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>

REPLY MEMORANDUM OF LAW IN SUPPORT OF MOTION TO DISMISS THE COMPLAINT

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PRELIMINARY STATEMENT

As an insurer who agreed "unconditionally and irrevocably" to provide insurance coverage on certain RMBS certificates, FGIC may not avoid the terms of its agreement.[1] Misapplying principles of New York law and equity, FGIC erroneously argues that it is entitled to rescissory damages, that it is entitled to damages that may never materialize, that the well-established "out of pocket" rule for fraud damages does not apply to it, that it is not bound by the sole remedy set forth in the governing agreements, that its fraud claim is not duplicative of its breach of contract claim even though those claims seek the same damages, and that it need not show justifiable reliance on alleged oral statements that were never incorporated into the written agreements. Despite its arguments to the contrary, FGIC cannot avoid the basic principle that it cannot recover for insurance payments that it has not yet paid, and may never pay. FGIC's other arguments are equally meritless for the reasons set forth below and in defendants' opening brief.

ARGUMENT

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

A. FGIC's Request for Future Damages Is a Request for Rescissory Damages, No Matter How FGIC Characterizes Such Damages

FGIC argues that its request for damages for insurance payments that it has not yet made, but may make in the future, is not a request for rescissory damages. However, requests by a monoline insurer for "damages in the amount of all payments [it] has made and will make pursuant to the [insurance] [p]olicy," are considered "the economic equivalent of rescission." *Assured Guar. Mun. Corp. v. RBS Secs., Inc.*, No. 13 Civ. 2019, 2014 WL 1855766, at *1-2 (S.D.N.Y. May 8, 2014) ("*RBS*"). As the First Department held in *MBIA Ins. Corp. v.*

[1] Abbreviations and defined terms not otherwise defined herein shall have the same meaning as in defendant's memorandum of law in support of its motion to dismiss, dated November 24, 2014 ("Mem.").

Countrywide Home Loans, Inc., 105 A.D.3d 412 (1st Dep't 2013) ("*Countrywide II"*), where, as here, plaintiff "voluntarily gave up the right to seek rescission – *under any circumstances*," it should "not be permitted to utilize [the] very rarely used equitable tool" of rescissory damages "to reclaim a right it voluntarily contracted away." *Id.* at 413 (emphasis in original).

Plaintiff's argument that *Countrywide II* allows it, pursuant to N.Y. Ins. Law §§ 3105 and 3106, to recover "payments *made* pursuant to an insurance policy," is unavailing. The question is not whether plaintiff can recover insurance payments already made, but whether it can recover payments it has *not made* and will not have made as of any final judgment. The latter, no matter how denominated, are rescissory damages, which *Countywide II* precludes. *RBS*, 2014 WL 1855766, at *2 ("Plaintiff's claim in this case includes damages for payments that the plaintiff 'will make' in the future, and such language makes it even clearer that the damages sought are indeed forward-looking rescissory damages. The plaintiff cannot escape the language of its pleadings by labeling the rescissory damages it seek as 'compensatory damages.'").

FGIC mischaracterizes Morgan Stanley's arguments and cases that have allowed monoline insurers to recover insurance payments. FGIC suggests that *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, No. 602825/2008, 2013 WL 1845588 (Sup. Ct. N.Y. Cnty. Apr. 29, 2013) ("*Countrywide III")* and *Assured Guar. Mun. Corp. v. Flagstar*, No. 11 Civ. 2375, 2013 WL 1620567 (S.D.N.Y. Apr. 15, 2013) ("*Flagstar"*) allowed monoline insurers to recover future damages. (Opp. at 10-11.) But that is not the case. In *Flagstar*, the court allowed the insurer to recover payments the insurer had *already made*. *See Flagstar*, 2013 WL 1620567, at *1 (allowing "an updated award of damages to cover those claim payments *made* between September 25, 2012 . . . and February 25, 2013") (emphasis supplied). Similarly, in *Countrywide III*, the court ruled, following the First Department's holding, that while the monoline insurer could not seek rescissory damages, it could seek recovery for "payments made." *Countrywide III*, 2013 WL 1845588, at *9. The court did not suggest that the insurer could recover for payments not yet made. As *RBS* held, such a demand would amount to a demand for rescissory damages, which are unavailable.[2]

FGIC also incorrectly contends that *RBS* "did not take issue with Justice Bransten's decision [in *Countrywide III*] after remand in *MBIA v. Countrywide* that future damages may be sought on claims 'for breaches of representations and warranties,'" and that the *RBS* decision is limited to fraud claims. (Opp. at 11.) *RBS* nowhere says that *Countrywide III* held that potential *future* claim payments are recoverable for breaches of representations and warranties, which is unsurprising since *Countrywide III* said no such thing. Further, although *RBS* addressed the question of rescissory damages in the context of fraud claims, its conclusion that plaintiff could not recover all current and future claim payments was founded on the principle articulated in *Countrywide II* that where a plaintiff has "contracted away any right to rescission, does not seek rescission, and has not shown that rescission was impracticable . . . rescissory damages are legally unavailable"—a principle that is applicable to breach of contract claims, and was applied by the First Department in *Countrywide II* to plaintiff's breach of contract claim. *See RBS*, 2014 WL 1855766, at *1-2 (citing *Countrywide II*, 105 A.D.3d at 413).

Finally, unable to dispute that the case law precludes FGIC from seeking recovery now for insurance payments it may or may not have to make in the future, FGIC suggests that defendants' argument would imply that FGIC would "never" be entitled to seek damages that are

[2] *Ins. Co. of N. Am. v. Kaplun*, 274 A.D.2d 293, 298 (2d Dep't 2000), cited by FGIC (Opp. at 10 n.7), likewise referred to insurance payments that had been made, not payments that might be made in the future. *Syncora Guarantee Inc. v. EMC*, 874 F. Supp. 2d 328, 340 (S.D.N.Y. 2012), also cited by FGIC (Opp. at 11), is unavailing. Insofar as the federal court in that case held open the possibility of rescissory damages, such a possibility has now been foreclosed by the First Department in *Countrywide II*.

incurred after the statute of limitations expired. (Opp. at 1, 8.) This is a red herring: whether FGIC could later seek recovery for insurance payments *actually made* in the future, based on legal claims previously brought within the statute of limitations, is not currently before this Court.[3] FGIC cites no authority relating to statutes of limitations that would change the result mandated by the case law, which is that FGIC cannot seek what amounts to rescissory damages by demanding recovery now for insurance payments that it may or may not make in the future.[4]

B. FGIC's Request for Future Damages Is Precluded by New York Law as Unduly Speculative

FGIC's argument that future profits "have been permitted" in New York, and that personal injury plaintiffs may be granted awards for future expenses and lost earnings capacity, fails to address the particular issues associated with this case. Losses to FGIC can only arise to the extent that the Trust experiences losses and in turn makes claims under FGIC's insurance policy. Where, as here, the more directly injured party has brought an action of its own against defendants to recover its alleged losses, the indirectly injured party's future damages "are speculative and unprovable" because it "is impossible to determine the award that would make" the plaintiff whole, in light of the fact that any recovery in the directly injured party's action will

[3] *Cf. Flagstar*, 2013 WL 1620567, at *1 (indicating that the case is "subject to reopening" if there are disputes "regarding future payments claimed to be due").

[4] Similarly, while FGIC argues in passing that damages determinations do not need to be made at the pleading stage (Opp. at 7-8), New York courts routinely dismiss, at the pleading stage, categories of damages claims that are unavailable as a matter of law. *See, e.g.*, *U.S. Bank Nat'l. Ass'n v. DLJ Mortg. Cap., Inc.*, No. 652699/2013, 2015 WL 298642, at *2-3 (Sup. Ct. N.Y. Cnty. Jan. 16, 2015); *Morgan Stanley Mortg. Loan Trust 2007-2AX v. Morgan Stanley Mortg. Cap. Holdings, LLC*, No. 650339/2013, 2014 WL 6669698, at *1 (Sup. Ct. N.Y. Cnty. Nov. 25, 2014); *Ace Sec. Corp. Home Equity Loan Trust, Series 2007-WM1 v. DB Structured Prods., Inc.*, No. 650312/2013, 2014 WL 5253511, at *1-2 (Sup. Ct. N.Y. Cnty. Sept. 25, 2014); *Pope v. N.Y. Prop. Ins. Underwriting Ass'n*, 112 A.D.2d 984, 985 (2d Dep't 1985), *aff'd*, 66 N.Y.2d 857 (1985) (ruling that while the complaint "adequately set[] forth a cause of action to recover damages for breach of contract as to the policy amount plus interest . . . to the extent that the first cause of action seeks punitive and other damages beyond the policy limit plus interest, plaintiffs have failed to state a basis for such relief").

necessarily "reduce [the plaintiff's] compensable injury correspondingly." *Jackson Nat'l Life Ins. Co. v. Ligator*, 949 F. Supp. 200, 207 (S.D.N.Y. 1996) (applying New York law).[5]

C. FGIC's Request for Future Damages is Also Precluded by the Insurance Agreement

In addition to being precluded by New York law, FGIC's attempt to recover for insurance payments it has not yet made and may never make is also precluded by the terms of the Insurance Agreement itself, which limits FGIC's damages claims to "amounts, if any, then due." (Mem. at 7.) FGIC argues that this language would include amounts "owed" by defendants under any of the Operative Documents (Opp. at 9), but cites no support for the proposition that amounts would be "owed" to FGIC in respect of claim payments before it was clear that FGIC would have to pay them. Nor does FGIC cite any support for the proposition that the phrase "amounts, if any, then due" should be deemed to apply to future events, which would be contrary to the plain meaning of "then due." *See In re Citigroup, Inc. Capital Accumulation Plan Litig.*, 652 F.3d 88, 91 (1st Cir. 2011) (interpreting a statute that required employers to pay discharged employees "the amount then due under the terms of agreement" to not include stock shares that vested after the employee resigned because "the stock was not then due").

Moreover, to the extent that FGIC argues that Morgan Stanley "owes" the Repurchase Price for any loans allegedly required to be repurchased under the repurchase protocol, that is an amount, if any, that would be owed to the *Trust*, not damages to be paid to *FGIC*. *See Assured Guar. Mun. Corp. v. Flagstar*, 920 F. Supp. 2d 475, 513-14 (S.D.N.Y. 2013) ("Assured is not

[5] The court's holding in *Assured Guar. Mun. Corp. v. Flagstar*, 892 F. Supp. 2d 596 (S.D.N.Y. 2012) is not, as FGIC asserts (Opp. at 13), to the contrary. In *Assured v. Flagstar*, the court rejected defendant's argument that, in light of the defendant's residual interest, the monoline plaintiff might be paid back for the claim payments it had *already made*, and that therefore the insurer's damages associated with such payments were too speculative. *Id.* at 605-06. Morgan Stanley is not asserting that any damages associated with payments that FGIC *has already made* are too speculative.

entitled to direct payment of the amounts Flagstar should have paid for a repurchase, but rather to reimbursement of the claims it has paid to the bondholders to the extent that the amounts Flagstar should have paid into the Trust would be sufficient to cover Assured's claim payments."). For the same reason, to the extent that the repurchase protocol is captured by the specific performance portion of I&I § 5.02(a)(iii)—referring to "enforc[ing] performance and observance of any obligation" of defendants—that does not support any damages claim by *FGIC*, much less a claim based on *future payments* that it has not yet made.

Finally, FGIC's argument that I&I § 5.02(b) makes available other remedies "existing at law or equity" fails because, as set forth above and in defendants' opening brief, under New York principles of law and equity, FGIC is not entitled to damages for claim payments it has not yet made and may never make.

D. Under New York's Out-of-Pocket Rule, Any Damages for Fraudulent Inducement Are Limited to Damages FGIC Has Already Incurred

Under New York law, a fraud plaintiff may only recover "the actual pecuniary loss sustained as the direct result of the wrong." *Lama Holding Co. v. Smith Barney, Inc.*, 88 N.Y.2d 413, 421 (1996); *see also First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 768 (2d Cir. 1994), *cert. denied*, 513 U.S. 1079 (1995) (a fraud plaintiff may only recover for those losses that it has "actually suffered," not for "losses that may occur").[6] In seeking future claim payments it *might* have to make, FGIC asks the Court to disregard this rule.

[6] FGIC attempts unsuccessfully to distinguish *Gelt Funding* by asserting that it only addressed the ripeness of the plaintiff's RICO claim in that case. (Opp. at 15 n.12.) To the contrary, *Gelt Funding* separately addressed the fact that, under the out-of-pocket rule, "the fraud defendant is not liable for all losses that may occur, but only for those actually suffered." *Id.* at 767. While this rule of fraud damages was applied in that case in the context of determining whether the plaintiff had standing under RICO, its holding concerning the out-of-pocket rule is not limited to that context.

In similar circumstances, courts have recognized that the rule requires the plaintiff to plead "actual, present loss," a standard which is not satisfied if a plaintiff may only suffer damages in the future, and only if another (more directly injured) party does not itself recover damages. *Jackson*, 949 F. Supp. at 208 (applying New York law) ("Jackson National's failure to allege provable, nonspeculative damages is particularly crippling in light of the fact that three of its four causes of action [including fraud] require the pleading of actual, present loss.").

Contrary to FGIC's suggestion, neither *Continental Cas. Co. v. PriceWaterhouseCoopers, LLC*, 15 N.Y.3d 264 (2010) nor *Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84, 87-88 (1928) provide any support for the notion that FGIC may recover "out-of-pocket losses" based on claim payments that it has not yet made and may never make. Similarly, contrary to FGIC's suggestion (Opp. at 13), N.Y. Ins. Law § 3105 says nothing about allowing insurers to recover for payments they have not yet made. Section 3105 simply provides, in pertinent part, that "[n]o misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material." It does nothing to abrogate the common law rule that a fraud plaintiff's damages are limited to its out-of-pocket losses.[7]

II. <u>**FGIC's Breach of Contract Claims Are Limited by the Express Terms of the Agreements**</u>

A. <u>The "Sole Remedy" Provision Applies to FGIC's Allegations</u>

FGIC seeks to avoid the "sole remedy" provision by arguing that it applies only to "loan warranties" and not to "transaction warranties." However, the substance of FGIC's allegations relating to both sets of warranties are fundamentally the same—namely, that Morgan Stanley

[7] It is black letter law that the common law is never abrogated by implication. N.Y. Stat. Law § 301(b) (McKinney 2012); *see also Gottlieb v. Kenneth D. Laub & Co.*, 82 N.Y.2d 457, 465 (1993) (the common law "must be held no further changed than the clear import of the language used in a statute absolutely requires" (internal quotation marks omitted)).

securitized loans that FGIC alleges were of lower quality than represented. (*See* Compl. ¶¶ 81-93.) Indeed, the complaint alleges that the same circumstances that allegedly constitute a breach of transaction warranties also constitute a breach of loan warranties. (*See id.* ¶¶ 97, 100.) Where, as here, the loan-level warranties referenced in the repurchase provision "overlap with" and "relate to" transaction-level warranties, the First Department has held that plaintiffs cannot avoid the "sole remedy" provision by bringing a complaint founded on the quality of the loans in the Trust and then characterizing such breaches as "transaction" breaches rather than "loan" breaches. *Ambac Assur. Corp. v. EMC Mortg. LLC*, 121 A.D.3d 514, 518 (1st Dep't 2014).[8]

Contrary to FGIC's suggestion, this same analysis applies to its third cause of action for breach of the Insurance Agreement. FGIC incorrectly asserts that defendants' opening brief does not address how the "sole remedy" provision impacts FGIC's third cause of action. This is not the case, as the opening brief explains why FGIC is limited to the sole remedy of repurchase for any claim of breach of the Insurance Agreement. (*See* Mem. at Section II.B.)

B. FGIC Cannot Evade the "Sole Remedy" Provision by Claiming a Separate Breach of Contract for Failure to Repurchase

Contrary to FGIC's claim that it has an independent claim for breach of the repurchase protocol, it is well-established that the repurchase protocol is a pre-suit remedial provision and not a separate basis for asserting a legal claim. *See, e.g.*, *Nomura Asset Acceptance Corp. Alt. Loan Trust v. Nomura Credit & Capital, Inc.*, No. 653390/2013, 2014 WL 2890341, at *6 (Sup. Ct. N.Y. Cnty. June 26, 2014) ("[T]he Appellate Division decision in *ACE* bars any claim by

[8] *Syncora Guarantee Inc. v. EMC*, 39 Misc.3d 1211(A) (Sup. Ct. N.Y. Cnty. 2013), cited by plaintiff, is distinguishable because the enhanced remedies described in § 5.02 of the I&I in *Syncora* expressly applied to breaches of both loan-level and transaction-level warranties. Because Syncora's I&I defined "Event of Default" in a manner that captured breaches of both loan-level and transaction-level warranties, the remedies described in § 5.02 were applicable to both kinds of claims, making it unnecessary to determine how breaches of loan warranties that could also be characterized as breaches of transaction warranties should be treated.

plaintiff here that failure to comply with the repurchase obligation under the sole remedy provision gives rise to an independent breach of contract."(citations omitted)). The issue is not whether breach of the repurchase protocol is itself subject to the sole remedy of repurchase, but whether failure to repurchase is a separate contractual breach at all; the law is clear that it is not.

III. FGIC Fails to State a Claim for Fraudulent Inducement

A. FGIC's Fraudulent Inducement Claim Is Duplicative of Its Breach of Contract Claim

As defendants explained in their opening brief, a fraud plaintiff's failure to allege fraud damages that are distinct from alleged breach of contract damages is an *independent* ground to find that the plaintiff's fraud claim is duplicative of the breach of contract claim. *See Chowaiki & Co. Fine Art Ltd. v. Lacher*, 115 A.D.3d 600, 600-01 (1st Dep't 2014); *Mosaic Caribe Ltd. v. AllSettled Group, Inc.*, 117 A.D.3d 421, 422-23 (1st Dep't 2014); *Manas v. VMS Assocs., LLC*, 53 A.D.3d 451, 454 (1st Dep't 2008); *Andres v. LeRoy Adventures, Inc.*, 201 A.D.2d 262, 262 (1st Dep't 1994). In its opposition, plaintiff posits that the courts that have so held simply did not mean what they said, and contends that as long as extraneous representations are alleged that involve a separate breach of a duty, a fraud claim is necessarily nonduplicative of a breach of contract claim. That is not what the cases provide. In *Andres*, for instance, the First Department expressly acknowledged that the plaintiff's fraud claim "may allege the partial, and therefore misleading, disclosure of an existing fact, rather than mere nonactionable expressions as to future conduct," but further held that "this alone is not sufficient" and dismissed the fraud claim on the ground that the alleged fraud damages were "duplicative" of the "recovery sought under the contract cause of action." *Andres*, 201 A.D.2d at 262. Likewise, in *Chowaiki*, the First Department held that "[a]lthough plaintiffs sufficiently allege an independent duty owed to them, arising from the attorney client relationship, the fraud claim is similarly redundant of the breach of contract claim, since it also seeks the same damages." *Chowaiki*, 115 A.D.3d at 600-01.[9]

FGIC contends that it has satisfied this rule because its breach of contract cause of action, in addition to seeking the same damages sought under its fraud claim, also seeks to enforce the repurchase protocol, but FGIC has the rule backwards. A fraud claim is duplicative unless the fraud claim alleges damages that are distinct from and that exceed the damages sought under a breach of contract claim. *See Andres*, 201 A.D.2d at 262 ("Under either theory of pecuniary loss discernable from plaintiffs' papers . . . their 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 and are therefore duplicative*." (emphasis supplied) (citations omitted)).[10]

Finally, contrary to FGIC's suggestion, there is no conflict between *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287 (1st Dep't 2011) and cases concluding that a fraud claim is duplicative where it seeks the same damages as the breach of contract claim. The defendants in *Countrywide* did not argue that plaintiff's fraud claim was duplicative because of a lack of distinct fraud damages, and therefore the Court had no reason to address that issue.

B. <u>FGIC Fails to Plead Justifiable Reliance</u>

FGIC argues that due to N.Y. Insurance Law § 3105, it need not plead justifiable reliance—a quintessential element of fraud. FGIC is incorrect. First, any claim under N.Y.

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[9] In *Mosaic Caribe*, similarly, the First Department held that the fraud claim was duplicative because "the proposed amended complaint seeks the same damages as the breach of contract claim." 117 A.D.3d at 422-23. In *Manas*, although the First Department determined that the fraud-based claims were deficient because the complaint contained "merely general allegations that defendants entered into a contract while lacking the intent to perform it," and thus did not allege "a breach of a duty separate from a breach of the contract," the Court also made clear that plaintiff's failure to allege distinct fraud damages was an "independent reason" to dismiss the fraud-based causes of action. 53 A.D.3d at 454 (internal quotation marks and alterations omitted).

[10] Of course, it is also the case that any damages associated with the repurchase protocol are damages that would be owed to the *Trust*, not *FGIC*. *See* pp. 5-6, *supra*.

Insurance Law § 3105 is time-barred. Even if not time-barred, § 3105 does not displace the common law rule that a fraud plaintiff must establish justifiable reliance.

Section 3105(b)(1) provides, in pertinent part, that "[n]o misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material. No misrepresentation shall be deemed material unless knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract." FGIC is not seeking to "avoid" (*i.e.*, rescind) the Insurance Policy it issued, and thus presumably invokes § 3105 on the ground that it is seeking to "defeat recovery" under the Insurance Policy. Plaintiff's claim to "defeat recovery" under its Insurance Policy pursuant to § 3105 is subject to the three-year statute of limitations for statutory claims, and is time-barred given that more than three years passed between the time the Insurance Policy was issued on June 20, 2007 and the time the complaint was filed on September 23, 2014. *See* N.Y. C.P.L.R. 214(2) ("[A]n action to recover upon a liability, penalty or forfeiture created or imposed by statute" must be commenced within three years). CPLR 214(2) applies to claims that are "'akin to common-law causes, [but which] would not exist but for the statute.'" *Gaidon v. Guardian Life Ins. Co. of Am.,* 96 N.Y.2d 201, 209 (2001). There was no distinct cause of action at common law to permit an insurer to "defeat[] recovery" under an Insurance Policy, and accordingly, FGIC's purported claim under section 3105(b) is subject to the three-year statute of limitations in CPLR 214(2). *Cf. GuideOne Specialty Mut. Ins. Co. v. Congregation Adas Yereim*, 593 F. Supp. 2d 471, 486 (E.D.N.Y. 2009) ("[T]here is no right at common law to selectively disclaim various obligations under an insurance contract that otherwise remains in full force and effect.").[11]

[11] An insurer's claim to rescind a policy was a cause of action that existed at common law, but again, FGIC is not seeking to rescind the policy, and therefore presumably relies on § 3105's second prong.

In addition, whether or not viewed as an independent cause of action, § 3105 does not displace the common law rule that a fraud plaintiff's reliance on a misstatement must be reasonable. This is demonstrated by, among other things, the numerous decisions that have addressed fraud claims in circumstances similar to this case without suggesting that § 3105 relieved the plaintiff of its obligation to demonstrate justifiable reliance. *See, e.g.*, *ACA Fin. Guar. Corp. v. Goldman, Sachs & Co.*, 106 A.D.3d 494, 494 (1st Dep't 2013); *CIFG Assur. N. Am., Inc. v. Goldman, Sachs & Co.*, 106 A.D.3d 437, 438 (1st Dep't 2013); *Ambac Assur. Corp. v. First Franklin Fin. Corp.*, No. 651217/2012, 40 Misc. 3d 1214(A), 2013 WL 3779636, at *6 (Sup. Ct. N.Y. Cnty. July 18, 2013); *see also Nat'l Union Fire Ins. Co. of Pittsburgh, PA v. Xerox Corp.*, 25 A.D.3d 309, 309 (1st Dep't 2006) (insurer could not have reasonably relied on representations that were not alleged to have been contained in insurance application). The plain language of § 3105 does nothing to eliminate the common law requirement that fraud plaintiffs prove justifiable reliance, nor the rule that a sophisticated plaintiff cannot assert a fraud claim "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). Because the common law "must be held no further changed than the clear import of the language used in a statute absolutely requires," N.Y. Stat. Law § 301(b) (McKinney 2012); *Gottlieb*, 82 N.Y.2d at 465, the absence of clear language eliminating the requirement is dispositive.

FGIC's reliance on alleged oral representations that were not incorporated into the governing agreement is unreasonable because FGIC did not use the means of verification available to it. FGIC contends that it need not do so because the oral representations were "inextricably intertwined" with representations in the bankruptcy court stipulation and the Prospectus Supplement that were incorporated into written warranties (Opp. at 22), but cites no law to that effect. FGIC instead relies on *DDJ Management, LLC v. Rhone Group LLC,* which explains that a plaintiff may be justified in relying on representations if it has "gone to the trouble to insist on a written representation that certain facts are true." 15 N.Y.3d 147, 154 (2010). Here, FGIC did *not* insist on written representations reflecting the statements regarding defendants' due diligence that it alleges were conveyed orally. *See New York City Educ. Constr. Fund. v. Verizon N.Y., Inc.*, 114 A.D.3d 529, 530-31 (1st Dep't 2014) (dismissing fraud claim based on lack of justifiable reliance and explaining that "unlike [*DDJ Mgmt.*] and [*CIFG Assur.*] . . . the case at bar does not involve a *written* representation." (emphasis in original)); *Ambac Assur. Corp. v. EMC Mortg. LLC*, No. 651013/2012, 39 Misc.3d 1240(a), 2013 WL 2919062, at *6 (Sup. Ct. N.Y. Cnty. 2013), *aff'd*, 121 A.D.3d 514 (1st Dep't 2014) ("The distinguishing element between *HSH Nordbank* and *Centro Empresarial Cempresa S.A.* (17 N.Y.3d at 279), where the element of justifiable reliance was found to be lacking at the pleading stage, and *DDJ Mgmt., LLC* (15 N.Y.3d at 154), where issues of fact warranted a denial of the motion to dismiss, was the presence of *written assurances* as to the accuracy of the information in the relevant transaction documents." (emphasis supplied)). Furthermore, the oral representations regarding due diligence that plaintiff has alleged are materially different from and more specific than any alleged representation in the Bankruptcy Court stipulation or Prospectus Supplement.[12]

Finally, plaintiff claims that it had no obligation to seek verification of Morgan Stanley's alleged oral representation that it conducted extensive due diligence on the loans at issue because this representation was "peculiarly within the knowledge of the defendants." But, even if such a

[12] *Compare* Compl. ¶ 40 ("Mr. Shapiro represented that Morgan Stanley would review approximately 50% of the loans, and use that due diligence review to select only the best mortgage loans for inclusion in the Transaction."), *with id.* ¶ 35 (alleging that the Bankruptcy Court stipulation indicated that Morgan Stanley had access to due diligence materials as a bidder in the auction) and *id.* ¶ 86 (alleging that the Prospectus Supplement disclosed that Morgan Stanley conducted due diligence on the *seller*, and that with respect to the *loans*, "[t]he scope of the mortgage loan due diligence varies based on the credit quality of the mortgage loans").

representation had actually been made, nothing would have prevented FGIC—a sophisticated monoline insurer—from asking for verification that such due diligence was conducted. "'[A]s 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.'" *UBS AG*, 95 A.D.3d at 194-95 (quoting *Ventur Grp., LLC v. Finnerty*, 68 A.D.3d 638, 639 (1st Dep't 2009)). The fact that one party to a transaction has superior knowledge of certain facts—a fact that will almost always be the case in sophisticated commercial transactions—does not relieve a sophisticated party from its obligation to ask the defendant for verification. *See MAFG Art Fund, LLC v. Gagosian*, 123 A.D.3d 458, 458 (1st Dep't 2014) ("As a matter of law, these sophisticated plaintiffs cannot demonstrate reasonable reliance because they conducted no due diligence; for example, they did not ask defendants, 'Show us your market data.'"); *Mosaic Caribe,* 117 A.D.3d at 422 (plaintiff did not justifiably rely on defendant's statement that one of his companies' owned a life insurance policy that the defendant would convey to the plaintiff because "[p]laintiff [could not] credibly claim that it had no available means of verification, as [] information [verifying ownership of the policy] would have been available from defendant or the proposed defendants had plaintiff requested it"). There is no allegation that FGIC asked for verification, and thus it has failed to plead that it justifiably relied on unincorporated representations.

IV. <u>FGIC Is Not Entitled to Reimbursement of Attorneys' Fees Under the Express Terms of the Agreement</u>

Section 3.03(d) of the I&I provides, in relevant part:

> The Sponsor agrees to pay to the Certificate Insurer any and all charges, fees, costs and expenses that the Certificate Insurer may reasonably pay or incur, including reasonable attorneys' and accountants' fees and expenses, in connection with (i) the enforcement, defense or preservation of any rights in respect of any of the Operative Documents, including *defending, monitoring or participating in any*

> *litigation* or proceedings (including any insolvency proceedings in respect of any Transaction participant or any affiliate thereof) relating to any of the Operative Documents, any party to any of the Operative Documents (in its capacity as such a party) or the Transaction. (Emphasis supplied.)

This provision's reference to "defending, monitoring, or participating in any litigation," all of which are actions that do not involve the certificate insurer *initiating* the litigation, suggests that intent of § 3.03(d) was not to permit FGIC to recover for expenses and fees incurred in a suit brought by FGIC against defendant. Because this provision does not make it "unmistakably clear" that it intends to waive the presumptive rule that each party bears its own costs and expenses in litigation, New York law requires that it be deemed to apply to third-party claims rather than first-party claims. *Hooper Assocs., Ltd. v. AGS Computers, Inc.*, 74 N.Y.2d 487, 492 (1989); *Home Equity Asset Trust 2007-2 v. DLJ Mortg. Cap., Inc.*, No. 651174/2013, 2014 WL 4966127, at *2 (Sup. Ct. N.Y. Cnty. Oct. 1, 2014).

CONCLUSION

For the reasons stated above and for those stated in defendants' opening brief, defendants respectfully request that this Court grant defendants' motion to dismiss.

Dated: New York, New York
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