Veleron Holding v Morgan Stanley
2016 NY Slip Op 30594(U)
March 11, 2016
Supreme Court, New York County
Docket Number: 652944/2014
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

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

Index Number : 652944/2014
VELERON HOLDING, B.V., ON
vs
MORGAN STANLEY
Sequence Number : 003
DISMISS

INDEX NO. _____
MOTION DATE 12/18/15
MOTION SEQ. NO. _____

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

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ **No(s).** 24-51
Answering Affidavits — Exhibits _____ **No(s).** 90-128, 173, 201-212
Replying Affidavits _____ **No(s).** 175, 189-193

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

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER

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

Dated: 3/11/16

SHIRLEY WERNER KORNREICH, J.S.C.

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

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

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VELERON HOLDING, B.V., on behalf of itself and as assignee of OJSC RUSSIAN MACHINES,

Plaintiff,

-against-

MORGAN STANLEY, MORGAN STANLEY CAPITAL SERVICES, LLC, and MORGAN STANLEY & CO., LLC,

Defendants.

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Index No.: 652944/2014

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Defendants (collectively, Morgan Stanley) move, as limited by the parties' briefs, to dismiss the complaint under CPLR 3211 on the ground that testimony in a recent federal insider trading trial is incompatible with the fraud claim asserted in the complaint. Morgan Stanley also contends that the negligent misrepresentation cause of action is not viable. For the reasons that follow, Morgan Stanley's motion is denied with respect to the fraud claim and granted with respect to the negligent misrepresentation claim.

I. Background & Procedural History

As this is a motion to dismiss, the facts recited are taken from the complaint (Dkt. 10) and the documentary evidence submitted by the parties.

This is at least the fourth legal proceeding[1] arising from an investment made by a Russian oligarch, Oleg Deripaska, in Magna International Inc. (Magna), a Canadian automotive parts manufacturer. Deripaska is the owner of a Russian industrial corporate conglomerate called Basic Element (Basic), which collectively accounts for approximately 1% of Russia's GDP. OJSC Russian Machines (RM) is a wholly owned subsidiary of Basic. Veleron Holding, B.V.

[1] As discussed herein, there was an arbitration in London, a jury trial in the Southern District of New York, and a bankruptcy proceeding in Russia.

(Veleron), the plaintiff in this action, is a Netherlands special purpose investment vehicle that is wholly owned by RM.[2] RM formed Veleron for the specific purpose of investing in Magna. Pursuant to a Credit Agreement, dated September 20, 2007, Veleron financed its purchase of approximately 20% of Magna's shares (the Shares) with a $1.2 billion margin loan (the Loan) from BNP Paribas S.A. (BNP), a French bank.[3] The Loan had a maturity date of September 20, 2009. The Shares were held as collateral for the Loan, but the Loan was otherwise a non-recourse obligation – that is, even if the Shares were worth less than any unpaid amount of the Loan, BNP had no right to seek a deficiency judgment from Veleron or its parent entities. The Credit Agreement had a "coverage ratio" requirement that permitted BNP to demand that Veleron post additional cash collateral if the price of the Shares fell below a certain amount relative to the outstanding loan balance. A failure by Veleron to meet a margin call constituted a defined Event of Default, entitling BNP to accelerate the Loan. If Veleron refused to pay, BNP had the right to liquidate the Shares.

To hedge the risks associated with issuing a $1.2 billion non-recourse loan to an SPV, BNP purchased credit default swaps (CDS)[4] from various banks, one of which was Morgan Stanley, the defendants in this action. The CDS with Morgan Stanley obligated Morgan Stanley to pay BNP 8.1% of any deficiency that resulted from a liquidation of the Shares. BNP also

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[2] The caption herein, as it relates to Veleron's standing, is addressed later in this decision.

[3] This transaction, as ironically noted by Judge McMahon, "was plainly and explicitly structured to avoid litigating in a US court." *See* Dkt. 87.

[4] CDS are derivatives that function as credit risk insurance. The seller of CDS sells "protection" on an event of default – here, for instance, default on the Loan – in exchange for premium payments. If the event of default occurs, the protection seller pays out a specified sum to the protection purchaser. So here, BNP paid premiums to other banks in exchange for coverage by those banks of a portion of BNP's loss should the Loan default.

entered into an Agency Disposal Agreement with Morgan Stanley whereby Morgan Stanley would sell the Shares in the event of default and would earn a commission of 1.25% of the Gross Realized Proceeds. *See* Dkt. 87 at 13.

Between December 2007 and July 2008, RM funded margin calls on behalf of Veleron in excess of $500 million. As of September 18, 2008, the outstanding balance on the Loan was $2.089 billion. In late September 2008, in the midst of the financial crisis, Magna's stock declined and triggered further margin calls. On September 29, 2008, at 4:38 PM (New York Time; it was after midnight in Russia), BNP demanded that Veleron make a margin call payment of approximately $92 million by October 1, 2008 at 1:00 PM. On September 30, 2008, Basic and RM requested on behalf of Veleron that BNP waive the margin call for two weeks to allow the parties to negotiate a restructuring agreement. According to Basic and RM, the Russian government had established a $50 billion emergency fund that could be used by Veleron to repay the Loan at the end of the forbearance period. BNP did not accept this proposal and, instead, increased its margin call to approximately $113.8 million during the evening of September 30, that amount still being due the following day, October 1, at 1:00 PM.

In the meantime, during the afternoon of September 30, Andrey Yashchenko, the Head of Corporate Finance at Basic and a member of RM's board, anticipated that BNP would increase its margin call demand in light of Magna's decreasing stock price. Yashchenko emailed various BNP employees, stating that RM was prepared to execute a guaranty of the Loan in exchange for forbearance. He proposed that in exchange for BNP converting the Loan to a recourse obligation as against RM, BNP would waive the margin call issued against Veleron and forbear on the default so the parties could attempt to work out a restructuring agreement.

BNP was amenable to this proposal, but only was willing to waive the margin calls if all of its CDS counterparties, including Morgan Stanley, agreed to do so. According to Veleron, Morgan Stanley was in somewhat of a precarious liquidity situation during the turmoil of the financial crisis and wanted to close out its CDS position. However, refusing Deripaska's forbearance request was not good for its business with the Russian oligarch. Morgan Stanley, therefore, allegedly wanted to string Veleron along in the hope that one of BNP's other CDS counterparty banks would withhold consent so Morgan Stanley would not be seen as the obstacle to forbearance.

Over the course of October 1, 2008, BNP, the Russian companies, and the other banks discussed the terms of a proposed guaranty agreement and restructuring plan. Shortly before 6:00 PM on October 1 (after midnight on October 2 in Russia), Oleg Kolesnik, an employee of Basic, acting on Yashchenko's authority (Yashchenko was copied on the email), sent BNP a guaranty agreement (the Guaranty) executed by RM's CEO and Chief Accountant. BNP provided the CDS counterparty banks, including Morgan Stanley, with a copy. In the Guaranty, as negotiated, RM "irrevocably and unconditionally" guaranteed Veleron's payment obligations on the Loan. The Guaranty, however, apparently still needed the approval of RM's board to be effective.[5]

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[5] The parties dispute whether RM's board ever approved the Guaranty, but the evidence at the federal trial indicated that it did. The arbitrator eventually held the Guaranty to be enforceable. That said, the question of what actions the board took with respect to the Guaranty is not relevant here. As discussed at oral argument, the relevant issues are the intentions of the employees of RM and Morgan Stanley before the Guaranty was transmitted to BNP. While there is no question that RM was silent as to the Guaranty's enforceability shortly after it was issued, and then vigorously contended that it was unenforceable in the subsequent litigation and arbitration, the parties' after-the-fact contentions are not dispositive. For the purpose of this motion to dismiss, there must be admissible evidence that RM did not intend the Guaranty to be valid when it was transmitted to BNP on the evening of October 1, 2008. No such evidence is in the record.

The parties spent the next day, October 2, 2008, negotiating a proposed restructuring plan. No agreement was reached. Shortly after 4:30 PM, BNP sent an acceleration notice to Veleron demanding all sums due on the Loan by 8:00 PM. Veleron did not pay. The next day, on October 3, 2008, Morgan Stanley liquidated the Shares on behalf of BNP. On October 6, 2008, BNP notified Veleron and RM that the Shares were liquidated and that there was a deficiency on the Loan of more than $79 million. BNP demanded payment by October 8, 2008 at 6:00 PM.

BNP did not collect the deficiency from Veleron. By letter dated July 23, 2010, BNP claimed that RM was obligated under the Guaranty to pay it more than $87 million, the amount BNP claimed was owed by Veleron inclusive of interest, costs, and legal fees. RM did not pay. On August 6, 2010, BNP commenced an arbitration proceeding against RM in the London Court of International Arbitration (the Arbitration). At issue in the Arbitration was whether RM is liable under the Guaranty in light of RM's contention that the Guaranty was legally invalid due to its board's supposed failure to approve it. In an award dated August 30, 2013, the arbitrator ruled in BNP's favor, holding that RM is liable under the Guaranty. On December 9, 2013, RM filed for bankruptcy in Russia.

Veleron alleges that on July 21, 2012, prior to the arbitrator's award and prior to the bankruptcy filing, RM assigned its claims against Morgan Stanley to Veleron "for value received." Veleron now claims to have the authority to prosecute this action on RM's behalf.

While Yashchenko and Gulzhan Moldazhanova (Basic's CEO) testified at trial, the person who transmitted the Guaranty, Kolesnik, did not. His testimony is essential.

However, Veleron must establish standing to pursue the claims on its own behalf, and not on behalf of RM, since it contends that the claims were properly assigned to it. [6]

On August 3, 2012, Veleron commenced an action in the United States District Court for the Southern District of New York against the financial institutions involved in the Magna transactions. *See Veleron Holding, B.V. v BNP Paribas SA*, No. 12-cv-5966 (SDNY) (McMahon, J.) (the Federal Action). In a thorough decision dated May 16, 2013, Judge McMahon resolved the defendants' motion to dismiss, leaving intact federal securities claims that, as explained below, eventually were tried before a jury. *See* Dkt. 87.[7]

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[6] The issue of standing and who is the proper party to this action will be further addressed at the preliminary conference and in discovery. Veleron was an SPV created by RM. The damages for the claim assigned to Veleron consist of the loss on the Guaranty which RM allegedly was wrongly induced to take on.

[7] Judge McMahon explained:

> This lawsuit has been cobbled together from two sets of claims against three differently situated groups of defendants.
>
> The gravamen of the lawsuit – the donkey, if you will – sounds in breach of contract. [Veleron], a Netherlands special purpose investment vehicle that fronts for a Russian manufacturing conglomerate, alleges that [BNP] breached three different agreements relating to a loan issued by BNP to the Russians (through Veleron) to facilitate the purchase of stock in [Magna]. ...
>
> Veleron has pinned two tails to this donkey.
>
> The first are claims of securities fraud, breach of contract, and tortious interference with contract/prospective economic advantage brought against a number of entities affiliated with [Morgan Stanley]. The securities fraud claim is properly before this court – it arises under US law and alleges misconduct by a US corporation in connection with the disposition of Magna stock owned by the Russian conglomerate and pledged as collateral for the BNP loan. Although it is among the least artfully pleaded complaints of its genre that I have seen, the First Amended Complaint ("FAC") manages to state a claim for relief. The breach of contract claim, by contrast, fails, because Veleron asserts rights under the agreements that are non-existent. The tortious interference claims are time-barred and must be dismissed.

While the Federal Action was pending, and after the arbitrator held that RM was liable to BNP under the Guarantee, Veleron commenced this action by filing a Summons with Notice on September 26, 2014. On September 30, 2014, Morgan Stanley removed this action to federal court, where it was assigned to Judge McMahon. By order dated November 13, 2014, Judge McMahon remanded the case back to this court. *See* Dkt. 3. After Morgan Stanley filed a demand for complaint, Veleron filed its complaint on February 17, 2015. *See* Dkt. 10. The complaint asserts two causes of action – fraud and negligent misrepresentation – both of which are based on the claim that Morgan Staley fraudulently induced RM to issue the Guarantee by falsely representing that it was willing to consider consenting to a restructuring agreement.

Morgan Stanley does not contend that such an allegation fails to state a valid claim. It is beyond cavil that a sane, sophisticated commercial actor does not voluntarily convert a multi-billion dollar non-recourse obligation against a judgment-proof SPV to a recourse obligation against its solvent parent without adequate consideration. It is undisputed that the consideration was the agreement by the banks, including Morgan Stanley, to engage in bona fide restructuring negotiations. Veleron alleges that Morgan Stanley never intended to agree to any restructuring

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> The second tail pinned consists of claims of tortious interference identical to those that are time-barred against Morgan Stanley, only asserted against three foreign banks, one of which claims that no US court has personal jurisdiction over it. The FAC reveals no obvious reason why New York law would apply to anything these foreign entities did to interfere with a European contract that is governed by Canadian law, or to a European shell corporation's relationship with a Canadian auto parts manufacturer.
>
> The only viable claim against Morgan Stanley-securities fraud- can be litigated independently of the claims against the other defendants. And it should be.

See Dkt. 87 at 2-3 (footnotes omitted).

agreement, and, hence, fraudulently induced RM to issue the Guarantee. The truth of this allegation is a question of fact that cannot be resolved without discovery.

That said, on March 6, 2015, Morgan Stanley moved to dismiss, *inter alia*, based on supposed admissions in the Federal Action. The scope of the motion has since narrowed because, in the interim, summary judgment in the Federal Action was denied, a trial took place, and Morgan Stanley was not held liable because the jury found that Veleron did not carry its heavy burden of proving scienter, the requisite intent to defraud.[8]

The court reserved on the instant motion after oral argument pending further submissions that would address the trial testimony. *See* Dkt. 199 (11/24/15 Tr.). As discussed below, the testimony at trial in the Federal Action does not provide a sufficient basis on this motion to dismiss to preclude the instant fraud claim. The negligent misrepresentation claim, however, is not viable for lack of a fiduciary or special relationship between the parties.[9]

II. Discussion

A. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty*

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[8] The trial was conducted between November 2 and November 13, 2015, concluding less than two weeks before oral argument on the instant motion. Nothing herein should be construed as the court opining on the merits or outcome of any of the other related proceedings, including the jury's verdict.

[9] To be clear, the court need not address the nature of the relationship between Morgan Stanley and Veleron because the allegedly defrauded party was RM, not Veleron. Morgan Stanley's relationship with RM, as discussed, was arms' length. That said, to avoid confusion, that Morgan Stanley may have had duties to Veleron with respect to the liquidation of the Shares has no bearing on whether a duty giving rise to a negligent misrepresentation claim exists for the purpose of inducing RM to enter into the Guaranty. Morgan Stanley's duties related to how collateral was to be liquidated had nothing to do with the parties' posture with respect to negotiating the restructuring and the Guaranty.

Corp., 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

B. Fraud

"The elements of a cause of action for fraud [are] a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009); *see Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc.*, 115 AD3d 128, 135 (1st Dept 2014). Pursuant to CPLR 3016(b), "the circumstances constituting the wrong shall be stated in detail." *Pludeman v Northern Leasing Sys., Inc.*, 10 NY3d 486, 491 (2008).

Morgan Stanley argues that Veleron's fraud claim must be dismissed on two grounds: (1) admissions in the federal trial "utterly refute" Veleron's claims; and (2) the *in pari delicto* doctrine. Neither argument warrants dismissal at this juncture.

The trial testimony does not definitively resolve the relevant inquiry, namely, whether at the time RM transmitted the Guaranty to BNP, RM intended that the Guaranty would not be legally effective. Obviously, if RM did not think it was guaranteeing anything, it could not establish the element of actual reliance. The record on this motion is devoid of any RM witness making such a judicial admission.[10] To be sure, it would be reasonable to conclude that the testimony of RM's witnesses raise a reasonable inference that after it issued the Guaranty, RM immediately had regrets and sought a way out of it. A reasonable finder of fact might also conclude that RM's conduct on October 2, 2008 is sufficient circumstantial evidence of its intent on October 1. After all, Moldazhanova basically admitted that she thought the Guaranty was not legally binding on October 2, but stayed silent in her conversations with the banks to permit them to operate under the false impression (in her view) of its validity. *See* Dkt. 189 at 17-18. Ultimately, as we know, such a strategy did not prove fruitful for RM since the arbitrator eventually held that the Guaranty is enforceable. Consequently, that RM may have acted

[10] Morgan Stanley avers that Yashchenko testified that he thought the Guaranty was invalid "when it was conveyed", but he did not quite testify to that effect. *See* Dkt. 189 at 9. Rather, Yashchenko testified that the Guaranty transmitted was to become effective after it was approved by RM's board, something RM may or may not have intended to do (though, as noted, the board does appear to have approved it). Yashchenko *did not* testify that RM intended to provide BNP with an unenforceable guaranty. This would have been a fatal admission; but no such admission was made. That said, Yashchenko's testimony suggests that the banks may not have completely understood the status of the Guaranty when it was transmitted, but this lack of clarity only highlights why there are questions of fact requiring discovery. The parties principally rely here on the trial testimony, and Veleron makes the critical observation that such testimony was not admitted for the purpose of establishing the validity of the Guaranty, but only to provide the jury with the context of the parties' relationship as relevant to the subject insider trading claim. *See* Dkt. 201 at 7-8, citing Dkt. 204 at 3 (Judge McMahon's explanation to the jury).

deviously on the day after the Guaranty was issued is of no moment at this juncture.[11] Nor is it dispositive that RM's witnesses may have perjured themselves in the arbitration and the Federal Action by being less than forthright about the actions of RM's board.[12] Regardless of the veracity of Moldazhanova's testimony about her views on October 2, neither she nor any other RM witness expressly testified about RM's intent as to the validity of the Guaranty when it was transmitted on October 1. To the extent Morgan Stanley asks this court to view Moldazhanova's testimony with a fair degree of skepticism and simply find her not to be a credible witness, such a determination would be improper on this motion to dismiss.

That said, despite the dubious positions taken by RM to date, discovery is necessary to ascertain RM's actual intent with respect to the Guaranty at the time Kolesnik transmitted it to BNP.[13] It may well be the case that RM wanted it to be effective, and intended to procure the requisite board approval, but only later had second thoughts. It also may be the case that RM always intended on duping the banks by giving them what RM's witness described as a "worthless piece of paper." But, as noted, neither Veleron nor Morgan Stanley points to any testimony definitively answering this question.[14] At best, the testimony raises certain inferences suggesting Morgan Stanley's proffered narrative is correct. But since all reasonable inferences

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[11] RM's conduct on October 2, however, may ultimately impact the viability of the fraud claim for the reason discussed below.

[12] This court, of course, does not mean to suggest that if any of the witnesses' testimony amounts to perjury, such perjury should be taken lightly.

[13] In light of the ample discovery produced in the Federal Action, discovery here will avoid costly duplication, particularly with respect to ESI.

[14] It should be noted that this is a public forum, where myriad matters the parties would prefer remain confidential surely will be made public. While the court has thus far permitted certain documents to be redacted or filed under seal by virtue of orders issued in the arbitration and the Federal Action, sealing information not expressly required by court order will not be permitted.

must be resolved in favor of plaintiff on a motion to dismiss, the court cannot accept Morgan Stanley's gloss. Absent definitive admissions, which are lacking here, the question of whether RM intended to trick the banks by issuing an unenforceable Guaranty to induce forbearance is a question for the finder of fact.

As for Morgan Stanley's *in pari delicto* defense, it is premature to rule on its viability at this time. The Court of Appeals has explained the contours of this doctrine:

> The doctrine of in pari delicto mandates that the courts will not intercede to resolve a dispute between two wrongdoers. This principle has been wrought in the inmost texture of our common law for at least two centuries. The doctrine survives because it serves important public policy purposes. First, denying judicial relief to an admitted wrongdoer deters illegality. Second, in pari delicto avoids entangling courts in disputes between wrongdoers. As Judge Desmond so eloquently put it more than 60 years ago, "[N]o court should be required to serve as paymaster of the wages of crime, or referee between thieves. Therefore, the law will not extend its aid to either of the parties or listen to their complaints against each other, but will leave them where their own acts have placed them".
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> The justice of the in pari delicto rule is most obvious where a willful wrongdoer is suing someone who is alleged to be merely negligent. A criminal who is injured committing a crime cannot sue the police officer or security guard who failed to stop him; the arsonist who is singed cannot sue the fire department. But, as the cases we have cited show, the principle also applies where both parties acted willfully. Indeed, the principle that a wrongdoer should not profit from his own misconduct is so strong in New York that we have said the defense applies even in difficult cases and should not be "weakened by exceptions".

Kirschner v KPMG LLP, 15 NY3d 446, 464 (2010) (internal citations omitted).

The parties dispute the level of interconnectedness of the parties' respective wrongdoing necessary for the doctrine to apply. Morgan Stanley contends that RM's alleged deceit after the Guaranty was transmitted, which began the very next morning, is relevant. Veleron avers that any wrongdoing after the Guaranty was issued is irrelevant because such wrongdoing is not part and parcel of the wrongdoing committed by Morgan Stanley. Stated differently, Veleron claims the parties are not *in pari delicto* unless they each sought to instill in each other a material false

belief to induce the Guaranty in exchange for forbearance. Veleron relies on general descriptions of the doctrine by federal courts that have stated that "plaintiff must be an active, voluntary participant in the unlawful activity that is the **subject of the suit**" and that "[p]laintiffs who are truly *in pari delicto* are those who have themselves violated the law in cooperation with the defendant." *See Pinter v Dahl*, 486 US 622, 636 (1988) (citations omitted; emphasis added). Morgan Stanley avers Veleron proffers an overly narrow interpretation of the words "subject of the suit" because, elsewhere in *Pinter*, the Supreme Court explained that "courts have expanded the [*in pari delicto*] defense's application to situations more closely analogous to those encompassed by the 'unclean hands' doctrine, where the plaintiff has participated 'in some of the same sort of wrongdoing' as the defendant." *See id.* at 632 (citation omitted). Neither party, however, proffers controlling New York State appellate precedent explaining how related the parties' wrongdoing must be or how such a standard is to be applied to this case. In light of the questions of fact about the parties' intentions regarding the Guaranty at the time it was transmitted, dismissal on *in pari delicto* grounds is premature.

The court notes, nonetheless, that it finds the *Pinter* Court's comparison to the unclean hands doctrine to be apt. While Veleron's fraud claim is a legal claim (it seeks monetary damages, not rescission), and thus unclean hands, an equitable defense, is not strictly applicable, an *in pari delicto* defense based on RM's unclean hands may be viable. Thus, Morgan Stanley might be entitled to dismissal if both sides were trying to defraud the other, even if RM's deception did not truly begin until the morning after the Guaranty was transmitted. This issue can be probed in discovery.[15]

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[15] Since New York State law governs, at the summary judgment stage, the parties' arguments based on the scope of the *in pari delicto* doctrine should be supported, if possible, by New York State appellate court cases.

C. Negligent Misrepresentation

Veleron's negligent misrepresentation claim, however, is not viable. "A claim for negligent misrepresentation requires the plaintiff to demonstrate (1) **the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff**; (2) that the information was incorrect; and (3) reasonable reliance on the information." *J.A.O. Acquisition Corp. v Stavitsky*, 8 NY3d 144, 148 (2007) (emphasis added). Likewise, "an omission does not constitute fraud unless there is a fiduciary relationship between the parties."[16] *Cobalt Partners, L.P. v GSC Capital Corp.*, 97 AD3d 35, 42 (1st Dept 2012), quoting *SNS Bank, N.V. v Citibank, N.A.*, 7 AD3d 352, 356 (1st Dept 2004), accord *Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 179 (2011).

Here, these sophisticated commercial actors were adverse financial counterparties, not fiduciaries.[17] Veleron does not cite a comparable case where a fiduciary relationship was found, and recent First Department precedent suggests that sophisticated counterparties in structured finance transactions are not in a special relationship, even when the parties' interests are somewhat more aligned than here. *See Basis Pac-Rim Opportunity Fund v TCW Asset Mgmt. Co.*, 124 AD3d 538, 539 (1st Dept 2015) (CDO investor and CDO collateral manager do not have special relationship) (collecting cases); *see also Basis Yield*, 115 AD3d at 141. Accordingly, it is

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[16] Veleron's second cause of action also appears to style this claim as one for fraudulent concealment or fraudulent omission.

[17] Since Morgan Stanley's liability to BNP on its CDS is dependent on the deficiency after liquidation of the Shares, Morgan Stanley had an economic interest in seeing RM cover that deficiency by virtue of the Guaranty. It is not clear from this record how much Morgan Stanley paid to BNP or if any amounts paid might be offset by BNP's recovery against RM in its bankruptcy proceedings (the details of which also are not before the court).

ORDERED that defendants' motion to dismiss the complaint is granted only with respect to the second cause of action, which is dismissed, and otherwise denied; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, for a preliminary conference on April 12, 2016, at 11:00 in the forenoon.

Dated: March 11, 2016

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C.