cause and the general credit crisis, are not sustainable issues for a motion to dismiss.” *Id.*

C. *Misrepresentation*

As noted, the Amended Complaint alleges misrepresentations in the Offering Materials including false or misleading statements regarding the loan originators’ and defendants’ underwriting guidelines, the LTV ratios, owner-occupancy, defendants’ due diligence into the loan originators and the mortgage loans and the accuracy of certain credit ratings. However, defendants argue that in the prospectus supplements, they disclaimed responsibility for information provided by the originators and could not vouch for its accuracy or completeness.

The court, however, rejects the notion that defendants are immunized from liability because the Offering Materials generally disclosed that the representations were based on information provided by the originators. Defendants may be liable for drafting and distributing statements they knew to be false, regardless of who they credit as the source of the information. *See Williams v. Sidley Austin Brown & Wood, LLP*, 38 A.D.3d 219, 220 (1st Dep’t 2007); *China Dev. Indus. Bank*, 86 A.D.3d at 436. For the same reason,

defendants can be held liable for promoting the securities based upon the high ratings from the credit ratings agencies, if, as alleged, they knew the ratings were based on false information provided to the agencies.

Defendants further argue that the prospectus supplements disclosed that the originators could make a “substantial” number of exceptions to the underwriting guidelines, warned of possibly high delinquency, foreclosure and bankruptcy rates and warned of various other risks.

As in other RMBS cases where such warnings have been deemed ineffective, defendants have merely identified “boilerplate disclaimers and disclosures in the relevant offering documents . . . that . . . [did] not disclose the risk of a systematic disregard for underwriting standards or an effort to maximize loan originations without regard to loan quality,” or alert plaintiffs’ to the other allegedly wrongful practices. *In re Morgan Stanley Mortg. Pass-Through Certificates Litig.*, 810 F. Supp. 2d 650, 672 (S.D.N.Y. 2011). A general warning that “exceptions” may occur where borrower demonstrates certain compensating factors does not give notice of, as alleged here, “a wholesale abandonment of underwriting standards.” *Plumbers’ Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 773 (1st Cir. 2011). *See also New Jersey Carpenters Vacation Fund v. Royal Bank of Scotland Group, PLC*, 720 F. Supp. 2d 254, 270 (S.D.N.Y. 2010) (“Disclosures that described lenient, but nonetheless

existing guidelines about risky loan collateral, would not lead a reasonable investor to conclude that the mortgage originators could entirely disregard or ignore those loan guidelines”); *Pub. Employees’ Ret. Sys. of Mississippi v. Merrill Lynch & Co. Inc.*, 714 F. Supp. 2d 475, 483 (S.D.N.Y. 2010) (“[T]he alleged repeated deviation from established underwriting standards is enough to render misleading the assertion in the registration statements that underwriting guidelines were generally followed.”); *In re IndyMac Mortgage-Backed Sec. Litig.*, 718 F. Supp. 2d 495, 509 (S.D.N.Y. 2010) (“Disclosures regarding the risks stemming from the allegedly abandoned standards do not adequately warn of the risk the standards will be ignored”). Accordingly, notwithstanding the disclaimers, plaintiffs’ allegations that the Offering Materials were misleading are sufficient to withstand a motion to dismiss.

Plaintiffs have also identified actionable misrepresentations regarding defendants’ due diligence into the loan originators and the loan origination processes and systems. Although defendants contend that their alleged practice of waiving defective loans into the pools was consistent with their disclosure that “a substantial portion of the mortgage loans may represent underwriting exceptions, this again ignores the larger context. Plaintiffs contend that defendants ignored the pervasive defects in the loans it securitized, ignored the findings of its due diligence providers, and used its knowledge of the defective underwriting process to negotiate reduced loan prices. Defendants’ occasional

disclaimers cannot be invoked to excuse the wholesale abandonment of underwriting standards and practices.

The court also finds that plaintiffs allegations of fraud in connection the LTV ratios, owner occupancy rates and credit enhancements state a claim. Misrepresentations of such data has been held to be actionable. *See MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d at 294; *Morgan Stanley Pass-Through Certificates Litig.*, 810 F. Supp. 2d 650, 672-73 (appraisals); *Stichting*, 38 Misc.3d 1214(A) at *9 (LTV ratios, appraisals, credit ratings). Defendants' attempt to again blame the source of the data fails, as plaintiffs allege that defendants provided it with knowledge of its falsity. And while defendants try to downplay the discrepancies as merely a difference in valuation methodologies, that theory rests on factual issues out side the scope of this motion.

The complaint alleges that the appraisers retained were biased and that the originators manipulated appraised values (Am. Compl. ¶¶77-80, 82, 104, 113, 125) with the result that the appraisals were inflated, the LTV ratios were understated, and the mortgaged properties were often worth less than the loan. (Am. Compl. ¶¶52, 163-64.) Plaintiffs allege that defendants knew these facts and purposefully delayed second appraisals to allow the loans to be securitized based on the original flawed information. (Am. Compl. ¶¶163-65.) These types of claims have been held to be actionable, notwithstanding defendants' contention that appraisals are statements of mere opinion.

See *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d at 293; *Morgan Stanley Pass-Through Certificates Litig.*, 810 F. Supp. 2d at 672-73; *Stichting*, 38 Misc.3d 1214(A) at *9. Moreover, appraisals are “akin to representations of fact” when they purport to represent an “analysis of the market conditions, sales histories and fair market values of the relevant collateral.” *Stewardship Credit Arbitrage Fund LLC v. Charles Zucker Culture Pearl Corp.*, 2011 WL 1744217, at *5 (Sup. Ct. N.Y. Cty. 2011).

D. *Reasonable Reliance*

Defendants argue that, as to the majority of the Certificates, plaintiffs cannot claim that they reasonably relied on the representations in the prospectus supplements because the offerings were purchased before the supplements were issued. However, this objection is misguided because the complaint defines the “Offering Materials” as including “drafts,” term sheets and other non-final documents, not merely prospectus supplements. Plaintiffs further allege that they reviewed the Offering Materials before they made their purchases, and relied upon the representations therein. This is sufficient. The pleading requirements for reliance are minimal on a motion to dismiss, and it is generally premature to decide the question at the pleading stage. *Knight Securities LP v. Fiduciary Trust Co.*, 5 A.D.3d 172, 173 (1st Dep’t 2004).

Defendants also contend that Allstate could not have reasonably relied on any alleged misrepresentations because it is a sophisticated investor in the mortgage-backed security market, and the information available to it, and to the public at large at the time the securities were issued, should have alerted it to the alleged misrepresentations. While it is true that “New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions,” *Global Minerals & Metals Corp. v. Holme*, 35 A.D.3d 93, 100 (1st Dep’t 2006), “such rule is not determinative . . . where [plaintiff] . . . has sufficiently alleged that [defendant] possessed peculiar knowledge of the facts underlying the fraud, and the circumstances present would preclude any investigation by [plaintiff] conducted with due diligence.” *China Dev. Indus. Bank*, 86 A.D.3d at 436. Plaintiffs allege that they lacked access to the underlying RMBS loan files and had to rely on defendants' representations about their quality (Am. Compl. ¶¶ 34, 36). This pleading distinguishes the instant case from *HSH Nordbank AG v. UBS AG*, 95 A.D.3d 185 (1st Dep’t 2012), as Plaintiffs’ allegations here stem from facts not alleged by either side to be discoverable through publicly available sources or ascertainable through means available to plaintiffs – i.e., the underwriting practices used to originate the loans in the securitization and the resulting quality of those loans. *See ACA Fin. Guar. Corp. v. Goldman Sachs & Co.*, 35 Misc.3d 1217(A), at *12-*13 (Sup. Ct. N.Y. Cty. Apr. 23,

2012). Accordingly, the Court finds that Plaintiffs have adequately pleaded reliance. *See Stichting*, 38 Misc.3d 1214(A) at *10 (“plaintiff has also alleged that it ‘had no reasonable means or ability to conduct its own due diligence regarding the quality of the mortgage pools’ because it did not have access to the underlying loan files, appraisals, or supporting documentation . . . [t]hese allegations are sufficient to plead justifiable reliance”).

E. *Damages*

Defendants contend that the complaint should be dismissed because plaintiffs fail to plead their damages with any detail. However, under CPLR 3016 (b), “[i]t is not necessary . . . that the measure of damages be pleaded, so long as facts are alleged from which damages may properly be inferred.” *Black v. Chittenden*, 69 N.Y.2d 665, 668 (1986). Moreover, the complaint alleges “[t]he Certificates are no longer marketable or salable at or near the prices Allstate paid for them, and Allstate has suffered significant losses as a result of the fraud perpetrated by Morgan Stanley.” (Am. Compl. ¶ 14.) While defendants assert that the proper measure of damages is the difference between the price paid for a security and its true worth at the time of purchase, it is easily inferable from the pleadings that plaintiffs paid an inflated price for the RMBS and are thus entitled to recover for the impermissible premium they paid. *See Allstate Ins. Co. v. Countrywide*

Fin. Corp., 824 F. Supp. 2d 1164, 1188 (C.D. Cal. 2011) (“Allstate has pleaded that the Defendants misrepresented the value and riskiness of the underlying loans and the collateral securing those loans . . . [i]f true, the RMBS may have been worth less than Allstate paid for them at the time of sale . . . [t]his is marginally sufficient, at the pleading stage, to establish damages under New York's common law rule”). Plaintiffs may also be entitled, as they claim, to the decline in the market value of the Certificates, *see Stichting*, 38 Misc.3d 1214(A) at *11.

III. Negligent Misrepresentation

The Court next turns to defendants’ motion to dismiss plaintiffs’ negligent misrepresentation claim. A negligent misrepresentation claim requires allegations of “(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 N.Y.3d 173, 180 (2011)(internal quotation omitted); *Gomez-Jimenez v. New York Law School*, 103 A.D.3d 13, at *3 (2012). While the existence of a special relationship to support a negligent misrepresentation claim “generally raises an issue of fact,” *see Kimmell v. Schaefer*, 89 N.Y.2d 257, 263 (1996), “where the plaintiff’s allegations, accepted as true and given all favorable inferences, simply do not support the finding of a

special relationship, the claim is subject to pre-answer dismissal.” *MBIA Ins. Co. v. Residential Funding Co., LLC*, 26 Misc.3d 1204(A), at *5 (Sup. Ct. N.Y. Cty. Dec. 22, 2009).

A duty to impart correct information falls only upon “persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified.” *Kimmell v. Schaefer*, 89 N.Y.2d 257, 263 (1996). Plaintiffs argue that defendants possessed superior knowledge or special expertise because of their access to the loan files and their understanding of the underwriting procedures and its inherent defects. However, “a company’s knowledge of the particulars of its own business is not the type of unique or specialized knowledge” that can create a duty. *MBIA Ins. Co. v. GMAC*, 30 Misc. 3d 856, 864 (Sup. Ct. N.Y. Cty. 2010) (quotations omitted). New York courts have dismissed negligent misrepresentation claims in other RMBS cases on the ground that “[m]ere possession of the loan files and servicing files does not create the type of specialized knowledge discussed in *Kimmell*.” *Id.* at 865; *see also Stichting*, 38 Misc.3d 1214(A) at *13 (dismissing negligent misrepresentation claim where plaintiff did not plead “specialized knowledge” despite assertions that Credit Suisse “had superior knowledge of its own underwriting procedures” and “it alone had the ability to investigate the underlying loans.”); *MBIA Ins. Corp. v. Residential Funding Co.*, 2009 WL 5178337, *6

(Sup. Ct. N.Y. Cty. 2009). Likewise here, dismissal of the negligent misrepresentation claim is warranted, given plaintiffs' failure to plead a special or privity-like relationship with defendants. Accordingly, plaintiffs' negligent misrepresentation claim is denied.

IV. Aiding and Abetting

Defendants challenge plaintiffs' aiding and abetting claim as conclusory.

However, plaintiffs have identified the various functions of the Deutsche entities and their role in the alleged loan underwriting fraud. A complaint may be sustained even where the case for corporate defendants' knowledge and participation in the alleged fraud is a purely circumstantial one drawn from the inferences arising from their positions and responsibilities at the defendant companies. *See Pludeman v. N. Leasing Systems, Inc.*, 40 A.D.3d 366, 367-68 (1st Dep't 2007) (“[a]t this early juncture, according plaintiffs' complaint the most favorable inferences, one can readily deduce, given the corporate positions and titles of the individual defendants, that these individuals actually operate the day-to-day business of the corporate defendant, and consequently were involved in or knew about the alleged fraudulent concealment of most of the lease

. . . [a]t this pre-discovery stage, plaintiffs are understandably unable to further state the details of the individual defendants' personal participation in, or actual knowledge of, the

alleged concealment"); *see also Bernstein v. Kelso & Co., Inc.*, 231 A.D.2d 314, 323 (1st Dep't 1997). Accordingly, the claim is sustained.

Order

Accordingly, it is hereby

ORDERED, that defendants' motion to dismiss is granted as to the second cause of action for negligent misrepresentation, and as to all claims for recovering under Certificates ACE 2005-WF1 and DBALT 2005-AR1, and it is further


ORDERED, that defendants' motion to dismiss is denied as to all other claims; and it is further

ORDERED that defendants are directed to serve an answer to the complaint within 20 days of receipt of a copy of this order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 442, 60 Centre Street, on April 30, 2013, at 10:45 AM.

Dated: 3-14-13

ENTER:


Hon. Eileen Bransten, J.S.C.