SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: CHARLES E. RAMOS **PART** 53
Justice

Index Number : 600976/2010
TSL (USA) INC.,
vs.
OPPENHEIMERFUNDS, INC.,
SEQUENCE NUMBER : 011
AMEND SUPPLEMENT PLEADINGS

INDEX NO. _____
MOTION DATE _____
MOTION SEQ. NO. _____

The following papers, numbered 1 to _____, **were read on this motion to/for** _____

Notice of Motion/Order to Show Cause — Affidavits — Exhibits _____ **No(s).** _____

Answering Affidavits — Exhibits _____ **No(s).** _____

Replying Affidavits _____ **No(s).** _____

Upon the foregoing papers, it is ordered that this motion is

Motion is decided in accordance with accompanying Memorandum Decision.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE
FOR THE FOLLOWING REASON(S):

Dated: 10/12/2012

_____, J.S.C.
CHARLES E. RAMOS

1. **CHECK ONE:** ..... ☐ CASE DISPOSED ☒ NON-FINAL DISPOSITION
2. **CHECK AS APPROPRIATE:** .....**MOTION IS:** ☒ GRANTED ☐ DENIED ☐ GRANTED IN PART ☐ OTHER
3. **CHECK IF APPROPRIATE:** ..... ☐ SETTLE ORDER ☐ SUBMIT ORDER
☐ DO NOT POST ☐ FIDUCIARY APPOINTMENT ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION

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TSL (USA) INC., BRYANT PARK FUNDING LLC, and THE BANK OF NOVA SCOTIA, NEW YORK AGENCY,

Plaintiffs,

Index No. 600976/10

- against -

OPPENHEIMERFUNDS, INC., HARBOURVIEW ASSET MANAGEMENT CORPORATION, and AAARDVARK IV FUNDING LIMITED,

Defendants.

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Hon. Charles Edward Ramos, J.S.C.:

In motion sequence 011, the plaintiffs TSL (USA) Inc. ("TSL"), Bryant Park Funding LLC ("Bryant"), and the Bank of Nova Scotia, New York Agency[1] ("BNS", together with TSL and Bryant, the "Lenders") move pursuant to CPLR 3025(b) to amend the amended complaint to: 1) clarify the nature of its allegations on its first cause of action for breach of contract against Oppenheimer, 2) assert two theories of damages in relation to its first cause of action, and 3) assert a fourth cause of action for common law fraud against the defendants Oppenheimer Funds, Inc. ("Oppenheimer") and Harbourview Asset Management Corporation ("Harbourview").

Background

Briefly, the relevant facts as alleged in the proposed third

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[1] BNS is a successor in interest to Liberty Bank. There was no opposition to this portion of the Lender's motion to amend (Transcript, Jun. 5, 2012, 30:21-31:9).

amended complaint (the "Complaint") are as follows:

AAArdvark IV

This action arises out of an arbitrage[2] system created by Oppenheimer in September 2006, known as AAArdvark IV Funding Limited ("AAArdvark IV", together with Oppenheimer and Harbourview, the "Defendants"). The purpose of Aaardvark IV was to borrow money at a low interest rate and then use that money to purchase securities that generate a higher interest rate, thus allowing Oppenheimer to retain the "spread," the difference between the two interest rates, as profit (Complaint, ¶ 23).

Since Oppenheimer was unable to borrow money at a low enough interest rate to generate a sufficient spread, it contracted with the Lenders to borrow that money and then lend it to Aaardvark IV to invest in securities (Complaint, ¶ 24).

The Lenders are all "commercial paper conduits," which are companies that issue short term "commercial paper." Commercial paper is a debt instrument maturing overnight, a week, a month, or even slightly longer. When the commercial paper is issued, the Lenders are effectively borrowing money at a low interest rate from various entities, which must be repaid when the debt matures. As a result, entities with large amounts of cash can

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[2] The simultaneous buying and selling of identical securities in different markets, with the hope of profiting from the price difference between those markets (Black's Law Dictionary [9th ed. 2009], arbitrage).

use commercial paper to generate interest income from its money, while also ensuring that the money will be safe and available for use in the near future (Complaint, ¶¶ 25, 27).

The Waterfall

The distribution of the interest income from AAArdvark IV is structured as a "waterfall" so that certain parties to the transaction are paid before others. For example, the waterfall provides that AAArdvark IV reimburses the Lenders for the cost of funding, which is the interest due to the various entities that purchased the commercial paper, before it distributes a fixed interest rate of 23 basis points ("bps") on the loans to the Lenders, and that the final distribution of the remaining interest income would go to Oppenheimer as its profit. The principal of the Lender's loans would be repaid when the securities in AAArdvark IV's portfolio were redeemed or matured to the extent that monies were received for them (Complaint, ¶¶ 28, 33, 37).

Oppenheimer projected that every $100 million of securities in AAArdvark IV would generate $380,000 above the Lenders' cost of funding. Of the $380,000, $80,000 would be paid for insurance and various fees, $230,000 would be paid to the Lenders as their fixed return of 23bps, and the remaining $70,000 would be paid to Oppenheimer as arbitrage profit (Complaint, ¶ 32). It was projected that, at its maximum lending facility limit of $1.3

billion, AAArdvark IV would generate annual arbitrage profits of over $910,000 for Oppenheimer (*id.*).

The Lenders all committed to lend AAArdvark IV specific amounts through the execution of note purchase agreements (the "NPAs"). TSL and BNS committed to lend $500 million and Bryant committed to lend $300 million, for a total lending facility amount of $1.3 billion (Complaint, ¶ 29). Pursuant to the NPAs, AAArdvark IV would repay the Lenders' loan principal as principal payments on the AAArdvark IV notes (the "Notes").

In addition, Oppenheimer caused AAArdvark IV to retain Oppenheimer as the administrative agent pursuant to an administration agreement (the "Administration Agreement") and an affiliate, Harbourview, as investment advisor, pursuant to an investment advisory agreement (the "Advisory Agreement") (Complaint, ¶¶ 30-1). AAArdvark IV paid fees to Oppenheimer and Harbourview for these services in addition to any distributions of interest income (*id.*). The Lenders were expressly intended to be third party beneficiaries of Harbourview's obligations under the Advisory Agreement and Oppenheimer's obligations under the Administration Agreement (Complaint, ¶¶ 45, 47).

In order for AAArdvark IV to purchase securities, Harbourview would identify a security to be purchased by AAArdvark IV and issue a written "Notice of Borrowing" to all the Lenders requesting that they advance money equal to the cost of

[* 6]

the securities (Complaint, ¶ 34). Pursuant to the NPAs, the Lenders were only obligated to fund the request if all Conditions Precedent to Funding listed in §§ 2.1 and 4.3 of the NPAs ("Conditions Precedent") were satisfied, and each "Notice of Borrowing" was deemed a certification that all Conditions Precedent were satisfied (*id.*).

If the request was funded, then Harbourview would purchase the securities for AAArdvark IV. The securities in AAArdvark IV's portfolio were pledged as collateral for the Lender's loan principal (Complaint, ¶ 35).

Amortization Event

The Lenders were not provided a right to accelerate in the event of breach, instead the Lenders were given an irrevocable right to terminate funding to AAArdvark IV upon the occurrence of an Amortization Event[3] (Complaint, ¶ 39). If an Amortization Event occurred, AAArdvark IV would go into a "pay down" mode, whereby it would be permitted to make only required waterfall payments, and repay the Lender's principal upon the maturity or redemption of the AAArdvark IV securities (Complaint, ¶ 40).

As administrative agent, Oppenheimer agreed, *inter alia*, to provide monthly portfolio reports for the AAArdvark IV securities and to determine daily if an Amortization Event was likely to occur, and notify the Lenders if an Amortization Event did occur

[3] (Complaint, Exhibit 4, § 1).

(Complaint, ¶ 44).

As investment advisor, Harbourview agreed to identify the securities that AAArdvark IV would purchase and monitor AAArdvark IV and take appropriate action to ensure its compliance with the Investment Policy as stated in §§ 2.01(I) and 2.02 of the Advisory Agreement.[4] A breach of the Investment Policy that remained unremedied after a 30 day period after it was known to AAArdvark IV and Harbourview would trigger an Amortization Event (Complaint, ¶ 46).

On April 16, 2010, the Lenders commenced this action alleging that Oppenheimer and Harbourview breached the Administrative Agreement and Advisory Agreement, respectively.

On January 31, 2011, the Lenders amended their complaint to withdraw certain causes of action against the Defendants.

Discussion

In the instant motion, the Lenders now seek leave to amend the amended complaint to clarify the nature of its allegations and the damages it seeks on its cause of action for breach of contract against Oppenheimer and to assert a fourth cause of action for common law fraud against Oppenheimer and Harbourview.

CPLR 3025(b) provides that leave to amend the complaint, absent prejudice or surprise, shall be freely granted. However, courts have "held that leave to amend a complaint is not granted

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[4] (Complaint, Exhibit 5, §§ 2.01 [I] and 2.02).

upon mere request without a proper showing. Rather, in determining whether to grant leave to amend, a court must examine the underlying merit of the causes of action asserted..." (*NAB Const. Corp. v Metro. Transp. Auth. by New York City Tr. Auth.*, 167 AD2d 301 [1st Dept 1990]).

The Lenders argue that leave to amend should be granted because the amendments in the Complaint are not palpably insufficient or clearly devoid of merit and would not result in prejudice or surprise to the Defendants.

First, the Lenders want to clarify that its first cause of action for breach of contract is not seeking rescission, but rather, the foreseeable damages resulting from Oppenheimer's breach. The Lenders allege that it incurred damages due to Oppenheimer's failure to notify the Lenders of the occurrence of Amortization Events.

Second, in support of its first cause of action, the Lenders seek leave to assert two theories of damages.

Loan Damages

In its first theory, the Lenders seek to recover the damages that arose from Oppenheimer's breach of the Administrative Agreement and the resulting increased loan exposure incurred by the Lenders (the "Loan Damages").

The Lenders allege that if Oppenheimer fulfilled its duties and obligations under the Administrative Agreement, the Lenders

would not have advanced over $767 million in loans to AAArdvark IV after the occurrence of an Amortization Event. As a result of Oppenheimers' breach, the Lenders allege that they have incurred over $481 million in damages from losses stemming from the additional loan exposure.[5]

Thus, the Lenders argue that in order to put them in the same position they would be in if Oppenheimer properly performed, they should be permitted to recover the total unpaid loan balance currently owed by AAArdvark IV. Furthermore, the Lenders argue that its damages should not be offset by the value of the AAArdvark IV securities portfolio because Oppenheimer will be subrograted to the Lenders' rights under the its agreements with AAArdvark IV. In essence, the Lenders seek to have Oppenheimer, as the breaching party, bear all the losses that arose and may thereafter arise from its breach of the Administrative Agreement.

Note Value Damages

In its alternative theory for damages, the Lenders seek to recover the loss in value of the Notes attributable to loans made after an Amortization Event occurred (the "Note Value Damages").

The Lenders' loan principal is repaid as principal payments on the Notes. The payments are derived from the redemption or maturity of the securities in the AAArdvark IV securities

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[5] The $481 million represents the loan balance when taken into account with repayments that were made at the time of the filing of this motion.

portfolio and it is the only source of repayment for the Lenders' loan principal.

Consequently, the value of the Notes is based on the likelihood that AAArdvark IV will receive full principal and interest payments on the securities in the portfolio.

The Lenders allege that the current aggregate balance of the Notes is $584 million, but the value of the Notes, as determined by the AAArdvark IV securities portfolio, has fallen by hundreds of millions. The Lenders further allege that the decline in value, if measured by the market value of the AAArdvark IV securities portfolio amounts to a loss exceeding $179 million, and on an expected cash flow value, the loss exceeds $92 million. The Lenders contend that they have already realized $16 million of those losses.

The Defendants argue that the proposed amendments to the amended complaint with respect to "Loan Damages" still seek rescissory damages, as in the return the entirety of their funds, despite the Lenders' representations that the cause of action is for breach of contract and not rescission.

Furthermore, with respect to the Note Value Damages, the Defendants argue that the Lenders fail to allege a causal connection between the decline in value of the Notes and the actions of the Defendants. Rather, the Defendants contend that the decline in value is actually due to the decline in the

overall economy and market forces.

However, the Lenders counter that they are not investors that assumed the inherent risks of the market because they bargained for specific provisions to restrict the types of securities that AAArdvark IV could purchase and set certain conditions that would terminate the lending facility. The Lenders argue that they contracted for the proceeds of AAArdvark IV and not the value of the AAArdvark IV securities portfolio (*Lappin v Greenberg*, 34 AD3d 277, 280 [1st Dept 2006]).

In an exercise of its discretion, this Court shall grant leave to the Lenders to clarify their breach of contract causes of action and to assert the Loan Damages and Note Value Damages theories, but this Court will finally determine the appropriate measure of damages upon the completion of discovery. The proposed amendments are not clearly devoid of merit and any additional discovery that would be conducted would not result in prejudice to either party because the market value of the AAArdvark IV securities portfolio is readily ascertainable. Furthermore, at this juncture of the litigation, it cannot be said that the decline in value is due to the economic crisis as a matter of law (*MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 296 [1st Dept 2011] ["it is the job of the factfinder to determine which losses were proximately caused by misrepresentations and which were due to extrinsic forces"]).

Fraud

Finally, the Lenders seek leave to amend the complaint to assert an additional cause of action for fraud against Oppenheimer and Harbourview.

The Lenders allege that facts revealed during discovery demonstrate that, not only did Oppenheimer and Harbourview breach the Agreement by failing to notify the Lenders of an Amortization Event, but subsequently, Oppenheimer and Harbourview affirmatively concealed that fact from the Lenders, with the intent of inducing the Lenders to continue lending money to AAArdvark IV.

The Lenders allege that Oppenheimer and Harbourview, *inter alia*, misrepresented in the March and June Portfolio Reports that AAArdvark IV made all waterfall payments in accordance with the Security Agreement and that AAArdvark IV did not suffer an Amortization Event in connection with their waterfall payments in the March or June Settlement Periods (Complaint, ¶¶ 136-7).

The Lenders allege that if they were properly notified of the true financial condition of AAArdvark IV, they would have exercised their right to terminate the lending facility pursuant to the terms of the Administration Agreement.

In opposition, the Defendants argue that the cause of action for fraud is duplicative of the Lenders' causes of action for

breach of contract. They argue that the Complaint alleges that Oppenheimer and Harbourview misrepresented their compliance with the provisions of the Administration Agreement and Advisory Agreement, respectively. Consequently, the Lenders' cause of action for fraud is merely a restatement of its cause of action for breach of contract. Additionally, the Defendants argue that rescissory damages are unavailable to the Lenders.

"A fraud claim should be dismissed as redundant when it merely restates a breach of contract claim" (*First Bank of Americas v Motor Car Funding, Inc.*, 257 AD2d 287, 291 [1st Dept 1999]). However, "a cause of action for fraud may be maintained where a plaintiff pleads a breach of duty separate from, or in addition to, a breach of the contract" (*id.*). For example, "[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.*, 87 AD3d 287, 293 [1st Dept 2011]).

In *MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, the plaintiff MBIA provided guarantee insurance on mortgages that were securitized by the defendant Countrywide.[6] Pursuant to

[6] "Securitization involves packaging numerous mortgage loans into a trust, issuing debt securities in the trust and selling those notes, known as residential mortgage-backed securities, to

written agreements, the subject transaction between the parties provided that "MBIA guaranteed the payments of interest and principal to investors...[therefore,] any shortfalls in trust payments to the investors would be covered by MBIA" (*id.* at 291).

In 2009, MBIA commenced the action alleging that Countrywide "made material misrepresentations and breached warranties concerning the origination and quality of the mortgage loans underlying the securitizations," and that the misrepresentations of present facts, specifically the quality of the mortgages, were made with the intent to induce MBIA to provide the guarantee insurance (*MBIA* at 291-4). MBIA argued that had it known of the true quality of the mortgages, it would not have issued the insurance coverage. As a result, "MBIA had paid $1.4 billion on its guarantees and faces future claims in excess of hundreds of millions of dollars more" (*id.* at 291).

The court held that the allegations that Countrywide's misrepresentations of present facts were made with the intent to induce MBIA into the subject transactions were sufficient to sustain an cause of action for fraud independent of MBIA's cause of action for breach of contract.

The court stated that "[i]t is of no consequence that some

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investors. The securities are backed by the mortgages, and the borrowers' payments of principal and interest on their mortgage loans are used to pay the investors who purchased the securities" (*MBIA* at 290).

of the allegedly false representations are also contained in the agreements as warranties and form a basis of the breach of contract claim" (*MBIA* at 295). "Unlike a misrepresentation of future intent to perform, a misrepresentation of present facts is collateral to the contract...therefore involves a separate breach of duty" (*MBIA* at 293 *quoting First Bank* at 292).

The Lenders allege in this action that in April and July 2007, Oppenheimer and Harbourview issued Portfolio Reports that represented to the Lenders that AAArdvark IV had sufficient funds to cover its expenses and that no Amortization Event had occurred. Based on their misrepresentations, the Lenders continued to issue loans to AAArdvark IV, ultimately leading to losses in the amount of $440 million.

The Lenders now allege that facts revealed in discovery demonstrate that Oppenheimer and Harbourview were aware that AAArdvark IV did not have sufficient funds to cover its expenses and that an Amortization Event did occur during March and June Settlement Periods despite the representations in the Portfolio Reports. The Lenders further allege that discovery has revealed that Oppenheimer and Harbourview, with knowledge of the Amortization Event in April and July 2007, took steps to conceal AAArdvark IV's actual performance by transferring funds from other accounts to hide its shortfalls (Complaint, ¶¶ 63-107).

The core of the Lenders' cause of action for fraud is that

Oppenheimer and Harbourview intentionally misrepresented the performance of AAArdvark IV, specifically, that its expenses exceeded its income, to induce the Lenders to not terminate the lending facility and to continue to loan funds to AAArdvark IV.

This Court finds that the Lenders have sufficiently alleged a cause of action for fraud that is independent of their cause of action for breach of contract and damages that flow from the fraud. The determination as to the Lenders' ability to recover rescissory damages is premature at this phase of the litigation.

Therefore, the Court will permit the Lenders to assert its cause of action for fraud against Oppenheimer and Harbourview.

Accordingly, it is

ORDERED that the plaintiffs' motion to amend is granted in its entirety and the third amended complaint in the proposed form annexed to the moving papers shall be deemed served upon service of a copy of this order with notice of entry thereof, and it is further

ORDERED that the defendants shall serve an answer to the amended complaint within 20 days form the date of said service, and it is

ORDERED that the plaintiffs' note of issue is stricken and plaintiffs shall serve a copy of this order on the Trial Support Office (Room 158) with notice of entry within 30 days from the date of entry.

This constitutes the decision and order of this Court.

Dated: October 12, 2012

ENTER:

J.S.C.

HON. CHARLES E. RAMOS