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

MBIA INSURANCE CORPORATION, Plaintiff, - against - CREDIT SUISSE SECURITIES (USA) LLC, DLJ MORTGAGE CAPITAL, INC., and SELECT PORTFOLIO SERVICING, INC. Defendants.	:	Index No. 603751/09

PLAINTIFF MBIA INSURANCE CORPORATION'S
MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO RENEW

PATTERSON BELKNAP WEBB & TYLER LLP

Erik Haas (ehaas@pbwt.com)
Nicolas Commandeur (ncommandeur@pbwt.com)
David Slarskey (dnslarskey@pbwt.com)
1133 Avenue of the Americas
New York, New York 10036
Telephone: (212) 336-2000
Fax: (212) 336-2222

Attorneys for MBIA Insurance Corporation

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Plaintiff MBIA Insurance Corporation ("MBIA") submits this memorandum of law in support of its motion pursuant to CPLR § 2221(e) for leave to renew consideration of the Court's June 1, 2011 Order (the "June 2011 Order") in light of intervening authority.

PRELIMINARY STATEMENT

New and controlling authority from the Appellate Division, First Department, requires the reinstatement of MBIA's fraudulent inducement claim. On July 30, 2010, this Court issued a decision and order denying defendants' motion to dismiss MBIA's fraudulent inducement claim (the "July 2010 Order"). But on June 1, 2011, after almost a year of discovery, the Court *sua sponte* vacated the July 2010 Order and, among other things, dismissed MBIA's fraud claim. The recent First Department decision clarifies that the July 2010 Order was correct and the June 2011 Order was in error with respect to the fraud claim. Accordingly, the June 2011 Order should be vacated and the July 2010 Order reinstated.

In both the July 2010 and June 2011 Orders, the Court acknowledged that MBIA had adequately pleaded material misrepresentations and justifiable reliance upon those misrepresentations in asserting its claim for fraudulent inducement against Credit Suisse Securities (USA) LLC ("CS Securities"). In June 2011, however, the Court reversed course and dismissed MBIA's fraudulent inducement claim on the basis that the claim duplicated MBIA's breach of contract claims against DLJ Mortgage Capital, Inc. ("DLJ"). That is, the Court held that the core representations giving rise to the fraud claim were duplicative of, and "subsumed by," the contractual warranties provided by DLJ. (Attachment 1, June 2011 Order at 19-20.)

That ruling was directly contrary to the Court's July 2010 holding that "[c]ontractual warranties against false or misleading information do not limit a plaintiff to a breach of contract action." In reaching that holding, the Court stated that it "concurs with the [trial] court's reasoning on this point in *MBIA v. Countrywide*, NY Co. Index No. 602825/08

(Sup Ct, NY County 2009)." The *Countrywide* trial court reasoned that "[b]ecause MBIA's claim relates to representations in connection with entering into the Insurance Agreement, and not simply a breach of its terms, the fraud claim is not duplicative." (Attachment 2, July 2010 Order at 13-14.) It is that holding—quoted by this Court in its July 2010 Order but not in its June 2011 Order—that the First Department recently affirmed.

In a decision dated June 30, 2011, the First Department stated unequivocally that a fraud claim "will be upheld when a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, even though the same circumstances also give rise to the plaintiff's breach of contract claim." *MBIA v. Countrywide*, Index No. 602825/08, N.Y. Slip Op. 05640, at 9 (1st Dep't June 30, 2011) (Attachment 3). "It is of no consequence that some of the allegedly false representations [underlying the fraudulent inducement claim] are also contained in the agreements as warranties and form a basis of the breach of contract claim." *Id.* at 11.

The First Department's decision in *Countrywide* clarifies that MBIA's fraudulent inducement claim in this action should not have been dismissed. Indeed, MBIA's fraudulent inducement claim that was the subject of the appeal in *Countrywide* is based on virtually identical allegations as those asserted against Credit Suisse in this action. In both cases, the misrepresentations are encompassed by contractual warranties and form the basis for alternative claims for fraudulent inducement and breach of contract.

MBIA respectfully submits therefore that its fraud claim should be reinstated, along with its damages and jury demands stricken by the June 2011 Order.

BACKGROUND

MBIA alleges that CS Securities fraudulently induced it to enter into an insurance agreement and issue an irrevocable financial guaranty policy that guarantees hundreds of millions of dollars in payments to securityholders of a residential mortgage backed securitization ("RMBS") trust. MBIA's claim for fraudulent inducement is based upon CS Securities's misrepresentations concerning (i) Credit Suisse's business practices and (ii) the attributes of the securitized loans. In the alternative, MBIA alleges that DLJ and Select Portfolio Servicing, Inc. ("SPS") breached the fraudulently-induced agreements. Specifically with respect to DLJ, MBIA alleges the falsity of the broad warranties DLJ provided concerning the truth and completeness of information provided to MBIA, and loan-level warranties concerning, *inter alia*, the origination, underwriting, and attributes of the loans.

A. The Court's July 2010 Order Rejects Credit Suisse's "Duplication" Argument and Upholds MBIA's Fraudulent Inducement Claim

On May 14, 2010, Defendants (collectively, "Credit Suisse") moved to dismiss, *inter alia*, MBIA's fraudulent inducement claim against CS Securities. On July 30, 2010, this Court denied the motion, rejecting Credit Suisse's two arguments for dismissing the fraud claim.

First, the Court held that "Defendants' arguments that MBIA cannot establish justifiable reliance are foreclosed by a recent Court of Appeals' ruling on this issue and a number of persuasive trial court decisions. In particular, defendants' contention that a sophisticated entity such as MBIA was required to look beyond Credit Suisse's contractual representations and conduct extensive due diligence was rejected in *DDJ Capital Management, LLC v. Rhone Group L.L.C.*, [15] NY3d [147], 2010 WL 2516811, 2010 N.Y. No. 131 (2010)." (July 2010 Order at 10.) The Court explained at length that under *DDJ*, the warranties MBIA secured entitled it to proceed with its fraud claim regardless of the ProSupp disclosures (*id.* at 9), which "merely

raised the possibility that there would be some variations in the quality of the loans due to the identity of the loan originator and other factors." (*Id.* at 11-13.) The Court further ruled that, "even prior to the reversal in *DDJ*, MBIA prevailed on a CPLR 3211 motion in another mortgage securitization action where arguments identical to those raised here were proffered." (*Id.* at 12, citing *MBIA Ins. Co. v. Countrywide Home Loans, Inc.*, No. 602825/08 (Sup. Ct. N.Y. County 2009).) "Consequently, in the complex and fact-sensitive context in which this case arises, the court cannot hold as a matter of law that MBIA was obligated to perform due diligence beyond that which it pursued in extracting the various representations and warranties from Credit Suisse." (*Id.* at 12.)

Having rejected the challenge to MBIA's justifiable reliance, the Court then turned to Credit Suisse's assertion that MBIA's fraudulent inducement claim failed as duplicative of its breach of contract claims. The Court rejected that argument as well, holding that "[c]ontractual warranties against false or misleading information do not limit a plaintiff to a breach of contract action. 'A warranty is not a promise of performance, but a statement of present fact . . . a fraud claim can be based on a breach of contractual warranties notwithstanding the existence of a breach of contract claim.'" (July 2010 Order at 13 (quoting *First Bank of Ams. v. Motor Car Funding, Inc.*, 257 A.D.2d 287, 292 (1st Dep't 1999)).)

Of particular significance to this motion, in the July 2010 Order, the Court stated that it "concurs with the [trial] court's reasoning on this point in *MBIA v. Countrywide*, NY Co Index No. 602825/08 (Sup Ct NY County 2009)." (July 30 2010 Order at 13-14.) As this Court accurately noted, in the analogous *Countrywide* action "MBIA alleges that Countrywide misrepresented, among other things, the origination and quality of the mortgage loans to induce [MBIA] into entering the Insurance Agreement. Because MBIA's claim relates to

representations in connection with entering into the Insurance Agreement, and not simply a breach of its terms, the fraud claim is not duplicative." (July 2010 Order at 13-14 (citing *MBIA v. Countrywide*).) This Court held, correctly, that the trial court's reasoning in *Countrywide* applies equally to this action, and required the rejection of Credit Suisse's motion to dismiss.

B. The Court's June 2011 Order Adopts Credit Suisse's "Duplication" Argument to Dismiss MBIA's Fraudulent Inducement Claim

As of April 2011, the parties had engaged in nearly a year of discovery encompassing MBIA's fraud claim. During this time, MBIA obtained compelling evidence that—as it had alleged—Credit Suisse had, *inter alia*, (i) concealed the true quality of, and the high breach rate in, the loan pools from which the securitized loans were drawn; (ii) concealed deficiencies in its monitoring of origination practices; (iii) misrepresented its quality control practices, which discovery has shown were designed to conceal (rather than reveal, as represented to MBIA) defects in the securitized loans; and (iv) misrepresented its repurchase practices, which Credit Suisse used to obtain double recoveries on securitized loans to the detriment of the securityholders and MBIA. Evidence of these fraudulent practices was filed with the Court on March 25, 2011 in connection with MBIA's motion to compel discovery. (*See* Docket Nos. 106-107, 113-115 (Affirmations of E. Haas, D. Slarskey, and A. Azhari, and corresponding memoranda of law).)

Nonetheless, without request or prompting from Credit Suisse and without any intervening change in the law, the Court informed the parties in April 2011 that it intended, *sua sponte*, to vacate its July 2010 Order and dismiss MBIA's fraudulent inducement claim. Thereafter, by letter dated April 11, 2011 (Attachment 4), MBIA offered to supply the Court with additional briefing to address any legal concerns the Court might have concerning the adequacy of the pleadings. The Court declined that request. MBIA then provided the Court with

citations to nine other trial court opinions considering similar allegations by financial guaranty providers, each upholding the insurer's claim of fraudulent inducement alongside of claims for breach of contract in connection with insurance policies issued for RMBS transactions.[1] Credit Suisse did not identify any authority supporting the dismissal of MBIA's fraudulent inducement claim.

MBIA also informed the Court that Countrywide had appealed the trial court decision that the Court had cited favorably in its July 2010 Order, *i.e.*, *MBIA v. Countrywide*, 602825/08 (Sup. Ct. N.Y. County 2009). Countrywide argued on appeal that MBIA's fraudulent inducement claim in that action failed as duplicative of its breach of contract claims. MBIA advised this Court that, as of April 2011, that appeal had been fully briefed and argued to the First Department. And MBIA proposed that, given the similarity of the allegations in the two cases and in the interest of judicial economy and efficiency, the Court await a ruling on the appeal before it *sua sponte* dismissed MBIA's fraud claim. The Court declined to do so.

The Court instead issued its June 2011 Order, dismissing MBIA's fraudulent inducement claim against CS Securities. The Court first reiterated its holding on the issue of justifiable reliance from the July 2010 Order with respect to the core misrepresentations encompassed by the warranties MBIA secured. In particular, the Court held that "defendants' arguments that, as a matter of law, MBIA was not justified in relying on defendants' contractual

[1] *See, e.g.*, *MBIA Ins. Corp. v. Morgan Stanley, et al*, No. 29951-10 (Sup. Ct. Westchester County May 26, 2011); *MBIA Ins. Corp. v. GMAC Mortgage, LLC*, No. 600837/2010, 30 Misc. 3d 856 (Sup. Ct. N.Y. County Dec. 10, 2010) (Fried, J.); *MBIA Ins. Corp. v. Countrywide et al.*, No. 602825/08 (Sup. Ct. N.Y. County Apr. 29, 2010) (Bransten, J.); *Syncora Guarantee Inc. v. Countrywide Home Loans*, No. 650042/09 (Sup. Ct. N.Y. County Apr. 2, 2010) (Bransten, J.); *MBIA Ins. Corp. v. Residential Funding Co., LLC*, No. 603552/08, 2009 WL 5178337 (Sup. Ct. N.Y. County Dec. 22, 2009) (Fried, J.); *MBIA Ins. Co. v. Countrywide et al.*, No. 602825/08, 2009 WL 2135167 (N.Y. Sup. Ct. July 8, 2009) (Bransten, J.); *MBIA Ins. Corp. v. Royal Bank of Canada*, No. 12238/09, 2010 WL 3294302 (Sup. Ct. N.Y. County Aug. 19, 2010) (Scheinkman, J.); *Ambac v. EMC*, No. 08 Civ 9464, Slip. Op., Feb. 8, 2011, 2011 WL 566776 (S.D.N.Y. 2011) (Berman, J.); and *Ambac v. EMC*, No. 08 Civ 9464, Slip. Op., Jan. 28, 2011 (S.D.N.Y. 2011) (Katz, M.J.).

representations and warranties . . . is foreclosed by the Court of Appeals decision in *DDJ Mgmt, LLC v. Rhone Group, LLC*, 15 NY3d 147, 154-56 (2010). *DDJ* holds that it is a question of fact whether a sophisticated party reasonably relies on facts contained in a bargained for contractual representation." (June 2011 Order at 18.)

With the relevant inquiry narrowed, the Court then reversed its prior ruling on the issue of duplicativeness. The Court first identified the core representations underlying MBIA's fraudulent inducement claim against CS Securities that were "subsumed by" warranties in the insurance agreement between MBIA and DLJ:

> …that [MBIA] was fraudulently induced because the loans did not conform to the originators' underwriting guidelines; that the loans purchased from originating banks, other than New Century, did not conform to Credit Suisse's Designated Guidelines; that the information on the loan tape was inaccurate; that the Prospectus and ProSupp did not adequately disclose information about the loans; and that Credit Suisse would back or vouch for the New Century loans by providing express contractual representations and warranties.

June 2011 Order at 19-20 (also noting "additional allegations subsumed by the contractual warranties").) The Court concluded, without reference to its earlier ruling or the analogous decisions cited by MBIA, that these alleged misrepresentations could not support a fraudulent inducement claim solely because such claim "duplicates the breach of contract claims" based upon false contractual warranties. (June 2011 Order at 18-19.) MBIA has noticed its appeal of the Court's June 2011 Order.[2]

[2] MBIA has also appealed the Court's ruling that certain other alleged representations were insufficient to sustain a claim for fraudulent inducement, either as "puffery" (*see* June 2011 Order at 17-18) or because, according to the Court, MBIA did not investigate the facts or obtain contractual warranties affirming the representations. (*Id.* at 21-23.) These additional findings do not impact whether MBIA's fraud claim should be reinstated: As this Court itself held, the core of MBIA's alleged misrepresentations were affirmed by contractual warranty.

C. The First Department Rejects the "Duplication" Argument and Affirms MBIA's Analogous Fraudulent Inducement Claim

On June 30, 2011, just weeks after this Court issued its dismissal order, the First Department ruled on Countrywide's appeal of the trial court's decision on its motion to dismiss in *MBIA v. Countrywide*. Among other things, the First Department clarified that a fraud claim should "be upheld when a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, even though the same circumstances also give rise to the plaintiff's breach of contract claim." *See MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 2011 N.Y. Slip Op. 05640 at 9 (citing *First Bank of Ams. v. Motor Car Funding*, 257 A.D.2d 287 (1st Dep't 1999)). In terms equally applicable to this action, the First Department held that "[b]ecause MBIA alleges misrepresentations of present facts, and not future intent, made with the intent to induce MBIA to insure the securitizations, the fraud claim survives. It is of no consequence that some of the allegedly false representations are also contained in the agreements as warranties and form the basis of the breach of contract claims." *Id.* at 10-11 (citation omitted). This intervening and controlling clarification of the law requires reinstatement of MBIA's fraudulent inducement claim.

ARGUMENT

A party seeking leave to renew to must "demonstrate that there has been a change in the law that would change the prior determination." CPLR § 2221(e)(2). An "intervening clarification of the law" by the Appellate Division is a proper basis for such motion. *See Roundabout Theater Co., Inc. v. Tishman Realty & Constr. Co., Inc.*, 302 A.D.2d 272, 272 (1st Dep't 2003). But the parties' may not seek renewal for issues not implicated by new facts or intervening law. *See, e.g., East 115th St. Realty Corp. v. Focus & Struga Bldg. Developers LLC*, No. 604164/2007 (Sup. Ct. N.Y. County, Jan. 12, 2011) (*citing Reyes v. Sequeira*, 64 A.D.3d

500, 503 (1st Dep't 2009). Under this standard, the sole issue in this motion is whether the "intervening clarification of the law" by the First Department in the *MBIA v. Countrywide* action requires reinstatement of MBIA's fraudulent inducement claim in this action. It does.

I. The First Department's Ruling in *Countrywide* Requires Reinstatement of MBIA's Fraudulent Inducement Claim

The new and controlling ruling by the First Department in *Countrywide*, coupled with this Court's reasoning in its July 2010 and June 2011 Orders, compels reinstatement of MBIA's fraudulent inducement claim.

To start, the *Countrywide* appellate decision conclusively endorses this Court's reasoning on the "duplication" issue in its July 2010 Order. Therein, this Court quoted the *Countrywide* trial court opinion for the proposition that"[b]ecause MBIA's claim relates to representations in connection with entering into the Insurance Agreement, and not simply a breach of its terms, the fraud claim is not duplicative.'" (July 2010 Order at 13-14, quoting *MBIA v. Countrywide*, No. 602825/08 (Sup Ct. N.Y. County 2009).) That reasoning has now been affirmed.

Conversely, the First Department's decision unequivocally rejects the key holding of this Court's June 2011 Order. After finding that MBIA adequately pleaded justifiable reliance with respect to the core representations on which its fraud claim is based, this Court nonetheless held that the representations could not support a fraud claim solely because they are duplicative of contractual warranties. (*See* June 2011 Order at 18-21.) That holding has been squarely rejected by the First Department, which unequivocally held that a fraud claim "will be upheld when a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, even though the same circumstances also give rise to the

plaintiff's breach of contract claim." *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 2011 N.Y. Slip Op. 05640 at 9.

Moreover, the alleged misrepresentations held viable by the First Department are virtually identical to those this Court alleged were actionable but for the duplication issue. Specifically, in *Countrywide*, the First Department affirmed MBIA's fraud claim based upon misrepresentations including:

> …false and misleading ***loan tapes and prospectuses***. The fraud claim also lists 4,689 loans that allegedly failed to comply with Countrywide's ***underwriting guidelines***, specifies that the defective loans had ***debt-to-income ratios or combined loan-to-value ratios*** exceeding guideline levels and alleges that the loans were approved on the basis of ***unverified borrower-stated income that was patently unreasonable***.

Id. at 10 (emphasis added). In this case, the Court rejected the same alleged misrepresentations as "subsumed by" and "duplicative of" contractual warranties, noting in particular that MBIA alleged that it:

> …was fraudulently induced because the loans did not conform to the originators' ***underwriting guidelines***; that the loans purchased from originating banks, other than New Century, did not conform to Credit Suisse's Designated Guidelines; that the information on the ***loan tape was inaccurate***; that the Prospectus and ProSupp ***did not adequately disclose information about the loans***; and that Credit Suisse would back or vouch for the New Century loans by providing express contractual representations and warranties…
>
> Other allegations allegedly constituting fraud … include: qualifying buyers who made ***false statements on loan applications***, and ***stated income that was not subjected to a reasonableness test***.

(June 2011 Order at 19-20 (emphasis added).) In light of First Department's ruling, it is inescapable that MBIA has adequately pleaded its claim for fraudulent inducement against CS Securities, at least upon those representations that the Court acknowledged were affirmed by the

contractual warranties.[3]

II. MBIA's Jury and Fraud Damages Demands Should Be Reinstated

In an order dated January 26, 2011, the Court held that "a party bringing claims of fraudulent inducement and breach of contract [has the right] to have the former claim put to a jury regardless of the presence of a jury waiver clause in the disputed contract," and denied Defendants' motion to dismiss MBIA's demand for a jury. (Attachment 5, the "January 2011 Order.") The June 2011 Order, however, struck MBIA's jury demands on the grounds that the fraudulent inducement claim was dismissed. (June 2011 Order at 26.) For the reasons stated in the Court's January 2011 Order, because the fraudulent inducement claim should be reinstated, the jury demand should be as well.

In addition, the Court dismissed MBIA's demand for punitive damages because it related "only to the now dismissed fraud claim." (June 2011 Order at 25.) Because the fraud claim must be reinstated, the punitive damages demand should be reinstated as well. The same reasoning applies to reinstating MBIA's demand for consequential damages. *See, e.g.*, *New York City Transit Authority v. Morris J. Eisen, P.C.*, 276 A.D.2d 78, 85 (1st Dep't 2000) ("[D]efendant is liable for all harm caused by plaintiff's justifiable reliance upon the [fraudulent] misrepresentation"); *MBIA v. Residential Funding Co., LLC*, No. 603552/08, 2009 WL 5178337 (Sup. Ct. N.Y. County, Dec. 22, 2009) (denying dismissal of demand for punitive and consequential damages as "premature" in light of viable fraud claim).

[3] Though Credit Suisse now argues, in pre-motion conference, that its ProSupp disclosures raised sufficient red flags to warrant dismissal of MBIA's fraud claim even under *DDJ*, this Court's clear and repeated ruling on this issue in the June 2011 Order is consistent with its prior order and every other decision addressing analogous allegations. *See supra* n.1 (citing cases). Moreover, there is no intervening authority upon which Credit Suisse could base a motion to renew for this point of law.

CONCLUSION

For the foregoing reasons, MBIA respectfully requests leave to renew consideration of the June 2011 Order, and asks the Court to (i) vacate its June 1, 2011 Order; and (ii) reinstate its July 30, 2010 and January 26, 2011 Orders, *inter alia* denying Defendants' motion to dismiss MBIA's claim for fraudulent inducement, and its jury and damages demands.

Dated: New York, New York
July 22, 2011

PATTERSON BELKNAP WEBB & TYLER LLP

By: /s/ Erik Haas

Erik Haas (ehaas@pbwt.com)
Nicolas Commandeur (ncommandeur@pbwt.com)
David Slarskey (dslarskey@pbwt.com)
1133 Avenue of the Americas
New York, New York 10036
Telephone: (212) 336-2000
Fax: (212) 336-2222

Attorneys for MBIA Insurance Corporation