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

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| FINANCIAL GUARANTY INSURANCE COMPANY, | : | Mot. Seq. 001 |
| Plaintiff, | : | Index No. 652853/2014 |
| - against – | : | Justice Friedman |
| MORGAN STANLEY ABS CAPITAL I INC., and MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, as successor to MORGAN STANLEY MORTGAGE CAPITAL INC. | : | Part 60 |
| Defendants. | : | |

**PLAINTIFF'S MEMORANDUM OF LAW IN OPPOSITION TO MOTION TO DISMISS**

Erik Haas (ehaas@pbwt.com)
Henry J. Ricardo (hjricardo@pbwt.com)
Jonathan Hatch (jhatch@pbwt.com)
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, NY 10036-6710
Telephone: (212) 336-2000
Fax: (212) 336-2222

*Attorneys for Financial Guaranty Insurance Co.*

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

**Page(s)**

**Cases**

**Statutes**

## PRELIMINARY STATEMENT

Morgan Stanley's motion to dismiss the Complaint is a waste of time and judicial resources, serving only to delay the progress of this matter.[1] Following the now well-worn residential mortgage backed securities ("RMBS") defense playbook, Morgan Stanley raises arguments already rejected by this Court and other courts. That effort is unavailing because the detailed Complaint more than satisfies the pleading standards for the contract claims alleged.

Morgan Stanley opens by calling this a case of "insurer's remorse." But FGIC's only regret is that it trusted the once-respected investment bank to comply with its contractual obligations to remedy breaches of its express warranties. Those breaches are pervasive. Morgan Stanley was among the largest financiers of defective loans in advance of the Great Recession, through its warehouse lending and securitization functions. By providing capital and a market for the defective loans, Morgan Stanley enabled and encouraged the wholesale abandonment of underwriting guidelines by originators of the loans in its securitizations, including those that Morgan Stanley bundled here. Indeed, 80% of the Mortgage Loans in the Underlying Securitizations came from 10 major originators of defective loans, and 20% of the loans came from one of the worst—New Century—which worked closely with and was dependent on Morgan Stanley. Morgan Stanley assured FGIC that it was intimately familiar with the securitizations, having created almost half and vetted all before acquiring the NIM securities that it purportedly "cherry-picked" for the Transaction. Morgan Stanley instead selected a pool replete with bad apples.

Morgan Stanley next emphasizes that FGIC entered into this Transaction knowing the inherent risks of NIM securities. In doing so, Morgan Stanley merely affirms FGIC's allegations

[1] Capitalized terms shall have the meanings ascribed to them in the Complaint ("Comp.") in this matter, NYSCEF Doc. No. 2, unless otherwise defined herein.

regarding the parties' bargain. The Complaint alleges that, because of these risks, and because Morgan Stanley had access to information concerning the originators and the Underlying Securitizations that FGIC did not, FGIC demanded, specifically negotiated, and obtained both broad warranties that the information Morgan Stanley furnished concerning the Transaction was not false or misleading and broad remedies to enforce those warranties. Those terms squarely imposed on Morgan Stanley the risk of loss for any false or misleading information it furnished to FGIC. Morgan Stanley's refrain that FGIC knew the risks thus proves the point—FGIC, wary of the risk, protected itself by securing the contractual warranties it now sues to enforce.

Morgan Stanley then raises three unpersuasive arguments for dismissal. First, it argues that the parties' Insurance Agreement and case law prevent FGIC from recovering, as damages, payments that will fall due under FGIC's irrevocable Policy at the maturity of the Transaction. The Insurance Agreement imposes no such restriction on FGIC's rights and remedies. Additionally, the very precedents Morgan Stanley cites—including *MBIA v. Countrywide* and *Assured v. Flagstar*—allowed analogous damages claims, *i.e.*, based upon projected claim payments, to proceed to trial. Morgan Stanley's contention that FGIC seeks unduly speculative "future damages" is belied by its simultaneous assertion that FGIC cannot escape the readily-determinable claim payments due under its "irrevocable" Policy. Morgan Stanley is not entitled to immunity from damages.

Second, Morgan Stanley asserts that it cannot be held liable for the falsity of the data it conveyed to FGIC regarding two key attributes of the Mortgage Loans—the CLTV and owner-occupancy status—because it only warranted that it accurately transmitted information provided by originators. That misstates its warranties and the law. The parties' specifically negotiated and agreed that Morgan Stanley would bear the risk of these disclosures proving to be false ***or***

***misleading*** because it had superior knowledge of and access to information concerning the Underlying NIM Securities, the Underlying Securitizations, the Mortgage Loans and the originators. The represented CLTV and owner-occupancy numbers were false *and* misleading, as the offering materials did not disclose that the originators had abandoned the sound origination and appraisal practices necessary to ensure their veracity. This Court has repeatedly held that such allegations are sufficient to plead an actionable misleading statement, even under the high pleading standard for fraud, let alone the lower standards for a breach of warranty claim.

Finally, Morgan Stanley argues that Section 3106 of New York Insurance Law requires FGIC to allege that Morgan Stanley's warranty breaches directly caused FGIC to incur claim payments. That contention is based upon a complete misreading of the decisions in *MBIA v. Countrywide*, which held that there is no such requirement under the Insurance Law. Rather, all that is necessary is a showing that a breach materially increased the "risk" of loss for the insurer. FGIC clearly alleges a material increase in the risk of loss from Morgan Stanley's warranty breaches, which is all that is required.

FGIC respectfully requests that Morgan Stanley's motion be denied in its entirety.

## STATEMENT OF FACTS

The facts recited herein are drawn from the allegations of the Complaint, which are incorporated by reference and are taken as true for the purposes of this motion to dismiss.

### A. Morgan Stanley Had Superior Knowledge of the Underlying NIM Securities, the Originators, and Mortgage Loans

This breach of contract action pertains to a securitization that Morgan Stanley sponsored known as the Basket of Aggregated Residential NIMS 2007-1 (the "Transaction"). As collateral for the Transaction, Morgan Stanley sold to the securitization Trust 48 previously-issued Net Interest Margin ("NIM") securities from its portfolio (the "Underlying NIM Securities"), each of

which entitled the holder to certain residual cash flows from prior securitizations (each, an "Underlying Securitization") of residential mortgage loans (the "Mortgage Loans"). (Comp. ¶¶ 1-2, 23, 49, 54.)

Before the Transaction, Morgan Stanley held ***all*** of the Underlying NIM Securities on its books. (*See id.*) Additionally, almost half of these securities were issued in securitizations Morgan Stanley sponsored and for which its affiliate, Saxon Mortgage Services, Inc., acted as servicer. (*See id.* ¶ 48.) Morgan Stanley purportedly "cherry-picked" the Underlying NIM Securities from its portfolio based upon its assessment of their quality. As a result, Morgan Stanley had intimate knowledge of the Underlying NIM Securities that FGIC did not have and could not replicate in deciding whether to participate in the Transaction. (*Id.* ¶¶ 2, 49, 51.)

Morgan Stanley also had knowledge of the originators of the Mortgage Loans. Ten originators accounted for nearly 80% of the Mortgage Loans, with over 20% originated by New Century. (*Id.* ¶ 126.) All ten originators are now known to be among the most egregious lenders in terms of their systematic abandonment of underwriting guidelines and their manipulation and inflation of property appraisals. (*Id.* ¶¶ 127-224.) Using the "originate-to-distribute" model, they sold poorly-underwritten loans to Morgan Stanley and other investment banks for securitization shortly after origination—a method that has been cited as a driver for the creation of poor-quality mortgage loans. (*Id.* ¶¶ 112, 114, 128.) New Century was a primary source of loans for Morgan Stanley's securitizations. Morgan Stanley financed New Century loans through its warehouse facilities, acquired the loans originated for its securitizations, and even took over the servicing of certain New Century loans in 2007. (*Id.* ¶¶ 228-29.)

According to Morgan Stanley, prior to acquiring Mortgage Loans for the Underlying Securitizations it sponsored, it conducted a detailed review of the originators' credit quality,

underwriting guidelines, and management. Where warranted, the review purportedly included origination practices, historical loan loss profile and quality control practices. (*Id.* ¶ 37.) Moreover, Morgan Stanley's warehouse financing facilities entitled it to additional disclosures from New Century and other originators to whom it advanced capital to fund their originate-to-distribute operations. (*Id.* ¶ 229.) As a consequence of its unique access, originator review process and status as a major sponsor, Morgan Stanley knew the originators had systematically abandoned underwriting guidelines and inflated their property appraisals. (*Id.* ¶¶ 226-27, 231.)

### B. Morgan Stanley Leveraged Its Superior Knowledge to Sell the Underlying NIM Securities on the "Eve of the Financial Crisis"

The Transaction closed on May 31, 2007 (Comp. ¶ 53): in Morgan Stanley's words, the "eve of the financial crisis." (Mem. of Law in Supp. of Defs.' Mot. to Dismiss Pl's. Compl. ("MS Br.") at 1, NYSCEF Doc. 11.) The timing was not a coincidence. Morgan Stanley was leveraging its inside knowledge to cleanse its balance sheet of the Underlying NIM Securities, eliminating its "skin in the game" just ahead of the market collapse.

### C. Because of its Superior Knowledge, Morgan Stanley Agreed to Bear the Risk of Loss For False or *Misleading* Information Furnished to FGIC

Both parties recognized and agreed that because Morgan Stanley had superior knowledge of, and access to information concerning, the Underlying NIM Securities, the Underlying Securitizations, the originators and the Mortgage Loans, it would bear the risk of loss if any such information furnished to FGIC was discovered to be false or misleading. (Comp. ¶¶ 46-51.) Recognizing the risks of a NIM transaction, FGIC demanded that Morgan Stanley provide broad warranties accepting that risk of loss. (*Id.* ¶ 52.) Morgan Stanley initially refused, but ultimately agreed, giving FGIC the requested warranties to induce its participation in the Transaction. (*Id.* ¶ 63.)

The warranties were memorialized in the parties' Insurance and Indemnity Agreement (the "Insurance Agreement").[2] Specifically, in Section 2.01(j), Morgan Stanley granted FGIC the Accuracy of Information Warranty, attesting that none of the documents or information furnished to FGIC relating to the Transaction, the Underlying NIM Securities, the Underlying Securitizations, or Morgan Stanley's operations "contain any statement of material fact which was untrue ***or misleading*** in any material respect when made." (Comp. ¶ 61 (emphasis added.)) This warranty covered, among other information, the offering documents used to market the Underlying NIM Securities and the Underlying Securitizations (the "Offering Documents"), certain electronic files disclosing attributes of the Mortgage Loans (the "Mortgage Loan Tapes"), and the "shadow ratings" provided by rating agencies to assess the credit quality of the Underlying Transactions. (*Id*. ¶¶ 26, 41.)

Additionally, in Section 2.01(k) of the Insurance Agreement, Morgan Stanley granted FGIC the Compliance with Securities Law Warranty, attesting that the offering document for the Transaction—which attached and incorporated by reference the Offering Documents—"does not contain any untrue statement of a material fact and does not omit to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, ***not misleading***." (*Id.* ¶ 61 (emphasis added).) Further, in Section 2.01(q), Morgan Stanley granted the Rating Agency Warranty, attesting that the information Morgan Stanley provided to secure the shadow ratings "did not contain any untrue statement of a material fact or omit to state any material fact required to be stated in order to make such information ***not misleading***." (*Id.* (emphasis added).) These warranties, found only in the Insurance Agreement and made only to FGIC, are referred to as the "Transaction Warranties."

[22] The Insurance Agreement is filed at NYSCEF Doc. 16.

Finally, Section 2.01(l) of the Insurance Agreement incorporated by reference each of the representations and warranties made in the Underlying NIM Purchase Agreement (the "Underlying NIM Warranties") "as if the same were set forth in full herein." The Underlying NIM Warranties assured that each of the Offering Documents for the Underlying NIM Securities was "true, ***complete*** and correct in all material respects." (*Id.* ¶ 65 (emphasis added).)

Reflecting the materiality of the warranties, Morgan Stanley's execution of the Insurance Agreement and certification of the truth and correctness of its representations and warranties was a condition precedent to the issuance of FGIC's Policy. (*Id.* ¶ 60; *see also id.* ¶¶ 32, 43, 58.)

**D. Morgan Stanley Agreed to a Broad Repurchase Protocol**

Further underscoring the materiality of its warranties, Morgan Stanley committed to repurchase any Underlying NIM Securities upon discovery of a breach of an Underlying NIM Warranty, without any other conditions. (Comp. ¶ 93; Underlying NIM Purchase Agreement ¶ 4(a), NYSCEF Doc. 14.) Morgan Stanley agreed that FGIC was entitled to enforce the Repurchase Protocol as an express third party beneficiary of the Underlying NIM Purchase Agreement. (Insurance Agreement §§ 2.02(i), 6.15; Underlying NIM Purchase Agreement § 8.)

**E. Morgan Stanley Granted FGIC Broad and Additional Remedies**

Morgan Stanley also agreed that FGIC is entitled to exercise additional, broad and cumulative remedies for Morgan Stanley's breach of the Transaction Warranties or Underlying NIM Warranties and for failure to comply with the Repurchase Protocol. For example, the breach of any of the warranties constitutes an "Event of Default" under Section 5.01(a) of the Insurance Agreement. Upon an Event of Default, FGIC can exercise "any one or more" of the rights and remedies set forth in Section 5.02(a). (Comp. ¶¶ 64, 97; Doc. 16.)

Most broadly, Section 5.02(a)(iii) authorizes FGIC to 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 . . . or to enforce performance and observation of any obligation, agreement or covenant" of Morgan Stanley. (Doc. 16.) Additionally, under Section 3.03(b), Morgan Stanley agreed to reimburse FGIC for any payment made under its Policy resulting from Morgan Stanley's failure to make payments due under the Repurchase Protocol.[3] (Comp. ¶ 258.) Under Section 3.03(c), FGIC also is entitled to reimbursement of the fees, costs and expenses it incurs to enforce its rights and remedies, "including reasonable attorneys' and accountants' fees." (*Id.* ¶ 260.)

Finally, Morgan Stanley agreed in Section 5.02(b) that no remedy conferred in the Insurance Agreement is exclusive of "any other available remedy," and that each remedy is cumulative of other remedies provided in the Insurance Agreement, the Underlying NIM Securities Purchase Agreement "or existing at law or in equity." (Doc. 16.)

**F. Morgan Stanley's False and Misleading Disclosures Breached its Warranties**

Since closing, the performance of the Transaction has been horrendous. (Comp. ¶ 69.) The losses on the Mortgage Loans have been so grave as to have made any further payment of principal or interest on the insured Notes highly unlikely. Under the terms of the parties' agreement and the irrevocable Policy, FGIC's claim payment for loss of principal must be made at maturity. (Policy at 1, NYSCEF Doc. 17.) FGIC has incurred that irrevocable obligation, and has made, and continues to make, claim payments to cover the interest shortfalls. (Comp. ¶¶ 238-39.) Those shortfalls would not exist had Morgan Stanley complied with the Repurchase Protocol upon its discovery of pervasive breaches of warranties.

As the losses mounted, FGIC retained consultants to conduct loan level analysis of a number of the Underlying Securitizations, focusing on two metrics having a material effect on the performance of the Transaction: the combined loan-to-value ratio ("CLTV ratio") and the

[3] Consistently, Section 5.02(a)(i) entitles FGIC to declare all indebtedness owed by Morgan Stanley, including amounts due under the Repurchase Protocol, "immediately due and payable."

owner-occupancy status, *i.e.*, whether the mortgaged property serves as the borrower's primary residence. (*Id.* ¶¶ 72-74.) These reviews uncovered material discrepancies between what Morgan Stanley represented and the true attributes of the Mortgage Loans. (*Id.* ¶¶ 74, 75-90.)

By themselves, these discrepancies evidenced breaches of the Transaction Warranties and Underlying NIM Warranties because the information that Morgan Stanley provided about the Mortgage Loans was materially false and misleading. Additionally, these discrepancies indicated that the Offering Documents were materially false and misleading in representing that the Mortgage Loans were originated in accordance with the described underwriting guidelines. With respect to the 22 Underlying Securitizations in which Morgan Stanley played a role, the findings show that Morgan Stanley did not follow its represented review and diligence protocols when it acquired those Mortgage Loans for securitization. (*Id.* ¶ 89.)

Evidence in the public domain further demonstrates breaches of the Transaction Warranties and the Underlying NIM Warranties. (*Id.* ¶¶ 103, 104, 129-224.) These and other disclosures regarding Morgan Stanley's contemporaneous knowledge establish that it knew that the originators of the Mortgage Loans had abandoned sound underwriting practices and systematically inflated property appraisals. (*Id.* ¶¶ 226-37.)

### G. Morgan Stanley Breached and Frustrated Its Repurchase Obligations

As noted, Morgan Stanley promised to repurchase the Underlying NIM Securities upon its discovery of a breach of its warranties. It did not do so. Accordingly, on May 24, 2013, FGIC demanded the repurchase of 30 of the Underlying NIM Securities in accordance with the Repurchase Protocol. Morgan Stanley nonetheless failed to repurchase ***any*** of these Underlying NIM Securities. (Comp. ¶¶ 91-96.) FGIC then sent a written notice of an Event of Default under the Insurance Agreement and commenced this lawsuit. (*Id.* ¶ 97.)

## ARGUMENT

The inquiry on a motion to dismiss is narrow. The court must "accept the facts alleged as true … and determine simply whether the facts alleged fit within any cognizable legal theory." The complaint must be construed "liberally" and the court must accept as true not only "the complaint's material allegations" but also "whatever can be reasonably inferred there from" in favor of the pleader. *P.T. Bank Cent. Asia v. ABN Amro Bank N.V.*, 301 A.D.2d 373, 375-76 (1st Dep't 2003). Morgan Stanley's motion fails under this standard.

### I. There is No Basis for Limiting FGIC's Damages Claims at the Pleading Stage

Morgan Stanley inflicted severe harm on FGIC at the close of the Transaction, which was marked by Morgan Stanley's breaches of warranties, and thereafter by its refusal to comply with its repurchase obligations. The harm is readily determinable based upon the breaching loans that already have defaulted, resulting in (i) claim payments already made for interest shortfalls, (ii) over $125 million in outstanding principal of the insured Notes that FGIC will be required to pay at maturity, and (iii) additional interest shortfalls that can easily be estimated using accepted modeling techniques. *See Assured Guar. Mun. Corp. v. Flagstar Bank, FSB,* 920 F. Supp. 2d 475, 514-515 (S.D.N.Y. 2013). Under established law, therefore, FGIC's damages claims may proceed, particularly at the pleading stage. *Black v. Chittenden*, 69 N.Y.2d 665, 668 (1986) (there is no requirement "that the measure of damages be pleaded, 'so long as there are facts alleged from which damages may properly be inferred'"); *see also Wathne Imports, Ltd. v. PRL USA, Inc.*, 101 A.D.3d 83, 89 (1st Dep't 2012) ("Where the existence of damages is certain, and the only uncertainty is as to its amount, the plaintiff will not be denied recovery . . . .") (internal citation omitted).[4]

[4] Moreover, although it already has incurred harm, FGIC would be entitled to proceed even if it had not. The law is clear that a plaintiff has a cognizable claim for breach of contract immediately upon breach,

Disregarding this precedent, Morgan Stanley advances three flawed theories to argue that FGIC improperly seeks what Morgan Stanley terms "future damages." First, Morgan Stanley misreads the Insurance Agreement to conjure up a limitation on damages where there is none. Second, it interprets authority concerning "rescissory damages" to preclude damages based upon financial projections, which is not remotely what the decisions hold. And third, Morgan Stanley argues that FGIC's damages are unduly "speculative" based on cases that both disprove its point and underscore the premature nature of its request.

Laid bare, Morgan Stanley asserts that FGIC cannot recover damages for principal shortfalls ***before 2037***, when its claim payments are due. This position effectively immunizes Morgan Stanley from recourse. Morgan Stanley's reasoning should be rejected.[5]

### A. Morgan Stanley Misconstrues the Insurance Agreement

Morgan Stanley begins by misreading the Insurance Agreement to bar suit by FGIC for "future damages." (MS Br. 8.) A full reading of the provision, Section 5.02(a)(iii), states that upon an Event of Default, which Morgan Stanley concedes, 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 Transaction Document ***or to enforce performance and observance of any obligation, agreement or covenant*** of the Responsible Party, the

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***even if no damages have been incurred at all***. *See Ely-Cruikshank Co. v. Bank of Montreal*, 81 N.Y.2d 399, 402 (1993); *see also Tigrent Grp., Inc. v. Process America, Inc.*, No. 12 Civ. 1314, 2012 U.S. Dist. LEXIS 78821, at *9 (E.D.N.Y. June 6, 2012) ("the fact that Process America has not yet suffered damages is not fatal to its claim"); *LNC Inv., Inc. v. First Fidelity Bank, N.A.*, No. 92 Civ. 7584, 1994 U.S. Dist. LEXIS 2549, at *14 (S.D.N.Y. Mar. 4, 1994) ("the uncertainty of the damages requested by plaintiffs does not preclude plaintiffs from bringing this action"), *modified on other grounds*, 1994 U.S. Dist. LEXIS 6880 (S.D.N.Y. May 24, 1994).

[5] Interpreting the agreement to preclude FGIC from having any claim for breach of warranty would be an absurd and commercially unreasonable result. *See Lipper Holdings, LLC v. Trident Holdings, LLC*, 1 A.D.3d 170, 171 (1st Dep't 2003) (citations omitted) ("A contract should not be interpreted to produce a result that is absurd, commercially unreasonable or contrary to the reasonable expectations of the parties.").

> Depositor or the Co-Issuers under this Insurance Agreement or any of the other Transaction Documents.

(Doc. 16. (emphasis added).) Morgan Stanley suggests the term "then due" limits FGIC's recovery to claim payments already made. But the provision says no such thing. The plain meaning of the term "then due" is a reference to amounts *owed by Morgan Stanley* under "any" Transaction Document, *e.g.*, the repurchase price that Morgan Stanley must pay under the Repurchase Protocol, or damages for Morgan Stanley's breaches of its Transaction Warranties.

The remainder of this provision entitles FGIC to bring suit "to enforce performance and observance of any obligation, agreement or covenant" of Morgan Stanley. This plainly allows FGIC to enforce, *inter alia*, Morgan Stanley's contractual repurchase obligation, regardless of when, or if, any claim payments are made.

Finally, the Insurance Agreement affords multiple, overlapping and alternative remedies for Morgan Stanley's breaches. In Section 5.02(b), the parties made clear that "no remedy herein conferred or reserved is intended to be exclusive of any other available remedy, but each remedy shall be cumulative and shall be in addition to other remedies given under this Insurance Agreement, the Indenture and any other Transaction Document ***or existing at law or in equity***." (*Id.* (emphasis added).) This language affords FGIC the broadest rights to seek recourse, without limiting damages.

### B. Morgan Stanley Misapplies Decisions Addressing Equitable Relief

Finding no valid limitation on FGIC's damages in the Insurance Agreement, Morgan Stanley cites decisions addressing the availability of equitable damages, portraying them as precluding an award of "future" damages. Those are two separate issues. The availability of equitable rescissory damages turns on, *e.g.*, whether there are adequate legal damages. Whether legal damages are properly calculated based on projections, however, is a separate question

addressed by a different line of authority (discussed in the following section). Either type of damages may (or may not) involve an analysis of amounts to be paid in the future.

Morgan Stanley contends that the First Department's decision in *MBIA v. Countrywide* bars the recovery of "future damages." (MS Br. at 9.) In fact, that decision addressed whether MBIA could recover equitable rescissory damages. The First Department held that equitable relief tantamount to rescission was unavailable, as MBIA had issued an irrevocable policy. 105 A.D.3d 412, 413 (1st Dep't 2013). But the court clarified that MBIA was entitled to recover its claim payments as legal damages under New York Insurance Law provisions governing material misrepresentations and breach of material warranties—Sections 3105 and 3106. *Id.* at 412. Indeed, the First Department rejected defendants' position that the insurer could not recover claim payments "without resort to rescission." *Id.*

Consistently, on remand, Justice Bransten construed this language as authorizing the recovery of claim payments as a form of compensatory damages. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, No. 602825/2008, 2013 N.Y. Misc. LEXIS 1818, at *28 (Sup. Ct. N.Y. Cnty. Apr. 29, 2013) ("While rescissory damages are unavailing . . . nothing in the contract language cited above bars other forms of monetary damages, such as compensatory relief.") MBIA thus moved forward with its demand for claim payments.[6]

Also instructive are the two federal cases that the First Department cited in endorsing the recovery of claim payments. First, in *Assured v. Flagstar*, Judge Rakoff awarded the financial guaranty insurer all of its claim payments, without relying on the concept of rescissory damages. *Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, No. 11 Civ. 2375, 2013 U.S. Dist. LEXIS

[6] S*ee also Ins. Co. of N. Am. v. Kaplun*, 274 A.D.2d 293, 298 (2d Dep't 2000) ("An insurance carrier that is precluded from rescinding a policy retroactively due to fraud is not without means of redress. For example, if the insurer is required to pay benefits under the policy to a third party, it may bring an action against its insured to recover such losses.")

57126, at *2-3 (S.D.N.Y. Apr. 12, 2013). The court accepted Assured's expert evidence that, "had Flagstar repurchased the defective loans at issue in this case, Assured would be reimbursed for all claims it has paid in relation to the Trusts—and that there would have been a substantial 'cushion' in each Trust to protect against future claims Assured might have to pay." *Id.* Indeed, the court included ***in compensatory damages*** claim payments that had not been made at the pleading stage (which Morgan Stanley dubs "future" claim payments). *Id.* Second, in *Syncora v. EMC*, Judge Crotty concluded he had authority to award rescissory damages, but ruled that it was premature on summary judgment to decide whether legal damages were adequate to compensate the insurer for claim payments made and to be made. *Syncora Guar. Inc. v. EMC Mortg. Corp.*, 874 F. Supp. 2d. 328, 340 (S.D.N.Y. 2012).

Ignoring these leading authorities, Morgan Stanley cites *Assured Guar. Mun. Corp. v. RBS Secs. Inc.*, No. 13 Civ. 2019, 2014 U.S. Dist. LEXIS 63811 (S.D.N.Y. May 8, 2014), incorrectly, for the proposition that future claim payments are never recoverable. In fact, the *Assured v. RBS* decision did not take issue with Justice Bransten's decision after remand in *MBIA v. Countrywide* that future damages may be sought on claims "for breaches of representations and warranties." 2014 U.S. Dist. LEXIS 63811, at *6. Rather, the court distinguished the case before it as one asserting only fraud claims. *Id.* Thus, even accepting the court's ruling, it supports FGIC's claims.[7]

### C. FGIC's Damage Claim is Not Unduly "Speculative"

Faced with controlling authority allowing the recovery of claim payments as legal damages, Morgan Stanley incorrectly asserts that New York law precludes as unduly speculative

[7] But even as applied to fraud claims, the court erred. As noted above, the governing First Department decision in *MBIA v. Countrywide* allowed recovery of claim payments under both breach of warranty and fraudulent inducement claims.

damages based on projected claim payments. (MS Br. at 10-11.) But Morgan Stanley's first case on this point observed that "[l]oss of future profits as damages"—which are necessarily based on future projections—"***have been permitted*** in New York under long-established and precise rules of law." *Kenford Co. v. Cnty. of Erie*, 67 N.Y.2d 257, 261 (1986) (emphasis added).[8] Indeed, "it is hardly novel in the law for damages to be projected into the future." *Van Wagner Advert. Corp. v. S&M Enter.*, 67 N.Y.2d 186, 194 (1986) (holding that damages should have been extended ***past the time of trial***). *See Ashland Mgmt. Inc. v. Janien*, 82 N.Y.2d 395 (1993) (upholding damages award based on projections); *Wathne v. PRL*, 101 A.D.3d at 89, (reversing exclusion of expert projections at trial). As these authorities illustrate, it is common for experts to calculate damages based on projections in commercial disputes.[9] Thus, it is premature to determine now that FGIC cannot offer proof of its future claim payments as part of its compensatory damages.

The second case Morgan Stanley cites, *Assured v. Flagstar*, does not support its argument either. As discussed above, Judge Rakoff allowed an analogous claim to proceed to verdict. 2013 U.S. Dist. LEXIS 57126, at *2-3. Morgan Stanley cites the second post-verdict decision in that case, in which the court refused to enhance the award to encompass additional future claims. (MS Br. at 10-11.) What Morgan Stanley omits is that Judge Rakoff declined to do so because

[8] Notably, the *Kenford* decision issued ***after verdict***.

[9] The award of "future damages" is well-accepted in personal injury litigation. *See, e.g., Reed v. City of New York*, 304 A.D.2d 1, 4 (1st Dep't 2003) (affirming substantial award of "future damages," including future expenses and lost earnings capacity, which was based on testimony of medical and economic experts). Additionally, CPLR 5041 expressly addresses how "future damages" are incorporated into a judgment after verdict. *See also Tractebel Energy Mktg., Inc. v. AEP Power Mktg., Inc.*, 487 F.3d 89, 112, n.26 (2d Cir. 2007) ("If it is true that projecting profits over twenty years is so absurdly speculative that economists can do no better than fortune tellers, it would have been imprudent for the parties to enter a contract for such a long period in the first place. ***The reality, however, is that long-term contracts are entered into regularly, and a degree of speculation is acceptable in the business community***.") (emphasis added).

the damages model Assured's expert presented did not support such a recovery. 2013 U.S. Dist. LEXIS 57126, at *3. This decision did not address the legal availability of recovery for future claim payments upon proof sufficient for that purpose.

Finally, Morgan Stanley professes concern regarding the impact of pending suits by trustees for certain of the Underlying Securitizations. (MS Br. at 11.) There are steps that can be taken later in the litigation to avoid double recovery without denying FGIC all recovery. For example, in *Assured v. Flagstar*, the court awarded the insurer damages, but ordered that if recoveries are greater than predicted, "Assured will be responsible for paying this money to Flagstar." 892 F. Supp. 2d at 606.

## II. FGIC Asserts Actionable Breaches of Morgan Stanley's Warranties

Morgan Stanley seeks dismissal of FGIC's breach of warranty claims on the theory that two particular types of representations—CLTV ratios and owner-occupancy statistics—are not actionable. This argument fails for two reasons. First, FGIC's breach claims are not limited to these two misrepresentations. Second, Morgan Stanley warranted that these represented attributes were not false or ***misleading***. The represented CLTV ratios and owner-occupancy statistic were misleading because they were reported without disclosing that the originators and Morgan Stanley had abandoned sound practices required to ensure their veracity. This Court has repeatedly found such misleading disclosures actionable, even under the higher pleading standard for fraud. They are certainly sufficient for a breach of warranty claim.

### A. FGIC's Contract Claims Are Based on More Than Misstated CLTV Ratios and Owner-Occupancy Statistics in the Offering Documents

Morgan Stanley focuses on misstated CLTV ratios and owner-occupancy statistics in the Offering Documents, but ignores additional misrepresentations alleged in the Complaint. These include representations in the Offering Documents regarding (1) compliance with underwriting

guidelines used to originate the Mortgage Loans (Comp. ¶ 36 and Ex. C), and (2) Morgan Stanley's mortgage-loan operations (*Id.* ¶ 37.)[10] These misstatements breach the Transaction Warranties. (*Id.* ¶¶ 39, 81, 103.) For example, Section 2.02(k) of the Insurance Agreement warrants that ***no statement*** of material fact in the Offering Documents is materially misleading. (*Id.* ¶ 61.) Section 2.01(j) is even broader, assuring that no "other information" furnished to FGIC concerning an Underlying Securitization or Underlying NIM Security is materially misleading. (*Id.*) Morgan Stanley's failure to address these other bases for FGIC's first two causes of action defeats its argument.[11]

### B. FGIC Pleads Actionable Breaches of Morgan Stanley's Warranty that CLTV Ratios Were Not Misleading

Morgan Stanley contends that misleading CLTV ratios in the materials it furnished to FGIC do not breach its warranties because the Underlying Securitization documents defined "CLTV" without reference to the actual value of the properties in question. (MS Br. at 14.)

Morgan Stanley warranted, however, that none of the materials furnished to FGIC "contain any statement of material fact which was untrue ***or misleading*** in any material respect when made" or "***omit to state a material fact*** necessary to make the statements made therein, in light of the circumstances under which they were made, ***not misleading***."[12] (Comp. ¶ 61, *quoting* Insurance Agreement §§ 2.01(j), (k) (emphasis added).) The proper question is not whether the CLTVs were mathematically accurate, but whether reporting them, accompanied by

[10] The false CLTVs and owner-occupancy statistics are evidence of these other breaches (*see, e.g.*, Comp. ¶¶ 81, 89), but are not the only evidence alleged. (*See, e.g., id.* ¶¶ 104-237.)

[11] These warranty breaches are the basis for FGIC's first two claims, for breach of warranties and for material breach of the Insurance Agreement. Morgan Stanley's argument appears to ignore both FGIC's third claim, addressed in Section III(C) below, for breach of Morgan Stanley's separate obligation under the Insurance Agreement to provide notice of defaults in the Underlying Securitizations (Comp. ¶¶ 253-256) and FGIC's fourth claim, for reimbursement of expenses, including attorneys' fees, incurred in enforcing FGIC's rights. (*Id.* ¶¶ 257-261.)

[12] *See also* Comp. ¶ 61, *quoting* the Rating Agency Warranty, Insurance Agreement § 2.01(q).

representations that the originators used sound appraisal practices to value the mortgaged properties, tended to mislead investors about the quality of the Mortgage Loans.[13]

The publication of "CLTVs" in the Offering Documents—without disclosing the originators' wholesale abandonment of sound appraisal practices—was materially misleading. The Complaint alleges that the appraisals were false based on AVM analysis finding inflated appraisals for 75,036 of the Mortgage Loans (Comp. ¶¶ 83-90), as corroborated by similar analyses of the same transactions conducted by other plaintiffs (*see id.* ¶¶ 100-101). FGIC also alleged the systematic manipulation and inflation of appraisals both industry-wide (*id.* ¶¶ 117-123) and by the ten largest originators of the Mortgage Loans. (*Id.* ¶¶ 124-224).[14] This Court repeatedly has held that analogous (and less detailed) allegations are sufficient to establish falsity under the particularity standards applicable to a fraud claim. *See HSH Nordbank AG v. Barclays Bank PLC*, No. 652678/2011, 2014 N.Y. Misc. LEXIS 845, at *57-58 (Sup. Ct. N.Y. Cnty. Mar. 3, 2014) (Friedman, J.) (finding actionable misrepresentations based upon "conclusory" allegations that offering materials failed to disclose systematically inflated appraisals).[15] Accordingly, FGIC's allegations satisfy the notice pleading standards applicable here.

Ignoring the claim alleged, Morgan Stanley argues that FGIC's allegations are insufficient because "there is no allegation here that Morgan Stanley knew the CLTV ratios to be

[13] Mathematical accuracy is but one aspect of the truth or falsity of the warranty. Describing a number as a "loan-to-value" ratio, when it bears no relation to actual value, is enough to render the warranty false.

[14] In addition, FGIC alleged that Morgan Stanley failed to disclose that it abandoned its represented due diligence protocols purportedly designed to ensure the veracity of loan attributes. (Comp. ¶¶ 225-37.)

[15] *See also, IKB Int'l, S.A. in Liquidation v. Morgan Stanley*, No. 653964/2012, 2014 N.Y. Misc. LEXIS 4668, at *12 (Sup. Ct. N.Y. Cnty. Oct. 28, 2014) (Friedman, J.). *HSH* also disposes of Morgan Stanley's argument that CLTV ratios are inactionable because they are based on appraisals, which according to Morgan Stanley, are themselves inactionable statements of opinion. (MS Br. at 15). As the Court explained, "this argument is without merit, where the complaint pleads facts calling into question the factual bases for the appraisals." *HSH*, 2014 N.Y. Misc. LEXIS 845, at *58-59. As discussed, FGIC's Complaint contains extensive allegations calling into question the factual bases for the appraisals conducted by the originators of the Mortgage Loans.

based on inflated appraisals." (MS Br. at 15.) But scienter is not required for a breach-of-warranty claim, and Morgan Stanley's knowledge (or lack thereof) has no bearing on whether the *statements themselves* were misleading. Additionally, Morgan Stanley is simply wrong about FGIC's pleading. The Complaint alleges that by acting as a leading RMBS sponsor, ***"Morgan Stanley was aware*** . . . of the systematic abandonment of underwriting guidelines" in connection with the Mortgage Loans "even in the transactions in which it played no direct role." (Comp. ¶ 231 (emphasis added).) Further, as a result of its diligence process, "***Morgan Stanley also knew*** about the industry-wide and borrower-specific inflation of appraisals" that tainted the reported CLTV ratios. (*Id.* ¶ 235 (emphasis added).) Although not necessary for a contract claim, the Complaint plainly alleges Morgan Stanley's knowledge of inflated appraisals.

### C. FGIC Pleads Actionable Breaches Based on Morgan Stanley's Warranty that Owner-Occupancy Statistics Were Not Misleading

Morgan Stanley similarly asserts that FGIC fails to state a claim based on misstated owner-occupancy statistics in the materials Morgan Stanley furnished because the figures reflect what the borrowers represented. (MS Br. at 13.) This argument again ignores the nature of the warranties Morgan Stanley provided. The question is whether these statistics, coupled with representations that the originators employed rigorous underwriting standards, would mislead investors about the quality of the Mortgage Loans.

The publication of owner-occupancy statistics in Offering Documents—without disclosing that these figures were the product of wide-spread borrower falsification—was materially misleading. (Comp. ¶¶ 34, 80, 103, 104, 235.) The Complaint alleges the falsity of the owner-occupancy data based upon a loan level analysis of 150,469 Mortgage Loans (*id.* ¶¶ 75-82), as corroborated by analyses conducted on the same transactions. (*Id.* ¶¶ 100-101.) Further, the Complaint alleges the systematic falsification of occupancy information in

conjunction with the abandonment of sound origination practices both industry-wide (*id.* ¶¶ 105-116) and by the originators of nearly 80% of the Mortgage Loans. (*Id.* ¶¶ 124-224.)[16] These allegations are similar to those held sufficient to establish the falsity of owner-occupancy data under the heightened pleading requirements for fraud; the same conclusion must follow here, under the more lenient pleading standards applicable to breach of contract claims. *See HSH*, 2014 N.Y. Misc. LEXIS 845, at *59-60 (*citing Allstate Ins. Co. v. Credit Suisse Secs. (USA) LLC*, No. 650547/2011, 2014 N.Y. Misc. LEXIS 428 (Sup. Ct. N.Y. Cnty. Jan. 24, 2014)).[17]

Morgan Stanley nonetheless seeks dismissal on the grounds that there are no allegations "that Morgan Stanley knew or would have known of false reports by borrowers about their occupancy statuses." (MS Br. at 13.) Morgan Stanley is trebly wrong. First, as explained above, FGIC need not allege scienter in support of its breach-of-warranty claim. Second, Morgan Stanley ignores the burden it assumed through its warranties as to the accuracy of the Offering Documents, assuring that the *statements themselves* were not false or misleading. Third, the Complaint actually contains the allegations that Morgan Stanley says are missing. For example, FGIC specifically alleges Morgan Stanley's awareness of the systematic disregard of underwriting guidelines by loan originators, including "in the transactions in which it played no direct role." (Comp. ¶ 231.) Further, based on Morgan Stanley's diligence process, the Complaint alleges: "***Morgan Stanley knew*** about both industry-wide and originator-specific ***falsification of loan applications by borrowers***," which tainted the reported owner-occupancy statistics. (*Id.* ¶ 235 (emphasis added).) These allegations would be sufficient to support a fraud

[16] As noted, *supra*, FGIC also alleged that Morgan Stanley abandoned its represented due diligence protocols purportedly designed to ensure the veracity of loan attributes. (Comp. ¶¶ 225-37.)

[17] This Court also rejected Morgan Stanley's argument that owner-occupancy statistics are not actionable because of disclaimers that they reflect borrower representations. *HSH,* 2014 N.Y. Misc. LEXIS 845, at *60.

claim, and are more than adequate under the notice pleading standards applicable here.

## III. Morgan Stanley Misstates the Elements and the Allegations of FGIC's Claims

Morgan Stanley argues that FGIC "fails to plead causation" (MS Br. at 15-19), contending that FGIC was required to, but fails to, allege: (1) that misstated CLTV ratios and owner-occupancy status "caused its losses" (*id.* at 15), *i.e.*, caused FGIC to make claim payments; and (2) that these same warranty breaches "materially increased the risk of loss" (*id.* at 17). Morgan Stanley is wrong on both counts. First, the sole decision that Morgan Stanley cites expressly holds that there is ***no*** requirement to establish a direct causal connection between warranty breaches and claim payments under Section 3106 of the Insurance Law. That holding was affirmed by the First Department. Second, contrary to Morgan Stanley's assertion, the Complaint repeatedly alleges that misstated CLTV ratios and owner-occupancy status materially increased FGIC's risk of loss from issuing its Policy.

### A. Morgan Stanley Reads in a Non-Existent "Causation" Requirement

The foundation for Morgan Stanley's entire argument is one sentence in *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 34 Misc. 3d 895 (Sup. Ct. N.Y. Cnty. Jan. 3, 2012) (Bransten, J.) ("*Countrywide I*"), *modified*, 105 A.D.3d 412 (1st Dep't 2013) ("*Countrywide II*"), but Morgan Stanley ignores that decision's actual holding, which expressly rejected the position Morgan Stanley advocates here.

*Countrywide I* granted a monoline insurer's summary judgment motion on the requirements of a claim for breach of warranties under Section 3106. MBIA argued that the insurer "must prove only that the breach of warranty materially increased the insurer's risk" and "is not required to establish a causal link between Countrywide's alleged misrepresentations and claims MBIA made under the insurance policies." 34 Misc. 3d at 901. In response, Countrywide contended, "MBIA must establish that the claims payments it made pursuant to its

issued policies were caused by Countrywide's alleged misrepresentations and not by another cause, including the economic downturn that began in late 2007." *Id.*

Justice Bransten ruled squarely in MBIA's favor: "[t]he court therefore finds that no basis in law exists to mandate that MBIA establish a direct causal link between the misrepresentations allegedly made by Countrywide and claims made under the policy." *Id.* at 906. Accordingly, the court's order at the end of the decision provided that it is:

> ORDERED that MBIA Insurance Corporation's motion for partial summary judgment is granted to the extent that MBIA must establish for its claim for breach of the Insurance Agreement against Countrywide Home Loans, Inc. ("CHL") that CHL's breach of warranties in the issued insurance policies' transaction document increased the risk profile of the issued insurance policies and ***MBIA is not required to establish a direct causal connection between proven warranty breaches by CHL and MBIA's claim payments made*** pursuant to the insurance policies at issue;

34 Misc. 3d at 913 (emphasis added). The First Department expressly acknowledged and affirmed this portion of the ruling: "pursuant to Insurance Law §§ 3105 and 3106, ***plaintiff was not required to establish causation*** in order to prevail on its fraud and breach of contract claims." 105 A.D.3d at 412, 414 (emphasis added). Moreover, the First Department specifically rejected Countrywide's attempt to read a causation requirement into a Repurchase Protocol that was not provided for by its plain terms. *Id.* at 413, *citing Syncora v. EMC and Assured v. Flagstar, supra.* FGIC is not required to prove, much less plead, that the warranty breaches caused it to make claim payments.

Given the holding of *Countrywide I*, Morgan Stanley plainly misconstrues the statement that MBIA needed to prove that it was "damaged as a direct result." MS Br. at 17 (citing *Countrywide I* at 906). This statement, which referred to what must be proven at trial, as

opposed to the pleading stage,[18] cannot be construed as a nullification of the decision's holding and order, particularly not after its affirmance by the First Department. Indeed, other courts have reached similar conclusions,[19] and Morgan Stanley cites no contrary holding.

### B. FGIC's First Two Claims Properly Plead an Increased Risk of Loss

With respect to FGIC's first claim (for breach of warranties) and second claim (for breach of the Insurance Agreement) Morgan Stanley contends that the Complaint fails to allege that discrepancies in CLTV and owner-occupancy statistics materially increased FGIC's risk of loss. (MS Br. at 17.) As explained in Section II above, FGIC's breach claims are not based exclusively on these two metrics.[20] Thus, the Motion fails to address each basis for FGIC's claims. But even focusing solely on CLTV ratios and owner-occupancy statistics, Morgan Stanley simply misreads the Complaint: there are clear allegations that misstatement of these attributes materially increased FGIC's risk of loss on its Policy.

For example, the Complaint alleges "material misstatements of owner-occupancy status

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[18] It appears that this sentence meant that MBIA would need to demonstrate at trial how the material misrepresentations increased its risk of loss. Whether such proof at trial is "not . . . an easy task," as Morgan Stanley argues, is irrelevant at the pleading stage. Moreover, this statement must be read in the context of the parties' dispute as to causation. It was common ground that "wrongdoing causing loss must be proven before damages are levied," *id.* at 902, but the parties disagreed as to "when causation occurs." *Id.* at 901. MBIA argued that "causation occurred, and liability results" when Countrywide made its misrepresentations and induced issuance of the policy. *Id.* On the other hand, Countrywide contended that MBIA must prove "its claims payments were directly and proximately caused by Countrywide's alleged misrepresentations," *id.* at 902, which the court rejected.

[19] *See Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, 892 F. Supp. 2d 596, 603 (S.D.N.Y. 2012) ("plaintiff must only show that the breaches materially increased its risk of loss. Put another way, the causation that must here be shown is that the alleged breaches caused plaintiff to incur an increased risk of loss."); *Syncora v. EMC Mortg. Corp.*, 874 F. Supp. 2d 328, 339 (S.D.N.Y. 2012) ("Syncora may establish a material breach of the I&I by proving that EMC's alleged breaches increased Syncora's risk of loss on the Policy, irrespective of whether the breaches caused any of the HELOC loans to default.").

[20] FGIC also alleges materially misleading warranties about the Mortgage Loans being originated in accordance with prudent guidelines, and concerning Morgan Stanley's diligence process for reviewing loan originators. (*See, e.g.*, Comp. ¶¶ 36, 37 and Ex. C.) Moreover, with respect to its claim for material breach of the Insurance Agreement, FGIC alleged that Morgan Stanley's breaches are so substantial and fundament as to defeat the object of the parties in entering into the Transaction. (*Id., e.g.*, ¶ 251.)

and CLTV ratios," which "had the effect of materially increasing FGIC's risk of loss from participating in the Transaction." (Comp. ¶¶ 12, 34-35.) Subsequent paragraphs elaborate further. After explaining that whether a mortgaged property is a borrower's primary home is an important indicator of credit quality (*id.* ¶ 75), the Complaint alleges that overstated owner-occupancy statistics "meant that FGIC faced a ***materially greater risk of loss*** from agreeing to participate in the Transaction than had been represented to be the case." (*Id.* ¶ 82 (emphasis added).) Similarly, the Complaint explains the heightened risks of loans with CLTV ratios in excess of 90% (*id.* ¶ 85) and 100% (*id.* ¶ 86), and that the understatement of CLTV ratios meant that "***FGIC faced a materially greater risk of loss*** from agreeing to participate in the Transaction than had been represented to be the case." (*Id.* ¶ 90 (emphasis added).) These allegations meet the requirements of Section 3106.

Finally, Morgan Stanley suggests that FGIC somehow bears a greater pleading burden because of the "sensitive" nature of the Underlying NIM Securities, *i.e.*, that because each NIM security "is extremely sensitive to losses on the related Mortgage Loans," FGIC must allege that misreported CLTV ratios and owner-occupancy statistics "made its obligation to insure NIM securities . . . riskier." (MS Br. at 17-18.) Morgan Stanley's own description of the sensitivity of NIM securities to losses on the Mortgage Loans provides such a linkage: any misrepresentation materially increasing the risk of loss in the Mortgage Loans necessarily increased risk of loss in the "sensitive" NIM securities backed by them.

But the Complaint goes even further, linking these two attributes to a defining feature of the Underlying NIM Securities: a right to receive "prepayment charges and/or excess cashflow" from the Mortgage Loans. (Comp. ¶ 2.) After explaining that occupancy status and CLTV ratios are "critical attributes" for assessing the likelihood of repayment, the Complaint alleges that

these same attributes were material to the credit quality of the Underlying NIM Securities, "***and in particular to the prepayment charges and excess cashflows*** that the Underlying NIM Securities could reasonably be expected to generate." (*Id*. ¶ 10 (emphasis added).) Thus, Morgan Stanley's warranties about these attributes "were material to FGIC's decision to issue its Policy." (*Id.*) Further, the Complaint alleges that breach of these warranties "materially and adversely affected FGIC's risk of loss as the insurer of the Transaction." (*Id.* ¶ 14.) Although FGIC has no obligation to plead a link between misstated CLTV ratios and owner-occupancy and losses on the Underlying NIM Securities, the Complaint actually does so.

### C. FGIC's Third Claim is Adequately Pleaded

Morgan Stanley's attack on FGIC's third claim is entirely misguided. This claim alleges that Morgan Stanley breached its obligation to advise FGIC of defaults in the Underlying Securitizations and Underlying NIM Securities. The Motion disputes neither the existence of this obligation, nor its breach. Instead, the Motion asserts a failure to allege "causation" or that this breach "materially increased FGIC's risk of loss." (MS Br. at 19.)

This argument confuses a warranty, which provides assurance about an existing fact, with a covenant, which is an obligation to perform after closing. Section 3106 of the Insurance Law applies to warranties, not covenants. Thus, FGIC's third claim is not subject to any requirement to allege increased risk of loss, much less causation. It is a simple claim that Morgan Stanley failed to comply with a contractual obligation after closing. Subject to notice pleading standards, no allegations of damages are necessary. It any event, the Complaint alleges that Morgan Stanley's failure to provide the required notice concealed its breaches of representations and warranties (Comp. ¶ 71), causing damages in an amount to be proven at trial. (*Id*. ¶ 256). These allegations are sufficient at the pleading stage.

## CONCLUSION

For all of the foregoing reasons, FGIC respectfully requests that the Court deny Morgan Stanley's motion to dismiss in its entirety.

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Respectfully submitted,

PATTERSON BELKNAP WEBB & TYLER LLP

By: /s/ Erik Haas

Erik Haas (ehaas@pbwt.com)
Henry J. Ricardo (hjricardo@pbwt.com)
Jonathan Hatch (jhatch@pbwt.com)
PATTERSON BELKNAP WEBB & TYLER LLP
1133 Avenue of the Americas
New York, NY 10036-6710
Telephone: (212) 336-2000
Fax: (212) 336-2222

*Attorneys for Financial Guaranty Insurance Co.*