SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

FINANCIAL GUARANTY INSURANCE COMPANY, Plaintiff, - against - MORGAN STANLEY ABS CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, MORGAN STANLEY & CO. LLC, as successor to MORGAN STANLEY & CO. INC., MORGAN STANLEY, and SAXON MORTGAGE SERVICES, INC., Defendants.	Mot. Seq. 001 Index No. 652914/2014 Justice Friedman Part 60 <u>ORAL ARGUMENT REQUESTED</u>

MEMORANDUM OF LAW IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS PLAINTIFF'S COMPLAINT

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PRELIMINARY STATEMENT

In this litigation, Financial Guaranty Insurance Company ("FGIC"), a monoline insurer who agreed to provide insurance coverage on certain certificates in a residential mortgage-backed securitization sponsored by Morgan Stanley, effectively asks this Court to redraft the terms of contracts to which sophisticated parties agreed.

FGIC's complaint alleges that loans in the underlying securitization breached representations and warranties, and seeks to recover not only for insurance payments that FGIC has made under the policy, but for payments that it *may* be required to make in the future as a result of the alleged breaching loans. But the trustee for this same securitization has brought its own separate lawsuit alleging breaches of representations and warranties in the underlying loans. While Morgan Stanley disputes the merits of those allegations, the outcome of that suit will necessarily impact whether, and the extent to which, FGIC may have to make insurance payments in the future. FGIC's attempt to seek damages for potential future payments under its insurance policy, prior to FGIC making such payments, raises the prospect of Morgan Stanley being required to pay twice in respect of the same alleged breaches, in the event any such breaches could be proven.

In all events, FGIC's attempt to recover for insurance payments it *may* be required to make in the future fails as a matter of law. First, it is foreclosed by the plain language of the Insurance Agreement, which permits recovery only of amounts "then due" under the agreement. Second, under New York law, FGIC's claim for future damages is viewed as equivalent to seeking rescission or rescissory damages, relief which the First Department has held to be unavailable to monoline insurers in cases like this one. Finally, under New York law, FGIC's

alleged future damages are unavailable because they are impermissibly speculative. That is particularly so here, where the trustee's separate lawsuit will necessarily affect whether FGIC may have to make any such payments, and the amount of any such potential payments.

FGIC's complaint further seeks relief beyond what is permitted under New York law insofar as it seeks damages beyond the "sole remedy" provided by the governing agreements. Like many RMBS cases before this Court, the governing contracts here provide that repurchase of any particular loans shown to be in material breach is the "sole remedy" for such breaches. The "sole remedy" provision applies to FGIC under the terms of the governing agreements, as this Court and others have concluded when presented with equivalent contractual provisions in lawsuits by monoline insurers. FGIC's efforts to avoid the "sole remedy" provision are meritless under the terms of the contracts and under New York precedent.

FGIC's breach of contract claim, moreover, must be limited to the loans for which it has provided notice of alleged breaches of representations and warranties, because with respect to the thousands of other loans in the trust for which FGIC has never alleged any breach, it has failed to satisfy a "condition precedent" to suit within the six-year statute of limitations. *See U.S. Bank Nat'l Ass'n v. DLJ Mortg. Capital, Inc.*, 121 A.D.3d 535, 535 (1st Dep't Oct. 21, 2014); *ACE Secs. Corp. v. DB Structured Prods., Inc.*, 112 A.D.3d at 522, 523 (1st Dep't 2013).

In addition to its breach of contract claims, FGIC asserts a claim for fraudulent inducement. That claim fails because FGIC has not alleged any fraud damages that are distinct from its alleged damages for breach of contract. Under New York law, FGIC's fraud claim must therefore be dismissed as duplicative of its contract claim. In addition, several of the alleged misrepresentations were incorporated into the parties' contracts, precluding FGIC from bringing

a fraud claim based on them. To the extent that there are certain alleged misrepresentations that were not incorporated into the contract, any fraud claim based on such alleged misrepresentations fails for two additional reasons. First, FGIC has failed to allege any details regarding when such statements were allegedly made, to whom they were allegedly made, and how they were allegedly made (orally or in writing), and has therefore failed to comply with CPLR 3016(b). Second, in order to assert a fraud claim under New York law, FGIC—a sophisticated commercial counterparty—was required either to conduct some diligence of its own concerning these alleged representations, or else, if it did not intend to do so, to insert a prophylactic provision into the contract in view of its decision not to conduct any inquiry. FGIC did neither of these things. Accordingly, under governing caselaw, it has failed to plead justifiable reliance.

BACKGROUND

A. The Structure of the Transaction

This case relates to a securitization transaction backed by subprime residential mortgage loans. Morgan Stanley ABS Capital I Inc. Trust 2007-NC4 ("MSAC 2007-NC4" or the "Trust") issued certificates, which are securities representing an interest in the assets of the trust fund, which were secured by a pool of 5,337 mortgage loans. (Compl. ¶ 73.)[1] The loans were originated by New Century Mortgage Corporation and its affiliates (*id.* at ¶72), and acquired by Morgan Stanley Mortgage Capital Inc., the predecessor of Morgan Stanley Mortgage Capital Holdings LLC (collectively "MSMC"). (*Id.* at ¶ 35.) MSMC transferred the loans to Morgan

[1] A copy of the complaint is attached as Exhibit 1 to the accompanying November 24, 2014 Affirmation of James P. Rouhandeh. References herein to "Ex. _" are to the exhibits attached to that affirmation.

Stanley ABS Capital I Inc. (“MSAC”) and entered into a Representations and Warranties Agreement dated as of June 20, 2007 (the “RWA”). MSAC in turn assigned its interest in the loans, as well as its rights under the RWA, to the trustee for the Trust, Deutsche Bank National Trust Company (the “Trustee”), pursuant to a Pooling and Servicing Agreement dated as of May 1, 2007 (the “PSA”). (PSA § 2.01(a) (Ex. 2).)[2]

In an Insurance and Indemnity Agreement dated June 20, 2007 (the “I&I” or “Insurance Agreement”), FGIC agreed to issue a financial guaranty insurance policy (the “Policy”) to “unconditionally and irrevocably” guarantee payments owed to senior Class A Certificateholders of the Trust. (I&I § 3.01 (Ex. 3).) In accordance with the Insurance Agreement, FGIC issued the Policy, with an effective date of June 20, 2007. (Policy at 1 (Ex. 4).)

B. The Transaction Documents

MSMC made certain representations and warranties to MSAC regarding the loans in the Trust. (RWA § 2 (Ex. 5).) MSAC then assigned its rights under the RWA to the Trustee. (*See* PSA § 2.01(a).) Section 4(a) of the RWA expressly provides for the following procedure in the event that a party alleges that a representation or warranty has been breached:

> Within sixty (60) days of the earlier of either discovery by or notice to the Sponsor of any breach of a representation or warranty which materially and adversely affects the value of the Mortgage Loans or the interest of the Depositor, the Certificateholders or the Certificate Insurer therein (or which materially and adversely affects the value of the applicable Mortgage Loan or the interest of the Depositor, the Certificateholders or the Certificate Insurer therein), the Sponsor shall cure such breach in all material respects and, if such breach cannot be cured, the Sponsor shall, at the Depositor’s option, within sixty (60) calendar days of the Sponsor’s receipt of request from the Depositor, repurchase such Mortgage Loan at the Repurchase Price.

[2] MSAC, MSMC, Morgan Stanley & Co., and Morgan Stanley are referred to collectively herein as “Morgan Stanley,” unless otherwise noted.

(RWA § 4(a).) The RWA also provides that "the obligation of the Sponsor set forth in Section 4(a) to repurchase for a Mortgage Loan in breach of a representation or warranty contained in Section 2 constitutes the *sole remedy* of the Depositor *or any other person or entity* with respect to such breach." (RWA § 4(c) (emphasis supplied).) FGIC, as the certificate insurer, is a third party beneficiary of the RWA. (RWA § 11.) The PSA contains the same "sole remedy" provisions, which are expressly made applicable to the "Certificate Insurer," and likewise makes FGIC a third-party beneficiary of the agreement. (*See* PSA §§ 2.03(e), 2.03(q), 12.13.)

Section 5.02 of the Insurance Agreement, which incorporates by reference the representations of the RWA and PSA, states that "[u]pon the occurrence of an Event of Default, the Certificate Insurer" may exercise the rights or remedies set forth in Section 5.02 to recover amounts "then due," and that "*[u]nless otherwise expressly provided*, no remedy herein conferred or reserved is intended to be exclusive of any other available remedy." (I&I §§ 1.01; 5.02(a) (emphasis supplied).)[3]

C. Procedural History

In September 2011—over four years after MSAC 2007-NC4 closed—FGIC began sending a series of letters to MSMC, purporting to provide notice of alleged breaches of representations and warranties in certain particular loans underlying the Trust, and demanded that MSMC repurchase the allegedly defective loans. MSMC responded to FGIC's demand letters on a timely basis under the contract, stating why MSMC believed the vast majority of

[3] The Insurance Agreement defines an Event of Default as including, among others, the following events: any instance in which a representation or warranty "shall prove to be untrue or incorrect in any respect which is material to the rights and interests of the Certificate Insurer"; failure by servicer Saxon Mortgage Services, Inc. ("Saxon"), MSAC, or MSMC to pay amounts due; or failure by Saxon, MSAC, or MSMC to perform the covenants or agreements contained in the Insurance Agreement. (I&I § 5.01.)

FGIC's repurchase demands to be without merit, and agreeing to repurchase the applicable loans in the rare instances in which MSMC believed that FGIC had asserted a legitimate claim for repurchase. FGIC filed suit on September 23, 2014. Separately, the Trustee has filed a summons with notice naming MSMC and MSAC as defendants and demanding repurchase of loans in this same Trust. Summons with Notice, *Deutsche Bank National Trust Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, No. 652877/2014 (Sup. Ct. N.Y. Cnty. Sept. 19, 2014) (NYSCEF Doc. No. 1).

ARGUMENT

"Generally, on a motion to dismiss made pursuant to CPLR 3211, the court must accept the facts as alleged in the complaint as true." *Morgenthow & Latham v. Bank of N.Y. Co.*, 305 A.D.2d 74, 78 (1st Dep't 2003) (internal quotation marks omitted). In cases such as this, however, "where the legal conclusions and factual allegations are flatly contradicted by documentary evidence," they are not presumed to be true or accorded every favorable inference. *Id.* FGIC's complaint runs directly contrary to the plain language of the RWA, PSA and Insurance Agreement, as well as New York law, and accordingly cannot survive dismissal.

I. FGIC Cannot Recover for Insurance Payments It Has Not Made

For both its breach of contract and fraudulent inducement claims, FGIC seeks damages not only for payments it has made, but also for payments that it may make in the future under the Policy. (*See* Compl. ¶ 17 (seeking "recovery of the claims payments that FGIC is liable to make in the future under its Policy"); *id.* ¶¶ 216, 222, 227, 233, 247, 252 (seeking unspecified damages that FGIC "suffered and will continue to suffer").) These requests fail as a matter of law.

A. The Plain Language of the Insurance Agreement Bars Future Damages

The plain language of the Insurance Agreement only permits recovery of damages already suffered, not potential future damages. It is well established that "[a]s with the construction of contracts generally, unambiguous provisions of an insurance contract must be given their plain and ordinary meaning, and the interpretation of such provisions is a question of law for the court." *Vigilant Ins. Co. v. Bear Stearns Cos.*, 10 N.Y.3d 170, 177 (2008) (internal quotation marks omitted). The Insurance Agreement states that, upon the occurrence of an Event of Default, FGIC may "take whatever action at law or in equity as may appear necessary or desirable in its judgment to collect the amounts, if any, *then due* under this Insurance Agreement or any other Operative Document." (I&I § 5.02(a)(iii) (emphasis supplied).) Accordingly, FGIC's requests for payments not yet due and any other future damages are precluded under the terms of the Insurance Agreement.[4]

B. FGIC's Request for Future Damages Is No More than a Request for Rescissory Damages, Which Are Precluded Under New York Law

In seeking all payments it has made and will be required to make in the future, FGIC actually seeks a return to its pre-contractual position—the equivalent of rescission or rescissory damages. The First Department has held, however, that neither form of relief is available here. *See MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 105 A.D.3d 412, 413 (1st Dep't 2013) ("*Countrywide II*"). In *Countrywide II*, the First Department held that where a monoline insurer promises to irrevocably insure securities, it "voluntarily [gives] up the right to seek rescission—*under any circumstances.*" *Id.* The insurer likewise forfeits its right to rescissory damages. *See*

[4] Indeed, the proviso "if any," reflects the parties' recognition that FGIC may have suffered no losses at all when an Event of Default occurs.

id. ("Plaintiff should not be permitted to utilize this very rarely used equitable tool [i.e., rescissory damages] to reclaim a right it voluntarily contracted away . . . ." (citation omitted)).

Countrywide II thus precludes FGIC's request for future damages. A federal court in New York recently held as much. *See Assured Guar. Mun. Corp. v. RBS Secs. Inc.*, No. 13 Civ. 2019 (JGK), 2014 WL 1855766, at ** 1-2 (S.D.N.Y. May 8, 2014) ("*RBS*") (discussing *Countrywide II*). In *RBS*, the court held that plaintiff-insurer improperly sought future damages on its claim for misrepresentations in connection with a monoline insurance contract. As the court observed, awarding plaintiff its requested "'damages in the amount of all payments [it] has made and will make pursuant to the [insurance] [p]olicy' . . . would effectively restore the insurer to the position it would have occupied had it not issued the [p]olicy. Therefore, such damages are in fact the economic equivalent of rescission and are thus clearly rescissory damages." *Id.* at *2 (citation omitted). Like FGIC, the monoline plaintiff in *RBS* sought "damages for payments that plaintiff 'will make' in the future," and thus "the damages sought are indeed forward-looking rescissory damages." *Id.* Accordingly, the *RBS* court properly dismissed plaintiff's claim for future damages. So, too, should this Court.

Finally, insofar as the claim for future damages is equivalent to seeking rescission or rescissory damages for breach of contract, such a claim is barred by the "sole remedy" provision of the governing contracts, which, as this Court has concluded, precludes any claim for rescission or rescissory damages. *See* Point II, *infra*.

C. FGIC's Request for Future Damages Requires Undue Speculation, Particularly in Light of the Trustee's Pending Litigation Concerning This Same Securitization

New York law provides that "projections" of future loss that are "subject to adjustment and modification" do not suffice to support an award of future damages. *Kenford Co. v. Cnty. of*

Erie, 67 N.Y.2d 257, 262 (1986). Future damages "may not be merely speculative, possible or imaginary, but must be reasonably certain and directly traceable to the breach, not remote or the result of other intervening causes." *Id.* at 261. The court in *Assured Guaranty Municipal Corporation v. Flagstar Bank, FSB* recently applied this rule in a suit brought by a monoline insurer, rejecting plaintiff's argument that the damages award should include a "cushion" to protect against potential future claims. No. 11 Civ. 2375 (JSR), 2013 WL 1620567, at *1 (S.D.N.Y. Apr. 15, 2013). The court thus limited plaintiff-insurer's damages to claim payments already made, and excluded claims for "undefined and speculative future claim amounts that [it] might have to pay." *Id.*

The "future damages" alleged here are especially speculative because the Trustee for the same securitization at issue has filed a repurchase action against Morgan Stanley alleging breaches of representations and warranties concerning the underlying loans. Summons with Notice, *Deutsche Bank National Trust Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, No. 652877/2014 (Sup. Ct. N.Y. Cnty. Sept. 19, 2014) (NYSCEF Doc. No. 1). In addition to the inherent speculativeness of "future damages," here, FGIC is seeking to obtain "future damages" that will necessarily be influenced by the outcome of the Trustee's suit. Among other unknown future developments, the outcome of the Trustee's suit will necessarily affect whether FGIC may have to make any insurance payments in the future, and the amounts of any such payments. *See Ambac Assurance Corp. v. EMC Mortg. LLC*, 121 A.D.3d 514, 2014 WL 5285261, at *4 (1st Dep't Oct. 16, 2014) (noting that an insurer is not left without a remedy where it can rely on the trustee to obtain any relief due to the trust based on breach of contract).

D. Any Damages for Fraudulent Inducement Are Limited by the Out-of-Pocket Rule

With respect to its fraudulent inducement claim, FGIC's request for damages in the amount of claims it expects it may pay in the future (Compl. ¶ 216) also runs afoul of New York's well-established out-of-pocket rule, which limits fraud damages to the "actual pecuniary loss sustained as a direct result of the wrong." *Cont'l Cas. Co. v. PricewaterhouseCoopers, LLP*, 15 N.Y.3d 264, 271 (2010). New York law thus precludes FGIC's request for fraud damages it has yet to sustain, and may never sustain. *See First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 768 (2d Cir. 1994) ("[T]he fraud defendant is not liable for all losses that may occur, but only for those actually suffered.").

II. FGIC's Breach of Contract Claims Are Limited by the "Sole Remedy" Provision of the Governing Agreements

A. The Agreements Provide That the Loan-by-Loan Repurchase Process Is FGIC's "Sole Remedy" for Breach of Contract

Both the RWA and PSA provide that, following notice of a breach of a representation and warranty, MSMC or MSAC then have 60 days to use their best efforts to cure the alleged breaches "and, if such defect or breach cannot be remedied, [MSMC or MSAC] shall purchase such Mortgage Loan at the Repurchase Price or, if permitted . . ., substitute a Substitute Mortgage Loan for such Mortgage Loan." (RWA § 4(a); PSA § 2.03(g).) The RWA goes on to provide that the obligation to cure, repurchase, or substitute any mortgage loan as to which a breach of a representation and warranty has occurred constitutes "the *sole remedy of* . . . *any other person or entity* with respect to such breach." (RWA § 4(c) (emphasis supplied).) The PSA likewise states that MSMC's or MSAC's obligation to cure, repurchase, or substitute any breaching loans "shall constitute the *sole remedies* against such Persons respecting such breach

available to Certificateholders, the Depositor (if applicable), or the Securities Administrator, *Certificate Insurer* or the Trustee on their behalf." (*Id.* § 2.03(q) (emphasis supplied).)

Accordingly, under the plain language of the agreements, FGIC is limited to this express sole remedy. FGIC, as a third-party beneficiary that is expressly bound by these agreements, cannot seek relief beyond the sole remedy provided. *See Assured Guar. Corp. v. EMC Mortg., LLC*, No. 650805/2012, 39 Misc.3d 1207(A), 2013 WL 1442177, at *4 (Sup. Ct. N.Y. Cnty. 2013) ("*EMC*") (plaintiff-insurer is bound to repurchase protocol in agreements to which it was a third-party beneficiary and where it was "expressly and specifically named in the 'sole remedy' provision" of those agreements); *Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, No. 11 Civ. 2375, 2011 WL 5335566, at **2-5 (S.D.N.Y. Oct. 31, 2011) ("*Flagstar*") (finding that insurer was contractually limited to repurchase remedy in Sale and Servicing Agreements ("SSAs") and Mortgage Loan Purchase Agreements ("MLPAs")).

In numerous RMBS cases like this one, involving the same "sole remedy" provision, this Court and others have repeatedly concluded that the "sole remedy" provision bars plaintiffs' attempts to seek relief that goes beyond payment of the amounts necessary to repurchase any particular loans that have materially breached representations and warranties. *See, e.g., Morgan Stanley Mortg. Loan Trust 2006-13ARX, by U.S. Bank, Nat'l Ass'n v. Morgan Stanley Mortg. Capital Holdings LLC*, No. 653429/2012, 2014 N.Y. Misc. LEXIS 4294, at *2 (Sup. Ct. N.Y. Cnty. Sept. 25, 2014) (finding that, under the PSA and Mortgage Loan Purchase Agreement, "plaintiff's remedies for breach of the mortgage representations are limited to specific performance of the repurchase protocol"); *Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc.*, No. 653390/2012, 2014 WL 2890341, at *7 (Sup. Ct. N.Y. Cnty.

June 26, 2014) (same).[5] The same conclusion applies here.

B. FGIC Cannot Evade the "Sole Remedy" Provision by Reading the Agreements in Isolation

FGIC attempts to plead around the "sole remedy" provision by alleging that the Insurance Agreement permits it to seek "any remedy available under law or equity" for breach of contract. (Compl. ¶ 7.) But FGIC's right to pursue any remedy available under law or equity is not unfettered. Rather, the Insurance Agreement anticipates that FGIC's remedies will be limited in some circumstances, providing that: "*[u]nless otherwise expressly provided*, no remedy herein conferred or reserved is intended to be exclusive of any other available remedy." (I&I § 5.02(b) (emphasis supplied).) As set forth above, the RWA and PSA *do expressly provide* that the notice, cure, and repurchase protocol is FGIC's sole remedy for the alleged breaches at issue. Moreover, the Insurance Agreement explicitly incorporates the representations and warranties included in the RWA and PSA, noting that "each of the Sponsor, the Servicer, and the Depositor hereby makes each such representation and warranty to, and for the benefit of, the Certificate Insurer as if the same were set forth in full herein." (I&I § 2.01(n).) Because the RWA and PSA do expressly provide that the notice, cure, and repurchase protocol is FGIC's sole remedy for alleged breaches of representations and warranties, FGIC is bound by the "sole remedy" provision for such alleged breaches.

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[5] *See also Morgan Stanley Mortg. Loan Trust 2006-10SL v. Morgan Stanley Mortg. Capital Holdings LLC*, No. 652612/2012, 2014 WL 3924620, at **6-7 (Sup. Ct. N.Y. Cnty. Aug. 8, 2014); *ACE Secs. Corp. v. DB Structured Prods., Inc.*, No. 653394/2012, 2014 WL 1384490, at **5-6 (Sup. Ct. N.Y. Cnty. Apr. 4, 2014); *U.S. Bank Nat'l Ass'n v. DLJ Mortg. Capital, Inc.*, No. 650369/2013, 42 Misc. 3d 1213(A), 2013 WL 6997183, at *3 (Sup. Ct. N.Y. Cnty. 2014); *Bank of N.Y. Mellon v. WMC Mortg., LLC*, No. 654464/2012, 41 Misc. 3d 1230(A), 2013 WL 6153207, at *1 (Sup. Ct. N.Y. Cnty. Nov. 21, 2013); *Morgan Stanley Mortg. Loan Trust 2006-14SL v . Morgan Stanley Mortg. Capital Holdings LLC*, No. 652763/2012, 2013 WL 4488367, at **6-7 (Sup. Ct. N.Y. Cnty. Aug. 16, 2013).

As courts have held, FGIC cannot avoid this result by reading the operative agreements in isolation. The Insurance Agreement, PSA, and RWA are interlocking agreements that incorporate one another by reference. (*See* I&I §§ 2.01(n), 2.02(k), 5.01(a) and (c), 5.02(b); PSA §§ 2.02, 2.03(q), 2.07.) Together the agreements form a single transaction, and accordingly, must be read as a whole. *See, e.g., Perlbinder v. Bd. of Managers of 411 E. 53rd St. Condo*, 65 A.D.3d 985, 987-88 (1st Dep't 2009) (where agreements are executed as part of the same transaction and cross-reference one another, they "'constitute part of the same transaction' and 'must be interpreted together'") (quoting *BWA Corp. v Alltrans Express U.S.A.*, 112 A.D.2d 850, 852 (1st Dep't 1985)). FGIC's claim that, despite the sole remedy provisions of the PSA and RWA, its remedies are not limited to the repurchase protocol because the I&I Agreement permits FGIC to pursue "any remedy available under law or equity," has been rejected before and should be rejected here. *See EMC*, 2013 WL 1442177, at *3; *Flagstar*, 2011 WL 5335566, at *5.

In *EMC*, the monoline insurer plaintiff argued that, notwithstanding a "sole remedy" provision in the MLPA, it could pursue other remedies because the I&I Agreement entitled the plaintiff "'in its sole judgment' to pursue 'whatever action at law or in equity' available to it." 2013 WL 1442177, at *3. The Court rejected that argument, finding that it was "premised upon a flawed interpretation of the I&I Agreement in isolation to the MLPA." *Id.* Reading the interlocking operative documents together, the Court concluded that the MLPA's "sole remedy" provision and the I&I Agreement's reference to that provision limited the plaintiff "to the remedy of the Repurchase Protocol to enforce [the defendant's] obligations under the Operative Documents." *Id.*

Similarly, in *Flagstar*, the monoline plaintiff argued that even though the SSAs and MLPAs limited the plaintiff's remedy for a breach of a representation or warranty to repurchase, the I&I Agreement gave the plaintiff remedies "above and beyond the remedies in the underlying Transaction Documents," because it permitted plaintiff, in connection with an Event of Default, to "take whatever action at law or in equity [] may appear necessary or desirable in its judgment to enforce performance of any obligation of [the defendant] under the Transaction Documents." 2011 WL 5335566, at *4. The court rejected plaintiff's argument, which was premised "on reading each of the provisions" of the Transaction Documents "in isolation," and explained that "the provisions of a contract or related set of contracts should be read as a whole and every effort should be made to give them consistent meaning in their overall context." *Id.* at *5. Read as a whole, the Transaction Documents made clear that the I&I Agreement's instruction that plaintiff may "take whatever action at law or in equity that may appear necessary" was not meant to nullify the "sole remedy" provisions of the SSAs and MLPAs. *Id.* The same result should follow here.

C. FGIC Cannot Evade the "Sole Remedy" Provision by Claiming a Separate Breach of the Repurchase Protocol

FGIC's effort to avoid the "sole remedy" by purporting to assert a separate claim for breach of the repurchase protocol (the fourth cause of action) likewise fails under First Department precedent. In *ACE*, the First Department reversed the lower court's holding that a denial of a repurchase demand constitutes an independent breach that triggers the running of the statute of limitations, and held that the breach occurred, if ever, at the time the representations and warranties were made. *See* 112 A.D.3d at 523. If the denial of repurchase demands were the basis for an independent cause of action, the First Department could not have reached the

decision it reached in *ACE*. The First Department's holding in *ACE* was also consistent with its prior holding in *Walnut Place* that the repurchase protocol "merely provides for a remedy in the event of a breach." *Walnut Place LLC v. Countrywide Home Loans, Inc.*, 96 A.D.3d 684, 684-85 (1st Dep't 2012).

Other courts, including this one, have likewise held that the repurchase protocol is remedial and does not constitute a basis for an independent breach of contract separate from the underlying breach of representations and warranties. *See, e.g., Morgan Stanley Mortg. Loan Trust 2006-13ARX*, 2014 N.Y. Misc. LEXIS 4292, at *4 ("[N]on-compliance with the repurchase protocol, a mere remedy, does not give rise to an independent breach of contract by the sponsor, or expand the remedies available to the sponsor under the contract"); *Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc.*, No. 653541/2011, 2013 WL 2072817, at *8 (Sup. Ct. N.Y. Cnty. May 10, 2013) ("The repurchase obligation in this case is merely a remedy. It is not a duty independent of the Mortgage Representation breach of contract claims.").

III. FGIC's Claims with Respect to Loans for Which It Has Not Already Made Repurchase Demands Are Untimely

FGIC's second cause of action seeks repurchase of unspecified "affected Mortgage Loans." (Compl. ¶ 223.) As explained above, the governing agreements set forth a specific process by which MSMC's repurchase obligations may be enforced. If FGIC believes that a mortgage loan breaches a representation or warranty, it must "give prompt written notice" to the other parties to the PSA and provide MSMC with 60 days to cure the alleged breach or repurchase "such Mortgage Loan." (PSA § 2.03(e); RWA § 4(a).) The First Department has held that providing such notice in time for defendant to cure or repurchase is a "precondition to

suit." *U.S. Bank*, 121 A.D.3d at 535; *see also ACE*, 112 A.D.3d at 523 (holding that providing notice and allowing the contractually mandated time to cure or repurchase to elapse is a "condition precedent" to filing suit).

In its complaint, FGIC alleges that it demanded the repurchase of "approximately 800 Mortgage Loans" underlying the Trust. (Compl. ¶ 106.) FGIC's claims with respect to any of the more than 4,000 mortgage loans for which no notice was provided must therefore be dismissed because a condition precedent to suit has not been satisfied for such loans. And because the six-year statute of limitations has already expired, any further notices of alleged breaches with respect to such loans would be untimely.[6]

IV. FGIC Fails to State a Claim for Fraudulent Inducement

In addition to asserting claims for breach of contract, FGIC alleges that it was fraudulently induced to issue the Policy based on alleged misrepresentations by Morgan Stanley. FGIC's complaint alleges that Morgan Stanley made representations about the following four categories of information: "(i) its loan review due diligence and selection process used to determine which Mortgage Loans would be included in the Transaction, (ii) the electronic files containing the attributes of the Mortgage Loans . . ., (iii) the offering documents, referred to as the term sheet, the Prospectus and the Prospectus Supplement, ('ProSupp'), that had been used to market the Insured Securities, and (iv) the ratings for the Transaction issued by ratings agencies based on information Morgan Stanley compiled." (Compl. ¶ 30.)

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[6] Moreover, to the extent FGIC demanded repurchase for any loans within six years, but did so on the eve of the expiration of the statute of limitations, without providing the contractually mandated 60-day period to cure/repurchase before filing suit, then under *ACE*, FGIC's suit is a "nullity" with respect to such loans as well. 112 A.D.3d at 523; *see U.S. Bank*, 121 A.D.3d at 535 ("[T]he cure period must have passed before suit can be brought.").

Under New York law, to state a claim for fraudulent inducement, a plaintiff must plead with particularity that the defendant knowingly made a misrepresentation or material omission of fact for the purpose of inducing the plaintiff to rely on it, that the plaintiff's reliance was reasonable, and that the plaintiff suffered an injury as a result. *See Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 178 (2011).[7] Even if such a claim is otherwise properly pled, it must be dismissed if it is duplicative of FGIC's breach of contract claims. *See Gordon v. Dino De Laurentiis Corp.*, 141 A.D.2d 435, 436 (1st Dep't 1988).

FGIC's fraud claim fails for three independent reasons. First, it is duplicative of its breach of contract claims, both because FGIC fails to plead any damages associated with its fraud claim that are distinct from its breach of contract claim, and because certain of the alleged misrepresentations (categories (ii), (iii) and (iv) from paragraph 30 of FGIC's complaint quoted above) were expressly incorporated into the parties' contract. Second, with respect to those alleged representations that were not expressly incorporated into the contract (category (i) from paragraph 30 of FGIC's complaint quoted above), FGIC fails to plead justifiable reliance. Third, FGIC has not alleged the details of the supposed representations as required by CPLR 3016(b).

A. FGIC's Fraudulent Inducement Claim Duplicates Its Breach of Contract Claims

1. FGIC Fails to Allege That It Sustained Any Fraud Damages That Are Distinct from Its Alleged Damages for Breach of Contract

In New York, "a cause of action for fraud will not arise when the only fraud charged relates to a breach of contract." *Gordon*, 141 A.D.2d at 436. In the context of "a fraudulent inducement claim, the alleged misrepresentation should be one of then-present fact, which would

[7] The elements of fraud and fraudulent inducement claims are substantially the same. *Nat'l Union Fire Ins. Co. v. Worley*, 257 A.D.2d 228, 233 (1st Dep't 1999).

be extraneous to the contract and involve a duty separate from or in addition to that imposed by the contract." *Hawthorne Group, LLC v. RRE Ventures*, 7 A.D.3d 320, 323 (1st Dep't 2004). Even if extraneous representations are alleged, fraud-based causes of action must be dismissed for an "independent reason" when the plaintiff fails to "allege that [it] sustained any damages that would not be recoverable under [its] breach of contract cause of action." *Manas v. VMS Assocs., LLC*, 53 A.D.3d 451, 454 (1st Dep't 2008); *see also Mosaic Caribe, Ltd. v. AllSettled Group, Inc.*, 117 A.D.3d 421, 423-24 (1st Dep't 2014) (dismissing fraud claim as duplicative where plaintiff's fraud claim sought "the same damages as the breach of contract claim"); *Chowaiki & Co. Fine Art Ltd. v. Lacher*, 115 A.D.3d 600, 600-01 (1st Dep't 2014) (same). Fraud claims and breach of contract claims are "designed to provide remedies for different species of damages." *Manas*, 53 A.D.3d at 454. While "the damages recoverable for a breach of contract are meant 'to place the nonbreaching part in as good a position as it would have been had the contract been performed,'" the damages recoverable for being fraudulently induced are intended to make up any loss suffered by such inducement. *Id.* Where the "damages under the fraud cause of action are limited to out-of-pocket expenses that do not exceed the recovery sought under the contract cause of action," the two causes of action are "duplicative." *Andres v. LeRoy Adventures, Inc.*, 201 A.D.2d 262, 262 (1st Dep't 1994). The First Department's decision in *MBIA Insurance Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287 (1st Dep't 2011) ("*Countrywide I*") is not to the contrary. In *Countrywide I*, the First Department did not consider (and defendants did not argue) whether plaintiff had alleged that defendants' misrepresentations proximately caused special damages that were not recoverable under a contract measure of damages.

FGIC fails to plead the existence of any such damages.[8] Indeed, FGIC seeks the same damages under both categories of claims, namely "monetary relief, including, but not limited to, the recovery of the claim payments that FGIC is liable to make in the future under its Policy, and its fees, costs, and other expenses incurred in connection with the Transaction." (Compl. ¶¶ 17, 216, 222, 227, 233, 252.) Because FGIC fails to plead damages proximately caused by Morgan Stanley's alleged misrepresentations that are not recoverable under a contract measure of damages or distinct from the breach of contract damages it seeks, its fraudulent inducement claim duplicates its breach of contract claims and must be dismissed.[9]

2. Certain of the Alleged Misrepresentations Were Expressly Incorporated into the Parties' Contract

FGIC's fraudulent inducement claim should be dismissed, as to certain of the alleged misrepresentations, for the additional and independent reason that FGIC fails to allege that they are "extraneous to the contract and involve a duty separate from or in addition to that imposed by the contract." *Hawthorne Group, LLC*, 7 A.D.3d at 323. In particular, FGIC alleges that Morgan Stanley made misrepresentations relating to information contained in the Mortgage Loan Tape (which allegedly provided the basis for the ratings issued by rating agencies) and the Offering Documents. (Compl. ¶ 30 (items (ii), (iii), (iv)); *id.* ¶¶ 4, 5, 43 51, 56, 57.) To the

[8] An "unelaborated request for punitive damages in connection with [a] fraud claim" will not render an otherwise duplicative fraud claim non-duplicative. *Mosaic Caribe, Ltd.*, 117 A.D.3d at 422-34.

[9] FGIC also cannot plead fraud damages in excess of any damages under its contract claims because it validly agreed that Morgan Stanley's liability for breaches of representations and warranties would be limited to repurchase of defective mortgage loans. Where parties to a commercial contract have included a limitation of liability provision, plaintiff's damages under its fraud claim are properly limited by the liability-limiting provision of the contract. *See Mom's Bagels of N.Y., Inc. v. Sig Greenbaum, Inc.*, 164 A.D.2d 820, 823 (1st Dep't 1990) (plaintiff "failed to allege the essential element of injury [or] damage" under fraud claim where parties' contract provided that defendant's "'sole liability [for] breach of warranty or otherwise shall be strictly limited to either the return of the goods sold . . . and repayment of the purchase price, or that [defendant] shall repair and replace the non-conforming goods or parts,'" and plaintiff had "received a refund of the purchase price").

extent that FGIC purports to rely on these alleged misrepresentations in support of its fraud claim, it cannot do so, because these representations were subsequently incorporated into the parties' contract. (*See* I&I §§ 2.01(k), (m), (n); RWA § 2, Exh. I; PSA §§ 2.03, 2.06, Schedules II, II-A, III.[10]) *See, e.g., Coppola v. Applied Elec. Corp.*, 288 A.D.2d 41, 42 (1st Dep't 2001) (explaining that a fraud claim was upheld as nonduplicative in another case because "[t]he alleged undisclosed fraudulent intent . . . related to an additional oral assurance not embodied in the terms of the agreement that was allegedly breached"); *J.E. Morgan Knitting Mills, Inc. v. Reeves Bros., Inc.*, 243 A.D.2d 422, 423 (1st Dep't 1997) ("[C]ause of action for fraud, which alleges that defendants knew at the time of contract execution that their warranty therein against undisclosed liability burdening the property was false, was properly dismissed as duplicative of plaintiffs' cause of action for breach of contract."); *Pramco III, LLC v. Partners Trust Bank*, No. 02318/2006, 15 Misc.3d 1142(A), 2007 WL 1574479, at *3 (Sup. Ct. Monroe Cnty. May 31, 2007) (representations that pre-dated formation of contract but became contractual warranties were not extraneous to the contract and could not "support an independent fraud claim").

B. FGIC Cannot Plead Justifiable Reliance as a Matter of Law

With respect to the representations that were not incorporated into the parties' contract (item (i) from paragraph 30 of FGIC's complaint), FGIC fails to meet the requirements for

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[10] Section 2.01(k) of the Insurance Agreement provides that "none of the material information relating to the Mortgage Loans or the operations of the Sponsor, the Depositor or the Servicer . . . furnished to the Certificate Insurer in writing or in electronic form by the Sponsor, the Depositor or the Servicer in connection with the Transaction . . . contains any statement of material fact which was untrue or misleading in any material respect when made." (I&I § 2.01(k).) Accordingly, in the event that any alleged misrepresentations were furnished to FGIC in writing or electronic form, they were incorporated into the Insurance Agreement. Similarly, Section 2.01(m) of the Insurance Agreement provides that the Offering Documents do not contain any material misrepresentation or omission, and Section 2.01(n) provides that all representations and warranties included in the governing agreements (including the mortgage loan schedule) are true and correct. (I&I §§ 2.01(m), 2.01(n).)

pleading justifiable reliance. In New York, "as a matter of law, a sophisticated plaintiff cannot establish that it entered into an arm's length transaction in justifiable reliance on alleged misrepresentations if that plaintiff failed to make use of the means of verification that were available to it." *HSH Nordbank AG v. UBS AG*, 95 A.D.3d 185, 194-95 (1st Dep't 2012) (internal brackets and quotation marks omitted). It follows that where a sophisticated plaintiff asserting a claim of fraud fails to plead "that it exercised due diligence by inquiring about . . . nonpublic information" relevant to the truth or falsity of a contracting party's statement, or that it secured "the appropriate prophylactic provision to ensure against the possibility of misrepresentation," its complaint "fails to establish justifiable reliance as a matter of law." *ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.*, 106 A.D.3d 494, 494 (1st Dep't 2013) ("*ACA*"); *see also Global Minerals & Metals Corp. v. Holme*, 35 A.D.3d 93, 100 (1st Dep't 2006).

That is precisely the case here. FGIC alleges that Morgan Stanley made misrepresentations concerning "its loan review due diligence and selection process used to determine which Mortgage Loans would be included in the Transaction" (Compl. ¶ 30), but fails to allege that it took any steps to attempt to verify those alleged statements, or that it insisted on inserting a prophylactic provision into the parties' contract to ensure the statements' accuracy.[11]

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[11] A prophylactic provision is a provision in the parties' contract that conditions the transaction on the accuracy of certain representations and provides for the transaction's rescission in the event of their inaccuracy. *See, e.g., Centro Empresarial Cempresa v. América Móvil, S.A.B. de C.V.*, 76 A.D.3d 310, 320 (1st Dep't 2010), *aff'd* 17 N.Y.3d 269 (2011) (plaintiffs "should have insisted that the release be conditioned on the truth of the financial information provided by defendants"); *Rodas v. Manitaras*, 159 A.D.2d 341, 342-43 (1st Dep't 1990) ("[T]he contract could have included a condition subsequent that the sale would be rescinded if the actual sales experienced were significantly less than the represented figure.").

Under the circumstances, as *ACA* instructs, plaintiff cannot establish justifiable reliance as a matter of law.[12]

In sum, FGIC's purported reliance on unincorporated representations runs afoul of New York's rule that, in order to allege justifiable reliance, sophisticated entities must exercise ordinary prudence by conducting due diligence or securing prophylactic provisions to protect their interests when entering into an arm's length transaction. Because FGIC did neither, "[it] will not be heard to complain that [it] was induced to enter into the transaction by misrepresentations." *Centro Empresarial Cempresa S.A. v. América Móvil, S.A.B. de C.V.*, 17 N.Y.3d 269, 279 (2011) (internal quotation marks omitted); *see also ACA*, 106 A.D.3d at 494-95 (relying on *Centro Empresarial* to dismiss a fraud claim where plaintiff "fail[ed] to plead that it exercised due diligence by inquiring about [relevant] nonpublic information . . . or that it inserted the appropriate prophylactic provision to ensure against the possibility of misrepresentation").

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[12] FGIC's claim is not assisted by either *DDJ Management, LLC v. Rhone Group LLC*, 15 N.Y.3d 147 (2010), or *CIFG Assurance North America, Inc. v. Goldman, Sachs & Co.*, 106 A.D.3d 437 (1st Dep't 2013). Neither case considered whether a plaintiff may justifiably rely on a representation that is not incorporated into a contract where the plaintiff did not perform basic due diligence on the statement and chose not to secure a prophylactic provision in the contract. *See DDJ Mgmt.*, 15 N.Y.3d at 153 ("Plaintiffs did . . . insist that [defendant] represent and warrant, in substance, that the financial statements were accurate."); *CIFG Assur.*, 106 A.D.3d at 438-39 (plaintiff "conducted its own due diligence, utilizing an outside consultant to analyze the characteristics of the underlying loans," and "[t]he characteristics analyzed by plaintiff's consultant were the subject of written warranties that were not demonstrably known by plaintiff to be false when made"). *ACA*, in contrast, addressed that situation head-on and held, as applicable here, that where the plaintiff neither conducted due diligence nor secured a prophylactic provision it cannot establish justifiable reliance as a matter of law. 106 A.D.3d at 494; *see also New York City Educ. Constr. Fund v. Verizon N.Y. Inc.*, 114 A.D.3d 529 (1st Dep't 2014) (dismissing fraud claim because plaintiff failed "to use ordinary intelligence to ascertain the truth of defendant's representations," and explaining that "'[u]nlike [*DDJ Mgmt.*] and [*CIFG Assur.*] . . . the case at bar does not involve a *written* representation" (emphasis in original)).

C. <u>FGIC's Fraud Claim Fails to Comply with CPLR 3016(b)</u>

Although FGIC's complaint purports to rely on statements extraneous to the contract allegedly made by a representative of Morgan Stanley—Steven Shapiro—it fails to allege the details of these supposed representations as required by CPLR 3016(b). Specifically, FGIC fails to allege to whom these representations were allegedly made, when they were made, and how they were communicated—whether orally or in writing. Indeed, if these representations were communicated in writing, then pursuant to I&I § 2.01(k), they would be incorporated into the parties' contract, *see* n.10, *supra*, and an allegation that Morgan Stanley knew the representations to be false would duplicate plaintiff's breach of contract claim. In light of these deficiencies, FGIC's fraudulent inducement claim is not adequately pled and should be dismissed. *See Summit Solomon & Feldesman v. Lacher*, 212 A.D.2d 487, 487 (1st Dep't 1995) (dismissing fraud claim where allegations failed to "state to whom defendant's purported representations were made, when they were made and the clients to whom they referred"); *Mazeh Const. Corp. v. VNB N.Y. Corp.*, No. 500728/2011, 2012 WL 2097690, at *4 (Sup. Ct. Kings Cnty. June 11, 2012) (dismissing fraud claim that was "devoid of any specificity as to who made the assurances, to whom the assurances were made, and when and where the assurances were made"); *David v. Simware, Inc.*, No. 602143/1997, 1997 N.Y. Misc. LEXIS 201, at *6 (Sup. Ct. N.Y. Cnty. 1997) (to satisfy CPLR 3016(b), a complaint's allegations should "specify, who allegedly made the misrepresentations; what was specifically stated; where and when these alleged misrepresentations were made; whether the defendants had knowledge that such statements were false when made and whether the statements were made to the plaintiff").

V. **FGIC Is Not Entitled to Costs and Expenses Under the Express Terms of the Agreement**

The complaint's fifth cause of action seeks costs and expenses, including attorneys' fees and expert fees, that FGIC may incur in connection with this litigation. FGIC, however, is not entitled to the requested costs and expenses because any intention to waive the presumptive rule that each party bears its own costs and expenses in litigation is not "unmistakably clear" from the language of the parties' agreement. *See Hooper Assocs., Ltd. v. AGS Computers, Inc.*, 74 N.Y.2d 487, 492 (1989); *Home Equity Asset Trust v. DLJ Mortg. Capital, Inc.*, No. 651174/2013, 2014 WL 4966127, at *2 (Sup. Ct. N.Y. Cnty. Oct. 1, 2014). Section 3.03(d) of the I&I Agreement provides that MSAC will pay FGIC for costs and expenses incurred in connection with the "enforcement, defense or preservation of any rights in respect of any of the Operative Documents." This language is indistinguishable from the language of the insurance agreements at issue in *MBIA Insurance Corporation v. Countrywide Home Loans, Inc.*, where the Court held that because the provision had "the potential to cover third-party actions seeking damages from [the insurer] in connection with its obligations under the Transaction Documents," it "was not sufficiently unequivocal as to accommodate reimbursement of attorneys' fees" between the parties. No. 602825/2008, 39 Misc.3d 1220(A), 2013 WL 1845588, at *14 (Sup. Ct. N.Y. Cnty. Apr. 29, 2013). Because the contractual provision at issue does not exclusively or unequivocally "reflect an intention that the defendant pay the costs arising out of litigation between the parties," the Court should not infer that the parties harbored such an unconventional intention when they agreed to language that is naturally read to refer to expenses incurred in connection with third-party actions. *Nomura Home Equity Loan Trust, Inc. v. Nomura Credit & Capital, Inc.*, No. 650337/2013, 2014 WL 5243512, at *2 (Sup. Ct. N.Y. Cnty. July 18, 2014).

CONCLUSION

For the reasons stated above, defendants respectfully request that this Court grant defendants' motion to dismiss plaintiff's complaint.

Dated: New York, New York
November 24, 2014

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