| **IKB Intl. S.A. v Morgan Stanley** |
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| 2023 NY Slip Op 30614(U) |
| March 1, 2023 |
| Supreme Court, New York County |
| Docket Number: Index No. 653964/2012 |
| Judge: Melissa A. Crane |
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# SUPREME COURT OF THE STATE OF NEW YORK
# NEW YORK COUNTY

**PRESENT:** HON. MELISSA A. CRANE **PART** 60M

*Justice*

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**INDEX NO.** 653964/2012

**MOTION DATE** 01/10/2023

**MOTION SEQ. NO.** 004

IKB INTERNATIONAL S.A. IN LIQUIDATION, IKB DEUTSCHE INDUSTRIEBANK AG,

Plaintiff,

- v -

MORGAN STANLEY, MORGAN STANLEY & CO. LLC (F/K/A MORGAN STANLEY & CO. INCORPORATED), MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC D/B/A MORGAN STANLEY MORTGAGE CAPITAL INC.,MORGAN STANLEY CAPITAL I INC.,MORGAN STANLEY ABS CAPITAL I INC.,SAXON FUNDING MANAGEMENT LLC (F/K/A SAXON FUNDING MANAGEMENT, INC.), SAXON ASSET SECURITIES COMPANY

Defendant.

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**DECISION + ORDER ON MOTION**

The following e-filed documents, listed by NYSCEF document number (Motion 004) 201, 202, 203, 204, 205, 206, 207, 208, 209, 210, 211, 212, 213, 214, 215, 216, 217, 218, 219, 220, 221, 222, 223, 224, 225, 226, 227, 228, 229, 230, 231, 232, 233, 234, 235, 236, 237, 238, 239, 240, 241, 242, 243, 244, 245, 246, 247, 248, 249, 250, 251, 252, 253, 254, 255, 256, 257, 258, 259, 260, 261, 262, 263, 264, 265, 266, 267, 268, 269, 270, 271, 272, 273, 274, 278, 279, 280, 281, 282, 283, 284, 285, 286, 287, 288, 289, 290, 291, 292, 293, 294, 295, 296, 297, 298, 299, 300, 301, 302, 303, 304, 305, 306, 307, 308, 309, 310, 311, 312, 313, 314, 315, 316, 317, 318, 319, 320, 321, 322, 323, 324, 325, 326, 327, 328, 329, 330, 331, 333, 334, 335, 336

were read on this motion to/for SUMMARY JUDGMENT(AFTER JOINDER .

Defendants Morgan Stanley et al. ("Defendants" or "Morgan Stanley") have filed a motion for summary judgment dismissing the remaining causes of action in the complaint of Plaintiffs IKB International S.A. in liquidation ("IKB SA") and IKB Deutsche Industriebank AG ("IKB AG") (collectively, "Plaintiffs") pursuant to CPLR 3212. In particular, Defendants seek summary judgment dismissing the causes of action for fraud and aiding and abetting fraud. Defendants assert entitlement to summary judgment on several grounds: (1) that the assignment to IKB AG of the right to bring these claims ("2012 Assignment") is void as champertous, (2) that the claims are

barred by collateral estoppel, and (3) that, regardless, Plaintiffs are not able to establish the elements of actual and justifiable reliance for their fraud claim. Defendants further argue that, if the court dismisses the fraud cause of action, the aiding and abetting fraud claim should be dismissed for lack of an underlying fraud. Following initial briefing and oral argument, the court permitted Defendants to file supplemental briefing relating to an aspect of statute of limitations. In their supplemental briefing, Defendants argued that, to the extent Plaintiffs claim that IKB AG sustained the injury in this case rather than IKB SA, IKB AG's claim is barred under Germany's applicable 3-year statute of limitations. For the following reasons, Defendants' motion is granted in part and denied in part.

## FACTUAL AND PROCEDURAL HISTORY

The lengthy history of this case began in the years immediately prior to the financial crisis of 2007-2008. Plaintiff IKB SA was a commercial bank incorporated in Luxembourg, currently in liquidation. IKB SA purchased a number of certificates ("Certificates") for residential mortgage-backed securities ("RMBS") from Morgan Stanley, allegedly in reliance on misrepresentations that Morgan Stanley made in its offering documents (Complaint, NYSCEF Doc. No. 2, ¶ 38). In particular, Morgan Stanley allegedly made misrepresentations to IKB SA's investment managers, Standish Mellon and BlackRock, including misrepresentations regarding loan-to-value ("LTV") and combined loan-to-value ("CLTV") statistics, owner-occupancy status of borrowers, and adherence to the originators' own underwriting guidelines (Complaint, §§ III.A-C). The contemporary value of the Certificates collapsed during the onset of the financial crisis as the poor quality of the underlying loans and resulting increased credit risk became apparent (*see* Complaint, ¶¶ 260-261). Ultimately, IKB SA was placed into liquidation as part of the German government's

bailout of IKB SA's parent, IKB AG (Memorandum of Law in Opposition to Motion for Summary Judgment ["Opposition"], p. 8).

In November 2008, IKB SA sold the Certificates to IKB AG. Two weeks later, IKB AG sold the Certificates to a newly created Irish special purpose vehicle called Rio Debt Holdings (Ireland) Limited ("Rio") (Opposition, p. 8). As part of the sale of Certificates to Rio, IKB AG became a junior lender to Rio and also became a portfolio administrator to Rio (Ex. 102, Bauknecht Deposition, NYSCEF Doc. No. 310, p. 29; Ex. 103, Hennessey Deposition, NYSCEF Doc. No. 311, pp. 41-42).

IKB AG and Rio subsequently executed the 2012 Assignment on May 9, 2012 in which Rio assigned to IKB AG "all the rights of action and claims against any other party with respect to the Securities it may have obtained in connection with its purchase of the Securities from IKB Deutsche Industriebank AG . . . except rights of action and claims for the receipt of interest and principal on the Securities" (Assignment Deed, NYSCEF Doc. No. 221, p. 1). In exchange, IKB AG agreed to provide to Rio "a sum equal to the proceeds of any recovery stemming from a resolution of claims relating to the Assigned Rights, net of all agreed costs, taxes and expenses, which shall be set out and governed by a separate agreement to be executed by the Parties" (Assignment Deed, pp. 1-2). IKB AG contends that under the Supplementary Deed and other governing documents, the parties agreed that 80% of the net litigation proceeds would revert to IKB AG (Opposition, p. 11; Supplementary Deed, NYSCEF Doc. No. 314, p. 5). Rio and IKB AG executed the Supplementary Deed on January 11, 2013—after Plaintiffs filed the summons in this action—but gave it retroactive effect from May 9, 2012 (Supplementary Deed, p. 1).

After the 2012 Assignment, IKB AG filed the summons in this action in November 2012 and later filed the complaint on May 17, 2013. The complaint alleged causes of action for fraud,

fraudulent concealment, aiding and abetting fraud, and negligent misrepresentation. Defendants moved to dismiss the complaint, in part for lack of standing, arguing that the 2012 Assignment of the fraud claims back to IKB AG was void as champertous (Decision and Order on Motion to Dismiss, NYSCEF Doc. No. 43, p. 2). The court denied the motion to dismiss on the basis of champerty, finding that Defendants had not shown on the record that "IKB AG's primary or sole purpose [for the assignment] was not to enforce a legitimate claim, or that the claim was not acquired as part of a larger transaction or for leverage in other disputes between the parties" (Decision and Order on Motion to Dismiss, p. 4). The court determined that IKB AG's intent in the 2012 Assignment was a factual question which required further development of the record (*id.*). However, the court went on to dismiss the causes of action for fraudulent concealment and negligent misrepresentation (Decision and Order on Motion to Dismiss, p. 9).

On this motion for summary judgment, Defendants make another attempt at their argument that the action should be dismissed on the basis of champerty. Defendants additionally argue that the case should be dismissed based on collateral estoppel as to the issues of actual and justifiable reliance because of a 2015 federal court decision in California, *IKB International S.A. v. Bank of America Corp. (In re Countrywide Financial Corp. Mortgage-Backed Securities Litigation)*, 2015 WL 1650851 (C.D. Cal. Feb. 23, 2015) ("*Countrywide*"). Lastly, Defendants argue that, regardless of whether or not reliance is settled as a matter of collateral estoppel, the complaint should be dismissed because Plaintiffs have failed to establish reliance. In Defendants' supplemental briefing, they argue that, in the alternative, the action is barred under Germany's statute of limitations to the extent that Plaintiffs now claim IKB AG was the injured party.

## DISCUSSION

Summary judgment is a drastic remedy which will be granted only when the party seeking summary judgment has established that there are no triable issues of fact (*see* CPLR 3212[b]; *DeCintio v Lawrence Hosp.*, 33 AD3d 329, 329 [1st Dept 2006]; *Orphan v Pilnik*, 66 AD3d 543, 544 [1st Dept 2009]). To prevail, the party seeking summary judgment must make a *prima facie* showing of entitlement to judgment as a matter of law tendering evidentiary proof in admissible form (*see Olan v Farrell Lines*, 64 NY2d 1092, 1093 [1985]; *Branda v MV Public Transp., Inc.*, 139 AD3d 636, 637 [1st Dept 2016]). If the party seeking summary judgment fails to meet their burden, the court must deny summary judgment "regardless of the sufficiency of the opposition papers" (*O'Halloran v City of New York*, 78 AD3d 536, 537 [1st Dept 2010]).

If the initial showing has been made, the burden shifts to the party opposing the motion for summary judgment to rebut the prima facie showing by producing evidentiary proof in admissible form sufficient to require a trial of material issues of fact (*see Vargas v Bhalodkar*, 204 AD3d 556, 557 [1st Dept 2022]; *Kershaw v Hospital for Special Surgery*, 114 AD3d 75, 82 [1st Dept 2013]). The court views the motion in the light most favorable to the opposing party (*see Negri v Stop & Shop*, 65 NY2d 625, 626 [1985]); *Kershaw v Hospital for Special Surgery*, 114 AD3d 75, 82 [1st Dept 2013]).

1. Statute of Limitations

In their supplemental briefing, Defendants highlighted statements that counsel for Plaintiffs made at oral argument to suggest that the party that originally sustained injury in this case was not the Luxembourg subsidiary, IKB SA, but the German parent, IKB AG (*see e.g.*, Transcript, NYSCEF Doc. No. 340, p. 14 ["Obviously, IKB AG had the injury"]). Therefore, Defendants argued, the applicable statute of limitations for the borrowing statute analysis should

be the German three-year statute of limitations rather than Luxembourg's thirty-year statute of limitations.

Defendants have failed to meet their burden to establish that the German statute of limitations bars this action. Under New York's borrowing statute, a cause of action brought by a nonresident must be timely both under New York's statute of limitations and the statute of limitations of the jurisdiction where the cause of action accrued (CPLR 202; *Andes Petroleum Ecuador Ltd. v Occidental Petroleum Company*, 2023 WL 1455786, *1 [1st Dept Feb 2, 2023]). Where the injury is economic, the cause of action "typically accrues where the plaintiff resides and sustains the economic impact of the loss" (*see* CPLR 202; *Portfolio Recovery Assoc., LLC v King*, 14 NY3d 410, 416 [2010] [citation and internal quotation marks omitted]). Additionally, if the originally injured party assigns the claims to another entity, the analysis of where the cause of action accrued focuses on the original assignor (*see Phoenix Light SF Ltd. v Deutsche Bank National Trust Co.*, 585 F Supp3d 540, 569 [SDNY 2022] [citing *Portfolio Recovery Assoc., LLC*, 14 NY3d 410 (2010)]).

Here, that party is IKB SA. IKB SA was the original purchaser of the Certificates, and IKB AG only obtained its right to sue on the Certificates through the 2012 Assignment. While Plaintiffs did assert at oral argument that IKB AG sustained injury as the parent of IKB SA, Plaintiffs also clearly stated that IKB SA had the "initial injury" because "they were the ones defrauded" (Transcript, p. 14). Even if IKB AG suffered an indirect injury prior to the 2012 Assignment sufficient to render it interested in the transaction for purposes of the champerty analysis, IKB AG is a separate corporation from IKB SA and had no right to sue prior to the 2012 Assignment (*see IKB Intern. S.A. v Bank of America*, 2014 WL 1377801, *6 [SDNY Mar 31, 2014] [rejecting argument that IKB AG was the injured party because it "violates the fundamental principal of

corporate law that . . . parent corporations are separate from their subsidiaries"]). Because the initial alleged economic injury at issue accrued to IKB SA, the borrowing statute requires application of both New York's six-year (CPLR 213[8]) and Luxembourg's thirty-year statutes of limitations. Any holding requiring application of the German statute of limitations would essentially penalize IKB AG for not earlier bringing a lawsuit that was almost certain to have been dismissed for lack of standing. Plaintiffs' claims are timely under both New York's and Luxembourg's statutes of limitations.[1]

2. Champerty

The ancient doctrine of champerty is codified in New York within Judiciary Law § 489 (*Ehrlich v Rebco Ins. Exchange, Ltd.*, 225 AD2d 75, 77 [1st Dept 1996]). Under Judiciary Law § 489, no corporation "shall solicit, buy or take an assignment of . . . a bond, promissory note, bill of exchange, book debt, or other thing in action, or any claim or demand, with the intent and for the purpose of bringing an action or proceeding thereon." However, for an assignment of a claim to be void for champerty, the assignee must have made the purchase "for the very purpose of bringing such suit" to the "**exclusion** of any other purpose" (*see Richbell Information Services, Inc. v Jupiter Partners*, 280 AD2d 208, 215 [1st Dept 2001] [emphasis added] [citing *Moses v McDivitt*, 88 NY 62 (1882)]). Thus, while assignments "for the primary purpose of obtaining costs or [harassment]" are void as champertous (*see 71 Clinton St. Apts. LLC v 71 Clinton Inc.*, 114 AD3d 583, 585 [1st Dept 2014]; *Trust For the Certificate Holders of Merrill Lynch Mortg. Investors, Inc. v Love Funding Corp.*, 13 NY3d 190, 198 [2009]), assignments are not champertous where the intent to bring a suit is merely "incidental and contingent" to other rights (*New York*

[1] To the extent the complaint involved claims relating to certificates purchased over six years prior to the date the parties entered into a tolling agreement, the court already dismissed those claims as untimely under New York law at the motion to dismiss stage (Decision and Order on Motion to Dismiss, p. 8).

*Chinese TV Programs, Inc. v U.E. Enterprises, Inc.*, 1989 WL 22442, *13 [SDNY Mar 8, 1989]). Additionally, champerty does not apply where the assignee had a "preexisting proprietary interest" in the subject matter (*see Trust For the Certificate Holders of Merrill Lynch Mortg. Investors, Inc. v Love Funding Corp.*, 13 NY3d 190, 198 [2009]).

Here, even if the initial alleged injury related to the Certificates accrued to IKB SA, the 2012 Assignment was not champertous, because IKB AG had a preexisting proprietary interest in the subject matter. In order to finance the initial assignment of the Certificates to Rio in 2008, IKB AG and Rio entered into a loan agreement (Loan Agreement, NYSCEF Doc. No. 315, p. 1). Pursuant to the 2008 loan agreement between IKB AG and Rio, IKB AG as junior lender was entitled to 80% of the profits from the assets (Loan Agreement, p. 8; Hennessy Deposition, pp. 57-58; Ex. 110, Schirmer Deposition, NYSCEF Doc. No. 318, p. 147 ["excess cash, is shared by the mezzanine lender and the junior lender [IKB AG] and the split is 80:20"]). While Defendants are correct that the loan has since been paid down to one dollar (Ex. 109, Kluge Deposition, NYSCEF Doc. No. 317, p. 126), this does not change the fact that, unlike other champertous assignments, the 2012 Assignment indisputably did not involve a "stranger" to the transaction, but a party with a prior interest (*see Jamaica Public Service Co., Ltd. v La Interamericana Compania De Seguros Generales SA*, 262 AD2d 73, 74 [1st Dept 1999]; *In re Imax Securities Litigation*, 2011 WL 1487090, *6 [SDNY Apr 15, 2011]).

Defendants have also failed to establish that the sole purpose for the 2012 Assignment was to profit off of litigation, to the **exclusion** of all other purposes. An assignment is not champertous merely because the parties enter into the assignment "for the purpose of collecting damages, by means of a lawsuit" (*Universal Inv. Advisory SA v Bakrie Telecom Pte., Ltd.*, 154 AD3d 171, 180 [1st Dept 2017]). Rather, there is a key distinction between "acquir[ing] a right in order to make

money from litigating it [champertous] and . . . acquir[ing] a right in order to enforce it [not champertous]" (*id.*). Here, Plaintiffs have provided evidence that they are **still** entitled to 80% of the **future** cash flows under the 2008 loan agreement with Rio because the loan was not paid off entirely—even though it was paid down almost in its entirety (Kluge Deposition, p. 124). Therefore, regardless of whether or not the 2012 Assignment's primary purpose was litigation, Defendants have not provided sufficient evidence to establish that the sole purpose, to the exclusion of all other purposes, was to **profit** off of litigation. As such, Defendants have failed to establish that the 2012 Assignment is void as champertous.

3. Collateral Estoppel

Defendants additionally argue that the *Countrywide* decision requires dismissal based on the doctrine of collateral estoppel. In particular, Defendants argue that Plaintiffs are barred from re-litigating the issue of reliance based on the *Countrywide* court's finding that the plaintiffs did not rely on alleged misrepresentations by the *Countrywide* defendants (Memorandum of Law in Support of Motion for Summary Judgment ("Memo in Support of Summary Judgment"), NYSCEF Doc. No. 202, p. 21). Defendants fail to establish entitlement to summary judgment on the basis of collateral estoppel.

Collateral estoppel applies to prevent a party from "relitigating in a subsequent action or proceeding an issue clearly raised in a prior action or proceeding and decided against that party . . . whether or not the . . . causes of action are the same" (*Simmons v Trans Express Inc.*, 37 NY3d 107, 112 [2021] [citations and internal quotation marks omitted]). However, the doctrine only applies where the issue in the second action is "**identical** to an issue which was raised" in the first action (*id.* [emphasis added]; *see also Orr v Yun*, 95 AD3d 661, 662 [1st Dept 2012]; *Reif v Nagy*, 149 AD3d 532, 533 [1st Dept 2017]).

Here, collateral estoppel is inapplicable because the Certificates at issue are undisputedly different certificates than the ones in *Countrywide*. *Countrywide* almost entirely involved mortgage-backed securities certificates that IKB SA acquired from Countrywide Securities Corporation (*Countrywide*, 2015 WL 1650851, *1), while this case involves certificates that IKB SA acquired from Morgan Stanley and alleged misrepresentations that Morgan Stanley made. Even if the theories of the two cases are similar, the issues plainly are not "identical" where the instruments at issue in the two litigations are different (*see Reif*, 149 AD3d at 533 [finding that collateral estoppel did not apply in Nazi-looted art case, in part, because the prior litigation involved different pieces of artwork]). Therefore, collateral estoppel does not apply.[2]

The Court of Appeals' decision in *Kaufman v Eli Lilly & Co.*, 65 NY2d 449 [1985], that Defendants cite, is inapposite. There, in a mass tort litigation relating to the drug DES, the Court found that collateral estoppel applied to bar re-litigation of issues relating to the defendant's alleged negligence in the testing and marketing of the drug (*id.* at 457-458). *Kaufman* clearly presented a more appropriate case for collateral estoppel, because both the first action and second action involved the exact same drug tested and marketed by the same defendant. Put simply, even though the plaintiffs in the two actions were different, Eli Lilly either was negligent in the testing and marketing of the drug or it was not, and the court in the second action did not need to relitigate that issue. Here, on the contrary, the defendants, certificates, and offering documents which contained the alleged misrepresentations are all different.

That the parties stipulated testimony from *Countrywide* could be used here (*see* Memo in Support of Summary Judgment, pp. 21-23) does not require a different result. While it is

[2] The court is mindful of the distinction that Defendants' counsel raised at oral argument between res judicata and collateral estoppel (Transcript, pp. 46-47). The court is by no means suggesting that identity of **parties** is required for the application of collateral estoppel—merely identity of **issues**.

undisputed that Standish Mellon and BlackRock purchased certificates on IKB SA's behalf from both Countrywide and Morgan Stanley, investment manager testimony regarding their methodology for investment selection does not conclusively establish that they utilized precisely the same methodology for both Countrywide certificates and Morgan Stanley certificates (*see e.g.*, Ex. 8, Yalamanchili Deposition, NYSCEF Doc. No. 211, p. 93 [Q: "Is there any reason to think you would have followed a different process for defendants than you did for Countrywide? A: "I don't recall what [sic] the process"]).

Therefore, *Countrywide* does not require summary judgment on the basis of collateral estoppel, because the issue of reliance on Morgan Stanley's alleged misrepresentations was not "actually litigated" and determined (*see A & Z Empire, Inc. v Shima*, 170 AD3d 628, 629 [1st Dept 2019]).

4. Reliance

Defendants additionally move for summary judgment on the basis that Plaintiffs have failed to establish actual and justifiable reliance for their fraud cause of action. The court grants in part and denies in part the motion for summary judgment on this basis. A plaintiff must show justifiable reliance in order to establish a cause of action for fraud (*see Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 [2009]; *Ambac Assur. Corp. v Countrywide Home Loans, Inc.*, 151 AD3d 83, 85 [1st Dept 2017] ["The element of justifiable reliance is 'essential' to any fraud claim"]). However, New York courts have repeatedly held that reasonable reliance can be determined at the summary judgment stage only under rare circumstances (*see Norddeutsche Landesbank Girozentrale v Tilton*, 178 AD3d 539, 539 [1st Dept 2019]; *Union Ave Estates, LLC v Garsan Realty Inc.*, 170 AD3d 498, 498-499 [1st Dept 2019]; *Brunetti v Musallam*, 11 AD3d 280, 281 [1st Dept 2004]).

Additionally, New York law imposes an "affirmative duty on sophisticated investors to protect themselves (*Global Minerals and Metals Corp. v Holme*, 35 AD3d 93, 100 [1st Dept 2006]). Where a party to whom a misrepresentation is made has "hints of falsity," the party is subject to a heightened degree of diligence (*id.*; *see also Norddeutsche*, 178 AD3d at 540).

*a. Actual Reliance*

The fraud claim is based on purported misrepresentations as to (1) LTV and CLTV statistics, (2) owner-occupancy status of borrowers, and (3) adherence to originator underwriting guidelines. The court denies Defendants' motion as to the first two categories of alleged misrepresentations. In order to establish actual reliance, Plaintiffs must only establish that the alleged fraud was a "substantial factor in inducing [Plaintiffs] to act in the way that they did" (*Aronoff v Ernst and Young,* 1999 WL 458779, *3 [Sup Ct, NY Cty Apr 26, 1999 [citing *Curiale v Peat, Marwick, Mitchell & Co.*, 214 AD2d 16 [1st Dept 1995)]; *Abu Dhabi Commercial Bank v Morgan Stanley & Co. Inc.*, 888 F Supp 2d 431, 462 [SDNY 2012]; *see also Ge Dandong v Pinnacle Performance Ltd.*, 2013 WL 5658790, *9 [SDNY Oct 17, 2013]). Defendants argue that Plaintiffs cannot establish actual reliance because, to the extent the write-ups referred to factors such as LTV or owner-occupancy rates, those factors did not affect the decisions of whether or not to purchase (Memo in Support of Summary Judgment, pp. 23-24). In response, Plaintiffs argue that the investment managers did consider and rely on those factors, even if those factors were not the sole factors they considered for their purchasing decisions (Opposition, pp. 5, 20-21).

Plaintiffs have raised questions of fact as to actual reliance regarding the purported LTV/CLTV and owner-occupancy misrepresentations. In particular, investment manager testimony and write-ups that the investment managers issued clearly reflect that LTV/CLTV and owner-occupancy were at least among the factors that they considered in recommending

Certificates. Gemmett testified that, while they did not have firm thresholds of LTV for their review of an investment, they would consider LTV as part of their holistic review (Ex. 78, NYSCEF Doc. No 286, pp. 24-25 [Q: "Can you recall any threshold for any collateral characteristic?" A: "No. But we would look at the collateral characteristic if there was compensating – other collateral characteristics. So if it had a low FICO, was it balanced by more credit enhancement **or by a lower LTV**"] [emphasis added]). Actual write-ups corroborate this testimony:

- MHEL 2006—1 write-up includes "High exposure to owner/occupancy" and "less exposure to higher LTV's" as "Strengths" (Ex. 6, NYSCEF Doc. No. 209). The MHEL 2006-1 conclusion states that they had "taken into account some of the negative collateral characteristics in [their] scenario stress-testing and believe that there is more than adequate credit enhancement to cover potential losses" (*id.*).
- MSAC 2005-HE7 write-up includes "High exposure to owner/occupancy" and "much less exposure to LTV's greater than 90%" as "Strengths" (Ex. 68, NYSCEF Doc. No. 271). The conclusion states that they have "taken into account some of the negative collateral characteristics" (*id.*).
- NCHET 05-C write-up includes the "Concern" of "Concentration in 85-90 LTV bucket" (Ex. 48, NYSCEF Doc. No. 251).
- ACCR 2006-1 write-up refers to "Strong LTV, with average LTV approximately 2% lower than database average with almost zero exposure to LTV's greater than 90%" (Ex. 49, NYSCEF Doc. No. 252).

In addition to the write-ups, the preliminary term sheets prepared by Morgan Stanley reflect that CLTV/LTV and owner-occupancy were clearly significant parts of their due diligence (*see*

*e.g.*, Ex. 9, Preliminary Term Sheet, NYSCEF Doc. No. 212, pp. 20, 29 [assessing LTV as part of the "Collateral Summary" and later providing data on "Distribution by Occupancy Type"]; Ex. 11, Term Sheet, NYSCEF Doc. No. 214, at MS_IKB00209425 [providing "Summary Statistics" including the "Weighted Average Combined Original LTV (%)"]).

Overall, testimony and documentary evidence support Plaintiffs' argument that they can show actual reliance, even if the individual particular factors at issue were not the sole determinative factors. Particularly, because the write-ups and preliminary term sheets explicitly refer to such factors as LTV, CLTV, and owner-occupancy, Plaintiffs have provided sufficient evidence to raise a question of fact as to whether, in the context of the investment managers' holistic review of many factors, changes to these particular factors would have been significant enough to change the purchasing determination.

*b. Justifiable Reliance*

Additionally, Defendants have failed to show entitlement to judgment as a matter of law as to justifiable reliance with respect to the LTV/CLTV and owner-occupancy representations. The parties do not dispute that, under New York law, sophisticated investors such as Plaintiffs have an affirmative duty to protect themselves from misrepresentations (*Global Minerals and Metals Corp. v Holme*, 35 AD3d 93, 100 [1st Dept 2006]). Nor do the parties dispute that when a party to whom a misrepresentation is made has "hints of its falsity," there is a heightened degree of due diligence (*id.*). However, Defendants have failed to establish that there were "hints of falsity." Defendants reference several purported "hints" in support of their argument, including:

- Deposition testimony from IKB AG RMBS expert Klaus Bauknecht that he became aware in the second half of 2005 that the "triple B subprime space [was] becoming, in general, increasingly vulnerable" (Ex. 32, NYSCEF Doc. No. 235, pp. 164-166).

- An October 2005 note authored by Bauknecht entitled, "Sub prime 05/06: The clock is ticking," stating that "[a] housing market correction is inevitable and its impact will likely send shockwaves through the economy" (Ex. 34, NYSCEF Doc. No. 237).
- A December 2005 note authored by Bauknecht stating that "[a]s anticipated for some time, evidence is emerging that the housing market has started to turn" (Ex. 35, NYSCEF Doc. No. 238). However, the note later stated that they "maintain[ed] [their] overall approach of how to model and assess the US economy and housing market and consequently, [their] base and worst-case scenarios regarding key variables driving RMBS remain[ed] unchanged" (*id.*).
- Testimonial and documentary evidence establishing that BlackRock stopped investing in subprime assets as early as August 2006 because they believed "the quality of the assets available on the market was no longer adequate" (Ex. 46, Wolfgang Güth Deposition, NYSCEF Doc. No. 249, p. 69; *see also* Ex. 121, Asset Manager Call Report, p. 2 ["BR prefers Alt-A RMBS rather than sub-prime, due to the likely rise in defaults in that sector over the next 18-24 months"]).
- A letter from the German government to IKB AG in March 2007 noting IKB SA's purchases of RMBS issued by United States mortgage specialists and requesting that IKG AG issue a statement assessing the risk (Ex. 27, NYSCEF Doc. No. 230, p. 8).
- Write-up references to Morgan Stanley's due diligence to show that investment managers approved purchases despite sometimes high rates of rejections of particular loans. For example, the MSHEL 2006-1 write-up (Ex. 6, NYSCEF Doc. No. 209) lists the percentages of underlying loans that underwent credit/compliance review and the percentages of those loans that were "kicked out" following the review. Defendants argue that there were hints

of falsity based on the failure of Morgan Stanley to review a larger percentage of loans where there was a high percentage of kickouts for the loans they did review.

The core problem underlying these purported "hints of falsity" is that they almost entirely relate to indications that the sub-prime housing market and the associated RMBS in general were deteriorating rather than indications that Morgan Stanley may have misrepresented particular facts relating to the securities at issue here. The failure to establish "hints" of falsity with respect to particular representations relating to the Certificates is fatal to this argument (*see Loreley Financing (Jersey) No. 3, Ltd. v Morgan Stanley & Co. Inc.*, 146 AD3d 683, 683-684 [1st Dept 2017] [finding that general disclaimer in final offering memorandum would not have provided hint of the falsity of the statement that Countrywide "would employ a detailed, loan-level, credit-driven analysis to select only the best collateral eligible"]; *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 39 Misc.3d 1220(A), *6 [Sup Ct, NY Cty Apr 29, 2013] [finding issues of fact as to whether there were "hints of falsity" because the purported hints "[a]t most . . . speak generally to risks that may exist with regard to the loans" and "do not contradict the specific representations and warranties"]). Even if Defendants have established that Plaintiffs were on notice of a general economic downturn, Defendants have not shown that the systemic concerns raised by Bauknecht, BlackRock, or the German government gave any hint of falsity of particular representations relating to these Certificates.

The only purported hints of falsity that directly relate to the particular securities here are the indications on the write-ups that Morgan Stanley, in some cases, reviewed only small percentages of the loans but rejected sizeable portions. However, again, Defendants do not set forth what particular representation they claim should have been flagged as potentially false based on the credit/compliance review and kickout percentages.

Nor have Defendants established that Plaintiffs' reliance was not justifiable because of their undisputed status as sophisticated investors. Sophisticated investors generally have an affirmative duty to protect themselves from misrepresentations (*Global Minerals and Metals Corp. v Holme*, 35 AD3d 93, 100 [1st Dept 2006]). However, the First Department has already ruled in this case that IKB SA was not required to "assume" that credit ratings on the securities were "fraudulent" and to "verify them through a detailed retracing of the steps undertaken by the underwriter and credit rating agency" (*IKB Intern. S.A. v Morgan Stanley*, 142 AD3d 447, 449-450 [1st Dept 2016]). This logic applies with equal force to the purported misrepresentations as to LTV/CLTV and owner-occupancy status. Absent particular hints of falsity, Plaintiffs were not required to "retrace" Defendants' steps for their reliance to have been justifiable.

*c. Originator Underlying Guidelines Representations*

However, the court finds that Defendants have established entitlement to judgment as a matter of law dismissing the fraud claim to the extent it relates to alleged misrepresentations regarding adherence to originator underwriting guidelines. Plaintiffs do not dispute that the preliminary term sheets that the investment managers received did **not** refer to originator underwriting guidelines (*see* Ex. 9, NYSCEF Doc. No. 212; Ex. 11, NYSCEF Doc. No. 214; Ex. 66, NYSCEF Doc. No. 269). While Plaintiffs are correct that some of the write-ups issued by the investment managers referred to underwriting guidelines (*see e.g.*, Ex. 49, NYSCEF Doc. No. 252 ["Mortgages are regionally underwritten to Accredited's guidelines"]), Defendants are correct that Gemmett of Standish Mellon testified that they would "learn about an originator's underwriting process through meeting with the **originator** or through an industry conference or maybe a conference call" (Ex. 44, NYSCEF Doc. No. 244, p. 38 [emphasis added]). Because Defendants have established that there is no evidence in the record concerning **Morgan Stanley**'s

representations about underwriting guidelines on which the investment managers could have relied, and because Plaintiffs failed to rebut that prima facie showing, the court grants summary judgment to the extent the fraud claim relates to these particular alleged misrepresentations (*see J.A.O. Acquisition Corp. v Stavitsky*, 18 AD3d 389, 390-391 [1st Dept 2005]).[3]

*d. Countrywide Decision*

In light of the extensive discussion of the *Countrywide* decision in the briefing and at oral argument, the court will briefly discuss that case here. The court notes that, while it is not bound to adhere to *Countrywide*, a decision issued by a federal district court in California, the decision is nevertheless persuasive authority given that both matters involve purchases of certificates by IKB SA through the same investment managers. As stated above in Section 4.c, the court finds, just as the *Countrywide* court did, that Plaintiffs have failed to provide sufficient evidence of reliance on any representations that Defendants adhered to underwriting guidelines because the preliminary term sheets did not make this representation (*see Countrywide*, 2015 WL 1650851, *4).

However, the court declines to apply the reasoning in *Countrywide* as to the LTV representations. The *Countrywide* court, faced with similar investment manager testimony that LTV was part of their "holistic" review of the securities, found this was not sufficient to establish "but for" reliance (*Countrywide*, 2015 WL 1650851, *5). However, as discussed above, Plaintiffs need not show that reliance on a particular misrepresentation was the sole factor inducing them to act, but merely a "substantial factor" (*Aronoff v Ernst and Young*, 1999 WL 458779, *3 [Sup Ct, NY Cty Apr 26, 1999 [citing *Curiale v Peat, Marwick, Mitchell & Co.*, 214 AD2d 16 [1st Dept

[3] The court also notes that it agrees with Defendants' argument that Plaintiffs are foreclosed from establishing reliance on purported underwriting guidelines misrepresentations based on alleged omissions of material fact (Reply in Further Support of Summary Judgment, NYSCEF Doc. No. 333, p. 14). Plaintiffs' description of Defendants' purported "duty to disclose" their lack of adherence to underwriting guidelines smacks of the fraudulent concealment cause of action which this court dismissed long ago (*see IKB Intern. S.A. v Morgan Stanley*, 2014 WL 5471650, *5 [Sup Ct, NY Cty Oct 28, 2014]; *see also* Complaint, ¶¶ 271-280 [alleging fraudulent concealment based on Defendants' failure to disclose "Concealed Material Facts," including information regarding "adherence to underwriting guidelines"]).

1995]; *Abu Dhabi Commercial Bank v Morgan Stanley & Co. Inc.*, 888 F Supp 2d 431, 462 [SDNY 2012]). The *Countrywide* court acknowledged that the plaintiffs needed only show that LTV representations were a "substantial" factor, but nevertheless granted summary judgment because "none of the[] write-ups listed LTVs as a reason supporting the purchase" (*Countrywide*, 2015 WL 1650851, *5). Quite to the contrary here, multiple write-ups in this matter explicitly list LTV in the "Strengths" section that immediately precedes "Weaknesses" and "Conclusion" (*see* Ex. 6, MHEL2006-1 Write-Up; Ex. 49, ACCR 2006-1 Write-Up; Ex. 68, MSAC 2005-HE7 Write-Up). Testimony from one of the investment managers that they would specifically consider LTV balanced against other factors (Ex. 78, Gemmett Deposition, pp. 24-25) additionally supports the argument that LTV was a "substantial factor" in the purchasing determination.

5. Aiding and Abetting Fraud

Defendants also move for summary judgment of the aiding and abetting fraud cause of action remaining in the complaint. Defendants are correct that the lack of an underlying fraud requires dismissal of an aiding and abetting claim (*see Stanfield Offshore Leveraged Assets, Ltd. v Metropolitan Life Ins. Co.*, 64 AD3d 472, 476 [1st Dept 2009]; *Little Rest Twelve, Inc. v Zajic*, 137 AD3d 540, 541 [1st Dept 2016]). Therefore, summary judgment is granted on the aiding and abetting fraud cause of action to the extent it relates to purported misrepresentations about originator underwriting guideline adherence.

Accordingly, it is

**ORDERED** that Defendants' motion for summary judgment is granted to the extent the fraud and aiding and abetting fraud claims relate to purported misrepresentations about adherence to originator underwriting guidelines; and it is further

**ORDERED** that Defendants' motion for summary judgment is otherwise denied in its entirety; and it is further

**ADJUDGED**, **DECREED**, and **DECLARED** that the 2012 Assignment from Rio to IKB AG was not champertous; and it is further

**ORDERED** that the parties appear before the court for a pre-trial conference on March 7, 2023 at 10:00 AM.

| 03/01/2023 | |
|---|---|
| **DATE** | **MELISSA CRANE, J.S.C.** |

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| **CHECK ONE:** | [ ] **CASE DISPOSED** | | [x] **NON-FINAL DISPOSITION** | |
| | [ ] **GRANTED** | [ ] **DENIED** | [x] **GRANTED IN PART** | [ ] **OTHER** |
| **APPLICATION:** | [ ] **SETTLE ORDER** | | [ ] **SUBMIT ORDER** | |
| **CHECK IF APPROPRIATE:** | [ ] **INCLUDES TRANSFER/REASSIGN** | | [ ] **FIDUCIARY APPOINTMENT** | [ ] **REFERENCE** |