SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

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

Plaintiffs,

Index No. 653123/13

-against-

CREDIT SUISSE AG, CREDIT SUISSE SECURITIES (USA) LLC, DLJ MORTGAGE CAPITAL, INC., CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORP., and ASSET BACKED SECURITIES CORP.,

Defendants.

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Hon. Charles E. Ramos, J.S.C.:

In motion sequence number 001, defendants Credit Suisse AG, Credit Suisse Securities (USA) LLC, DLJ Mortgage Capital, Inc., Credit Suisse First Boston Mortgage Securities Corp., and Asset Backed Securities Corp. move, pursuant to CPLR 3211 (a) (1), (3), (5), and (7), to dismiss the plaintiffs' amended complaint.

The following factual allegations are set forth in the amended complaint, and for the purposes of this motion are accepted as true.

This action arises out of the purchase of more than $362 million worth of residential mortgage-backed securities (RMBS). The claims at issue here arise from 31 separate certificate purchases made in 16 different offerings (the Certificates), all

of which were structured, marketed, and sold by the defendants during the period of 2005 through 2007 (amended complaint, ¶ 1).

The Plaintiffs

During the relevant time period, nonparties WestLB AG (WestLB), a German corporation, Greyhawk Funding LLC (Greyhawk), a Delaware limited liability company, Harrier Finance Limited (Harrier), a Cayman Islands limited liability company, Blue Heron Funding III Ltd., a Cayman Islands company, and Blue Heron IV Ltd., a Cayman Islands company, purchased some of the Certificates, and, subsequently, assigned them to plaintiff Phoenix Light SF Limited (Phoenix), a limited liability company incorporated in Ireland. Plaintiff Kleros Preferred Funding V PLC (Kleros), a "public limited company" incorporated under the laws of Ireland, is also an assignee of some of the Certificates purchased by WestLB. Plaintiff Silver Elms CDO PLC (Silver Elms), a public limited liability company incorporated under the laws of Ireland, is an assignee of some of the Certificates purchased by nonparty Paradigm Funding LLC (Paradigm), a now defunct Delaware limited liability company (amended complaint, ¶¶ 4-5; 10; 12).

Plaintiff Silver Elms CDO II Limited (Silver Elms II), a "public limited company" formed under the laws of Ireland, claims it was an original purchaser of some of the Certificates, as well as an assignee of the Certificates that were initially purchased

by WestLB and Paradigm. Finally, plaintiffs Blue Heron Funding II Ltd., Blue Heron Funding V Ltd., Blue Heron Funding VI Ltd., and Blue Heron Funding VII Ltd., Cayman Island companies, were original purchasers of some of the Certificates (amended complaint, ¶¶ 6-9; 11). Plaintiffs Phoenix, Silver Elms, Silver Elms II, and Kleros allege that the assignment of the Certificates included an assignment of all rights, title, interest, causes of action, and claims in and related to the Certificates (amended complaint, ¶¶ 4; 10-12).

Credit Suisse Offerings

The amended complaint alleges that "[d]efendants used U.S. Securities and Exchange Commission (SEC) forms, such as registration statements, prospectuses, and prospectus supplements, as well as other documents - such as pitch books, term sheets, loan tapes, offering memoranda, draft prospectus supplements, 'red,' 'pink' and 'free writing' prospectuses and electronic summaries of these materials - to market and sell the certificates to plaintiffs" (amended complaint, ¶ 2). Defendants disseminated the key information in these documents to third parties, such as rating agencies and broker-dealer and analytics firms, for the purpose of marketing and selling the Certificates to plaintiffs (collectively, the documents and information disseminated by defendants will be referred to as the Offering Documents) (*id.*).

Plaintiffs make several allegations that the Offering Documents for each of the 16 offerings at issue were materially false and misleading and omitted material information. First, plaintiffs allege that the Offering Documents' representations concerning the loan originators' underwriting guidelines were false and misleading, as the loan originators abandoned their stated underwriting guidelines in order to originate as many loans as possible, and were not evaluating the borrowers' ability to repay the loans or assessing the actual value and adequacy of the mortgaged properties serving as collateral (*see* amended complaint, ¶¶ 50-53; 65-67; 79-81; 93-95; 107-109; 121-125; 137-140; 152-154; 166-168; 176-179; 191-196; 208-212; 224-226; 238-240; 252-254; 266-268; 278-291; *see also* ¶¶ 293-386). Plaintiffs allege that defendants knew that the Certificates' underlying loans were not originated pursuant to underwriting guidelines and that the loans were not likely to be repaid and failed to disclose this information (*see id.*; ¶¶ 426-428; 431-442; 446-451).

According to the amended complaint, a number of originators, including New Century Mortgage Corporation, WMC Mortgage Corp., Ameriquest Mortgage Company, Long Beach Mortgage Company, and Wells Fargo Bank, N.A., faced lawsuits and investigations in connection with their abandonment of underwriting guidelines (amended complaint, ¶¶ 294-301; 311-312; 317-319; 348-349; 352-

356; 365-373).

Second, plaintiffs allege that the Offering Documents made material misrepresentations about the loan-to-value ratios (LTV Ratios) regarding the Certificates' underlying loans. It is alleged that the Offering Documents misrepresented the actual percentages of the Certificates' underlying loans that had LTV Ratios in excess of 80% and 100%. Defendants allegedly used false and inflated appraisals and valuations for the loan properties in order to generate artificial LTV Ratios in the Offering Documents. Further, it is alleged that defendants were well aware that the appraisal valuation process was being manipulated by the loan originators and appraisers by virtue of the due diligence defendants performed on the loans, their participation in originating the loans, and through their ownership and control of lender (*see* amended complaint, ¶¶ 54-54; 68-69; 82-83; 96-97; 110-111; 126-127; 141-142; 155-156; 180-181; 197-198; 213-214; 227-228; 241-242; 255-256; 269-270; 387-395; 440-444; 447-451).

Third, the Offering Documents allegedly misrepresented the underlying loans' owner occupancy rates (OOR). It is alleged that the Offering Documents falsely represented that a large percentage of the loans supporting the Certificates were issued to borrowers who actually lived in the properties serving as collateral for those loans in order to create the impression that

it was unlikely that these borrowers would default on the loans (*see* amended complaint, ¶¶ 56-57; 70-71; 84-85; 98-99; 112-113; 128-129; 143-144; 157-158; 182-183; 199-200; 215-216; 229-230; 243-244; 257-258; 396-400).

Fourth, it is alleged that defendants misrepresented the credit ratings for the Certificates. Specifically, the Offering Documents represented that the Certificates had been assigned high "investment grade" ratings by Standard & Poors (S&P), Moody's Investor Services (Moody's), and Fitch Ratings (Fitch), and one of the primary reasons why S&P, Moody's, and Fitch assigned such high ratings was because defendants had given them falsified information regarding the Certificates' underlying loans. It is further alleged that all of the 31 Certificates have now been downgraded to speculative "junk" status or below, and 25 of the 31 Certificates now have a credit rating of a "D" by S&P and/or "C" by Moody's, indicating they are in default (*see* amended complaint, ¶¶ 58-60; 72-74; 86-88; 100-102; 114-116; 130-132; 145-147; 159-161; 169-171; 184-186; 201-203; 217-219; 231-233; 245-247; 259-261; 271-273; 401-408; 452-454).

Lastly, plaintiffs allege that an essential aspect of the mortgage securitization process is that the issuing trust for each RMBS offering must obtain good title to the mortgage loans comprising of the pool for that offering. At least two documents, a promissory note and a security instrument (either a

mortgage or a deed of trust), must be validly transferred to the issuing trust. It is alleged that defendants, despite their representations in the Offering Documents, failed to ensure the proper transfer of these documents to the issuing trust at closing, and, in turn, the trusts were not able to foreclose on the loans, because they could not prove that they owned the mortgages as title was never properly transferred at the closing of the offerings (*see* amended complaint, ¶¶ 409-425; 455-457).

The amended complaint alleges that defendants hired nonparty Clayton Holdings, Inc. (Clayton) to test samples of the loans that they were placing into their offerings to determine whether the loans met underwriting guidelines, were supported by valid appraisals, and had other valid characteristics. It is alleged that 32% of the mortgage loans tested did not comply with underwriting guidelines and did not have factors that would merit approval. Further, defendants allegedly included 33.4% of those defective loans into the RMBS offerings they sold to plaintiffs despite knowing the loans were defective (*see* amended complaint, ¶¶ 382-386).

Plaintiffs assert that, in reliance on the representations made in the Offering Documents, they invested a significant amount of capital into the Certificates. It is alleged that plaintiffs did not learn of, and had no means by which they could have learned of, defendants' misrepresentations and omissions

prior to purchasing the Certificates, because such information was peculiarly within defendants' knowledge and control and defendants "refused to allow plaintiffs, the assigning entities or other investors access to such information" (amended complaint, ¶ 506). Plaintiffs allege that defendants refused as "a matter of course" to share access to the loan files and/or Clayton and similar due diligence reports, as it was industry custom and practice not to share such information (*id.*).

The amended complaint sets forth five causes of action: (1) common-law fraud, (2) fraudulent inducement, (3) aiding and abetting fraud, (4) negligent misrepresentation, and (5) rescission based upon mutual mistake. Defendants now seek to dismiss the amended complaint on the grounds that certain plaintiffs lack standing, all claims are time-barred, and that the amended complaint fails to state a claim.

Analysis

Motion to Dismiss Standard

On a motion to dismiss, "[t]he court must accept the facts alleged in the complaint as true and accord the plaintiffs the benefit of every possible favorable inference (*Leon v Martinez*, 84 NY2d 83, 87 [1994])." However, "factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that inherently incredible or clearly contradicted by documentary evidence" are not presumed to be true

on such a motion (*Skillgames, LLC v Brody*, 1 AD3d 247, 250 [1st Dept 2003]). Fraud claims, as alleged here, must be pled with particularity, stating each circumstance constituting fraud in detail (CPLR 3016 [b]).

Motion to Dismiss Fraud Claims for Failure to State a Claim

On June 13, 2014, this court issued a decision in a separate, but similar case, *Phoenix Light SF Limited, et al. v. The Goldman Sachs Group, Inc., et al.*, index No. 652356/2013 (43 Misc 3d 1233[A], 2014 NY Slip Op 50917[U] [Sup Ct, NY County 2014]) dismissing the complaint for failure to plead justifiable reliance (the Goldman Decision). On June 17, 2014, admittedly, as a result of the Goldman Decision, plaintiffs in the present action filed an amended complaint in an attempt to cure any potential deficiencies identified by the Goldman Decision. Thus, the question to be examined is whether plaintiffs have sufficiently pled justifiable reliance in support of their claims for fraud.

To state a claim of fraud under New York law, the complaint 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 NY3d 553, 559 [2009]). These allegations must be pled in particular detail (*id.*; CPLR § 3016 [b]).

As stated in the Goldman Decision, under New York law, there is an affirmative duty imposed on sophisticated investors, such as plaintiffs, "to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions" (*Global Mins. & Metals Corp. v Holme*, 35 AD3d 93, 100 [1st Dept 2006]).

> "If the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, 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"

(*DDJ Mgt., LLC v Rhone Group L.L.C.*, 15 NY3d 147, 154 [2010] [internal quotations and citations omitted]).

The amended complaint still fails to allege that plaintiffs made an inquiry in regard to acquiring the loan files and/or the due diligence reports summarizing those loan files, i.e., the information that would have uncovered the fraud, and that, after such inquiry, defendants denied them access. Even accepting as true the allegations that it was common practice for defendants to "refuse" to share such information with investors such as plaintiffs, there was still no inquiry, at the very least, by plaintiffs as to why it was not defendants' practice to share these materials (*see Graham Packaging Co., L.P. v Owens-Illinois, Inc.*, 67 AD3d 465, 465 [1st Dept 2009] [finding that, even if defendants could not have learned of certain information by the

exercise of reasonable diligence, as sophisticated entities represented by counsel, defendants should have at least inquired about such information]). Admittedly, plaintiffs, as sophisticated investors, entered into these deals without even questioning why such important information was not shared, a red flag to say the least.

The allegations clearly show that plaintiffs accepted what was presented to them without any true due diligence. Plaintiffs cannot claim justifiable reliance when they turned a blind eye to the information they needed to confirm that their investments were sound. Once again, the nature of the risk being assumed could have been ascertained from reviewing these loan files and/or due diligence reports and plaintiffs never asked for them nor inquired as to why it was not common practice to share them (*see HSH Nordbank AG v UBS AG*, 95 AD3d 185, 195 [1st Dept 2012]). If plaintiffs had inquired about the loan files and due diligence reports, and were actually refused them, not only would it have been an indication that something was awry, but also, they would be able to claim justifiable reliance here.

The amended complaint also alleges that plaintiffs received multiple "assurances" as to the "accura[cy] and reliab[ility]" of the "loan characteristics and underwriting standards set forth in defendants' Offering Documents" (amended complaint, ¶ 508 [b]-[d]). It is alleged that these "assurances" included "written

representations and warranties provided by parties with direct access to information concerning the loans' true characteristics and credit quality" (amended complaint, ¶ 508 [b]). Plaintiffs allege that these representations and warrantees were described by defendants in the Offering Documents (*id.*).

> "[W]here a plaintiff has gone to the trouble to insist on a written representation that certain facts are true, it will often be justified in accepting that representation rather than making its own inquiry. Indeed, there are many cases in which the plaintiff's *failure* to obtain specific, written representation is given as a reason for finding reliance to be unjustified"

(*DDJ Mgt., LLC v Rhone Group L.L.C.*, 15 NY3d at 154). However, plaintiffs have failed to plead that they actually asked defendants for these warranties and representations that the facts contained in the Offering Documents were true. In fact, the allegations make it clear that plaintiffs never asked for warranties and representations from defendants, and merely relied on the ones given by other parties to the defendants, and not them directly. Plaintiffs once again chose not to act with due diligence and chose not to take the initiative to insist on warranties and/or representations made directly from defendants to them. Plaintiffs failed to obtain specific, written representations from defendants, and their failure shows a lack of due diligence on their behalf.

Based on the allegations set forth in the amended complaint, plaintiffs have failed to allege justifiable reliance, and, in

turn, all of the fraud claims are dismissed, because to state a claim for fraudulent inducement, as well as aiding and abetting fraud, plaintiff must allege the basic elements of fraud (*see High Tides, LLC v DeMichele*, 88 AD3d 954, 957 [2d Dept 2011]; *Oster v Kirschner*, 77 AD3d 51, 55 [1st Dept 2010]).

Plaintiffs also fail to state claims for negligence misrepresentation and rescission based on mutual mistake. A claim for negligent misrepresentation must allege "(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information" (*J.A.O. Acquisition Corp. v Stavitsky*, 8 NY3d 144, 148 [2007] [citations omitted]).

Plaintiffs allege that defendants possessed unique and special knowledge and expertise, which created a duty, because they had exclusive control over the loan files and due diligence reports on the underlying loans and they had superior knowledge of its own underwriting procedures. However, "[a] company's knowledge of the particulars of its own business is not the type of unique or specialized knowledge" that creates a duty (*MBIA Ins. Co. v GMAC Mtge. LLC*, 30 Misc 3d 856, 864, 2010 NY Slip Op 20537 [Sup Ct, NY County 2010]). Further, "a special relationship does not arise out of an ordinary arm's length business transaction between two parties" (*MBIA Ins. Corp. v*

Countrywide Home Loans, Inc., 87 AD3d 287, 296 [1st Dept 2011] [citations omitted]). These were ordinary arm's length business transactions between sophisticated parties and did not create any duty supporting a claim of negligent misrepresentation. Thus, this claim is dismissed.

Plaintiffs argue that their rescission claim based on mutual mistake is actionable, because both the defendant underwriters and plaintiffs believed that the depositors had transferred title of the mortgage loans to the trusts, a vital step in the securitization process, and they had not done so at the time of the sale and purchase of the Certificates; thus, plaintiffs argue that there was no meeting of the minds.

"Generally, a contract entered into under a mutual mistake of fact is voidable and subject to rescission. The mutual mistake must exist at the time the contract is entered into and must be substantial" (*Matter of Gould v Board of Educ. of Sewanhaka Cent. High School Dist.*, 81 NY2d 446, 453 [1993] [internal citations omitted]).

Here, plaintiffs allege that the Offering Documents represented that "the depositor will sell, transfer, assign, set over and otherwise convey without recourse to the trustee in trust for the benefit of the certificate holders all right, title, and interest of depositor in and to each mortgage" (amended complaint, ¶ 414). This representation in the Offering

Documents was a future obligation. Thus, the parties could not have been mistaken about the status of the transfers at the time the contract was entered into based on this representation of something that was to occur in the future. Plaintiffs' allegation that the underwriter defendant, Credit Suisse Securities, believed that the mortgages and notes were assigned to the trust and/or trustees at the time the Certificates were purchased by plaintiffs directly is conclusory and is in conflict with the allegations that defendants failed to make the transfer (*see* amended complaint, ¶¶ 415-416).

In light of the fact that no claim has been asserted for breach of contract, the complaint must be dismissed.

Accordingly, it is

ORDERED that defendants' motion to dismiss is granted on the grounds of failure to state a claim, and it further

ORDERED that the portion of defendants' motion to dismiss based on standing is denied as moot; and it is further

ORDERED the amended complaint is dismissed with costs and disbursements as taxed by the Clerk of the Court, and the Clerk is directed to enter judgment accordingly.

Dated: April 16, 2015

ENTER:

J.S.C.

CHARLES E. RAMOS