Ambac Assur. Corp. v Countrywide Home Loans, Inc.
2016 NY Slip Op 32482(U)
December 19, 2016
Supreme Court, New York County
Docket Number: 653979/2014
Judge: Marcy Friedman

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK – PART 60

PRESENT: Hon. Marcy Friedman, J.S.C.

AMBAC ASSURANCE CORPORATION and THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION,

Plaintiffs,

– against –

COUNTRYWIDE HOME LOANS, INC., COUNTRYWIDE SECURITIES CORP., COUNTRYWIDE FINANCIAL CORP., and BANK OF AMERICA CORP.,

Defendants.

Index No.: 653979/2014

DECISION/ORDER

This fraud action arises out of the issuance by plaintiff monoline insurer Ambac Assurance Corporation (Ambac) of policies insuring eight residential mortgage-backed securities (RMBS) transactions that closed between 2005 and 2007 (the Transactions).[1] (Compl., ¶¶ 1, 7.) The policies at issue (the Policies) have since been allocated to plaintiff The Segregated Account of Ambac Assurance Corporation. (Id., ¶¶ 17-18.) As alleged in the complaint, defendant Countrywide Home Loans, Inc. originated or supplied all or a significant portion of the loans for the various Transactions (id., ¶ 21), while defendant Countrywide Securities Corporation was the underwriter for one of the Transactions. (Id., ¶ 22.) Both Countrywide entities are wholly-owned subsidiaries of defendant Countrywide Financial Corporation. (Id., ¶¶ 21-22.) Defendant

[1] The Transactions fall into three groups: The "Harborview Transactions" (Harborview Mortgage Loan Trust 2005-16 and Harborview Mortgage Loan Trust 2006-9); the "CWALT Transactions" (CWALT 2005-81 and CWALT 2006-OA19); and the "Lehman Transactions" (Lehman XS 2005-7N, Lehman XS 2006-2N, Lehman XS 2007-7N, and Lehman XS 2007-15N). (Compl., ¶ 8 & n 6-7.)

Bank of America Corp. (BofA) is allegedly the successor-in-interest to the Countrywide defendants' liabilities or their alter ego. (Id., ¶ 24.)

The complaint alleges that the Countrywide defendants (collectively Countrywide) fraudulently induced Ambac to issue the Policies by misrepresenting Countrywide's mortgage origination and quality control practices, its compliance with underwriting guidelines, and the quality and characteristics of the loans backing the Transactions. (Id., ¶¶ 1, 3-6.) According to the complaint, Countrywide made these misrepresentations in due diligence meetings between Ambac and Countrywide, in the Prospectus Supplements issued in connection with the offering of the Transactions (the Offering Documents), in loan tapes provided to Ambac, and in the agreements between Countrywide and its counterparties to the securitizations. (Id., ¶¶ 42, 55, 217.)

As is common in the RMBS fraud litigation, many of the misrepresentations alleged by Ambac concern Countrywide's adherence to its underwriting guidelines or the quality and characteristics of the underlying loans. Ambac pleads that Countrywide misrepresented that it made exceptions to its underwriting guidelines only if compensating factors existed. (See e.g. id., ¶¶ 45-49.)[2] Ambac also alleges that Countrywide misrepresented to Ambac that Countrywide's loan guidelines "were conservative and rigorously followed" while, "[i]n reality, Countrywide made rampant 'exceptions' to the guidelines . . . ." (Id., ¶ 4.) In addition, Ambac alleges that the loan tapes contained false loan-level information about "key metrics for assessing the borrowers' ability to repay their loans and the sufficiency of the underlying properties as

[2] By Order of the Administrative Judge, dated May 23, 2013, this court was designated to hear "all actions hereafter brought in this court alleging misrepresentation or other wrong in connection with or arising out of the creation or sale of residential mortgage-backed securities." This court has considered claims regarding such misrepresentations in numerous cases. (See e.g. Deutsche Zentral-Genossenschaftsbank AG v UBS AG, 2014 WL 1495632 [Sup Ct, NY County, Apr. 17, 2014, No. 652575/2012]; HSH Nordbank AG v Barclays Bank PLC, 2014 WL 841289 [Sup Ct, NY County, Mar. 3, 2014, No. 652678/2011]; Allstate Ins. Co. v Credit Suisse Secs. (USA) LLC, 2014 WL 432458 [Sup Ct, NY County, Jan. 24, 2014, No. 650547/2011].)

collateral." (Id., ¶ 56.)

The complaint pleads, and it is not disputed, that all of the Countrywide mortgage loans used as collateral for the Transactions were negative amortization loans (generally referred to in the complaint as "PayOption ARMs").[3] (Id., ¶¶ 11-12.) Many of Countrywide's alleged misrepresentations concern the negative amortization loans. (See e.g. id., ¶¶ 11-14, 47-53.)

During the relevant time period, Countrywide allegedly "assured Ambac that it did not let borrowers use the [PayOption ARM] product to buy homes that they could not otherwise afford," informing Ambac that "borrowers were qualified at the fully amortizing rate and would be able to make loan payments after the mortgage rates reset." (Id., ¶¶ 13, 50-51.) Countrywide also allegedly represented to Ambac that "its sophisticated systems and access to extensive historic information [] allowed the lender to stay ahead of the market" with respect to "the potential property bubbles and risks associated with negative amortization products." (Id., ¶ 48.)

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[3] As described in the complaint:

> "Amortization is the process of paying off debt over time. While a borrower who has a traditional mortgage gradually pays off his or her loan balance by making monthly payments of principal and interest (i.e., the loan is self-amortizing), a borrower with a negative amortization mortgage makes monthly payments for an initial time period that do not cover the interest owed for that month. As a result, a borrower with a negative amortization mortgage sees his or her principal loan balance increase during that initial time period. This arrangement is used during an introductory period of an agreed-upon duration so as to permit the borrower to make a lower monthly payment than will be required after the loan 'recasts' and becomes self-amortizing. Borrowers who have negative amortization mortgages may experience a 'payment shock' because their monthly payments will increase when the initial low-rate period concludes and their mortgages become self-amortizing. As a result, the underwriting of such mortgage loans must be conservative and attuned to the risk of payment shock.
>
> . . . An 'ARM' is an adjustable rate mortgage, which means that the mortgage's interest rate changes during the life of the mortgage loan. By contrast, a traditional fixed-rate self-amortizing mortgage loan has a specified interest rate that does not change over the life of the mortgage loan. In the case of the mortgages included in the Transactions, the interest rate adjusted annually after the conclusion of a low-interest rate 'teaser' period. The 'Option' feature of the mortgage program allowed borrowers to decide whether to make only the minimum payment (thereby allowing the mortgage to negatively amortize) or to make greater payments that would permit earlier amortization of the loan."

(Id., ¶¶ 11-12.).

Countrywide asserted that it "follow[ed] a conservative approach in qualifying borrowers for Option-ARMs at the fully-indexed rate . . . " (id., ¶ 47), and that Countrywide used "conservative underwriting guidelines and qualification standards" for the PayOption ARM program." (Id., ¶ 51.) Countrywide also allegedly represented that its "PayOption ARM product performed 'twice as well' as fixed rate collateral." (Id., ¶ 50.)

As alleged in the complaint, Countrywide executives in fact believed, but concealed from Ambac, that PayOption ARM loans like those backing the Transactions "were the riskiest product on the market," that "borrowers were lying about their income [,] and that they would not be able to make their payments after the mortgage rates reset." (Id., ¶ 14.) Countrywide's "solution to this hazard was to keep as many of its PayOption loans off of its books as possible." (Id., ¶ 98.) Countrywide executives allegedly "instructed their employees that the PayOption ARM program non-owner-occupied properties were so toxic that every single one should be sold." (Id., ¶ 14.) This policy persisted despite concerns from the President of Countrywide Home Loans that "it could give the impression that Countrywide was cherry picking the assets on its own books and overwhelming its securitization pools with higher risk loans – 'an adversely selected pool.'" (Id., ¶ 98.)

As further alleged in the complaint, at the time Ambac agreed to insure the Transactions, Countrywide had "completely abandoned its prudent mortgage origination practices in favor of a system that was designed to reward quantity over quality in loan origination . . . ." (Compl., ¶ 83.) Countrywide "loosened and then ignored its underwriting guidelines, even resorting to outright fraud to close as many loans as possible." (Id.) "[E]xceptions became the norm rather than being granted only in 'moderation.'" (Id., ¶ 125.) Countrywide also allegedly "engaged in predatory and abusive lending practices" in marketing its PayOption ARMS, offering "teaser"

interest rates to borrowers who could not afford them. (Id., ¶ 113.) Countrywide purportedly "used its overwhelming market share to exert its influence over even ostensibly independent sectors of the mortgage industry such as appraisers and due diligence underwriters, ensuring that as many of its loans as possible were approved and securitized without ever being properly reviewed to ensure the borrower had the ability to repay." (Id., ¶ 83.)

Prior to bringing suit, Ambac allegedly undertook a forensic review of over 9,000 of the loans included in the Transactions (id., ¶ 275), comparing information in its possession to information available in the public record, such as tax information, credit records, and property and lien records. (Id., ¶¶ 277-280.) Ambac also used an automatic valuation model (AVM) to assess the appraised value given to the reviewed mortgage properties. (Id., at 286-287.) This review allegedly revealed that a significant amount of data in the loan tapes and Prospectus Supplements, including owner occupancy statistics and loan-to-value ratios, was false or misleading. (Id., ¶ 275.) According to Ambac, these differences "fundamentally altered the represented characteristics of the collateral in the Transactions . . . ." (Id., ¶ 276.) Ambac alleges that it would not have agreed to insure the Transactions had it known the truth about these matters. (Id., ¶¶ 15, 276.)

The complaint alleges that "[a]s a result of Countrywide's false and misleading statements and omissions, Plaintiffs have suffered, and will continue to suffer, damages including claims payments under the Policies." (Id., ¶ 380.) According to Ambac, as of November 2014, the pools of loans underlying the Transactions had experienced cumulative collateral losses of more than $3 billion and, as of October 31, 2014, Ambac had "paid, accrued, and expected claims of over $600 million" with respect to the eight Transactions. (Id., ¶¶ 270-271.)

Ambac's complaint pleads two causes of action. The first, against Countrywide, alleges that Countrywide fraudulently induced Ambac to issue the Policies. (Id., ¶¶ 372-381.) The second, against BofA, pleads that BofA is liable for Countrywide's wrongdoing on "successor-in-liability" and alter-ego theories.[4] Countrywide now moves to dismiss the complaint pursuant to CPLR 3016 (b) and 3211 (a) (1) and (7) on the ground that Ambac has not pleaded the required element of justifiable reliance. In the alternative, Countrywide seeks dismissal of Ambac's claim for damages in the amount of all past and future claims payments on the Policies.

DISCUSSION

It is well settled that on a motion to dismiss pursuant to CPLR 3211 (a) (7), "the pleading is to be afforded a liberal construction (see, CPLR 3026). [The court must] accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory." (Leon v Martinez, 84 NY2d 83, 87-88 [1994]. See 511 W. 232nd Owners Corp. v Jennifer Realty Co., 98 NY2d 144 [2002].) However, "the court is not required to accept factual allegations that are plainly contradicted by the documentary evidence or legal conclusions that are unsupportable based upon the undisputed facts." (Robinson v Robinson, 303 AD2d 234, 235 [1st Dept 2003]; see also Water St. Leasehold LLC v Deloitte & Touche LLP, 19 AD3d 183 [1st Dept 2005], lv denied 6 NY3d 706 [2006].) When documentary evidence under CPLR 3211 (a) (1) is considered, "a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." (Leon, 84 NY2d at 88.)

[4] BofA has not served a separate motion to dismiss the complaint, but joins in the arguments set forth in Countrywide's motion to dismiss. (BofA Joinder [NYSCEF No. 29].) BofA further argues that, because no claim is stated against Countrywide, no claim exists against Bank of America Corp. for successor liability. (Id.)

Fraudulent Inducement—Justifiable Reliance

"The elements of a cause of action for fraud require a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." (Eurycleia Partners, LP v Seward & Kissel, LLP, 12 NY3d 553, 559 [2009].) A fraud claim must be pleaded with particularity pursuant to CPLR 3016 (b).

Here, Countrywide contends that Ambac's fraud claim must be dismissed for failure to plead the required element of justifiable reliance. According to Countrywide, the Offering Documents for the Transactions contained disclosures "calling into question the accuracy of [] and at times contradicting" the representations on which Ambac allegedly relied, triggering Ambac's duty to perform a heightened degree of diligence and/or barring its claim of justifiable reliance as a matter of law. (Defs.' Memo. In Supp., at 16-18.) Countrywide further contends that, despite these disclosures, Ambac failed to use the means available to an insurer of its size and sophistication to protect itself from the alleged fraud. (See id., at 3, 19-23.) In particular, Countrywide argues that Ambac could have demanded access to the loan files from the securitization Trustees and hired a consultant to audit a sample of the loans, or could have checked information in the pre-closing loan tapes in its possession against publicly available information, such as market data about property values. (Id., at 3, 19-22.) Alternatively, Countrywide claims that Ambac could have obtained contractual representations and warranties from Countrywide regarding the securitizations or the underlying loans. Instead, Countrywide's representations and warranties were made in agreements to which Ambac was neither a party nor, according to Countrywide, an intended beneficiary. (Id., at 3, 8-10, 23-28.)

In opposition, Ambac asserts that New York Insurance Law § 3105 does not require proof of justifiable reliance. (Pls.' Memo. In Opp., at 1.) Ambac alternatively contends that the

complaint adequately pleads justifiable reliance, and that the question of whether its reliance on Countrywide's representations was reasonable implicates factual issues, the resolution of which would be inappropriate on this motion to dismiss. (Id., at 1, 14.) According to Ambac, the disclosures identified by Countrywide concern only the ordinary risks of investing in RMBS, not the alleged "wholesale abandonment of underwriting guidelines and rampant misrepresentation of loan characteristics that occurred here." (Id., at 20.) Ambac nonetheless contends that it "conducted its own extensive due diligence of Countrywide's origination practices, underwriting processes, and internal diligence operations," and that it "evaluated the structure of each securitization, performed cash flow analysis of the loan pool, and analyzed historical performance of similar collateral, among other things." (Id., at 17-18 [internal quotation marks and citation omitted].) Ambac disputes that it was required, as a matter of law, to review the loan files (id., at 22-24) or to undertake a forensic review of the information on the loan tapes before issuing the Policies. (Id., at 24-26.) Ambac also contends that its review of contractual representations and warranties made by Countrywide to other parties supports its pleading of justifiable reliance. (Id., at 26-30.)

Ambac's opposition to Countrywide's motion opens with the assertion that Insurance Law § 3105 does not require proof of justifiable reliance.[5] However, Ambac does not develop this argument and, instead, focuses its opposition on the sufficiency of its pleading of justifiable reliance. (See Pls.' Memo. In Supp., at 13-14 [plaintiffs' sole discussion of the requirements of

[5] Section 3105 (a) defines a representation as a statement of past or present fact, made to an insurer as "an inducement to the making of" the insurance contract. Section 3105 (b) (1) provides, in pertinent part: "No misrepresentation shall avoid any contract of insurance or defeat recovery thereunder unless such misrepresentation was material." Section 3106 (a) defines a warranty in an insurance contract, and section 3106 (b) provides: "A breach of warranty shall not avoid an insurance contract or defeat recovery thereunder under unless such breach materially increases the risk of loss, damage or injury within the coverage of the contract."

the Insurance Law].) For the reasons discussed below, the court holds that the complaint adequately pleads the justifiable reliance element of a common law fraud claim. The court therefore need not determine, on the limited briefing here, whether Insurance Law § 3105 dispenses with this element.[6]

The general standards for pleading and proof of justifiable reliance have repeatedly been addressed by the Court of Appeals. In New York, sophisticated parties have an affirmative duty to protect themselves from misrepresentations made in arm's length business transactions by undertaking a reasonable investigation of the details of the transactions. As the Court of Appeals has repeatedly reaffirmed:

> "[I]f the facts represented are not matters peculiarly within the defendant's knowledge, and the plaintiff has the means available to it of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, the plaintiff must make use of those means, or it will not be heard to complain that it was induced to enter into the

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[6] The court notes, however, that contrary to Ambac's apparent contention, the Appellate Division of this Department has not held that Insurance Law § 3105 dispenses with the element of justifiable reliance in a fraud claim brought by an insurer in the RMBS context. (See Pls.' Memo. In Supp., at 13-14.) As discussed further above (infra, at 29), in MBIA Ins. Corp. v Countrywide Home Loans, Inc. (105 AD3d 412, 412 [1st Dept 2013] [MBIA], modifying 34 Misc 3d 895 [Sup Ct, NY County, Jan. 3, 2012, No. 602825/08, Bransten, J.), the Court modified the trial court by reversing its holding that the insurer was entitled to rescissionary damages, but affirmed the trial court's holding on causation. In CIFG Assur. N.A., Inc. v J.P. Morgan Secs. LLC (___ AD3d ___, 2016 WL 6954098, * 1-2 [1st Dept Nov. 29, 2016] [CIFG], modifying 2015 WL 3922134 [Sup Ct, NY County, June 26, 2015, No. 654074/2012]), the Appellate Division held that although this court properly dismissed a cause of action for "material misrepresentation in the inducement of an insurance contract (pursuant to Insurance Law § 3105)," this court should have granted leave to replead the cause of action. In MBIA Ins. Corp. v J.P. Morgan Secs., LLC (___ AD3d ___, 2016 WL 6465453, * 2 [2d Dept Nov. 2, 2016]), the Court reversed the denial of the plaintiff monoline insurer's motion for leave to plead a cause of action for material misrepresentation in the procurement of an insurance contract "brought under common law as informed by New York Insurance Law Section 3105."

None of these appellate decisions addresses whether an Insurance Law § 3105 claim requires proof of justifiable reliance. CIFG, in discussing the statute of limitations for a § 3105 claim, does reason generally that "Insurance Law § 3105 does not, by its terms, create a cause of action, but merely codifies common law principles," at least in the field of insurance. (2016 WL 6954098, * 4.)

Elimination of the requirement of proof of justifiable reliance, in fraud claims brought by issuers of financial guaranty policies for complex securities, would have wide-ranging implications for the monoline insurer RMBS litigation and beyond. This issue should be determined only upon consideration of the legislative history of the statute and upon comprehensive briefing on the application of the statute in the context, not merely of consumer insurance transactions, but of complex commercial insurance transactions.

transaction by misrepresentations."

(ACA Fin. Guar. Corp. v Goldman, Sachs & Co., 25 NY3d 1043, 1044 [2015] [ACA] [internal quotation marks, brackets, and citations omitted]; DDJ Mgt., LLC v Rhone Group L.L.C., 15 NY3d 147, 154 [2010] [DDJ] [same, noting that this rule has frequently been applied to "sophisticated" business persons or entities]; accord IKB Intl. S.A. v Morgan Stanley, 142 AD3d 447, 448-449 [1st Dept 2016] [IKB (Morgan Stanley)].)

"Moreover, 'when the party to whom a misrepresentation is made has hints of its falsity, a heightened degree of diligence is required of it. It cannot reasonably rely on such representations without making additional inquiry to determine their accuracy.'" (ACA, 25 NY3d at 1044-1045, quoting Centro Empresarial Cempresa S.A. v America Movil, S.A.B. de C.V., 17 NY3d 269, 279 [2011] [Centro].) Thus, where a plaintiff is aware that it has not been provided with financial information to which it is entitled, its duty to perform a "heightened degree of diligence" is triggered. (ACA, 25 NY3d at 1045 [internal quotation marks and citations omitted].) If, notwithstanding such knowledge, the plaintiff "neither insist[s] on a prophylactic provision nor exercise[s] due diligence by seeking the information to which [it is] entitled," it may be barred from alleging justifiable reliance. (Id. [discussing and distinguishing Centro].)[7] Absent hints of falsity, however, where a misrepresentation has been made on a matter as to which the plaintiff has inquired, the plaintiff may be entitled to rely on the representation without making further inquiry or obtaining a prophylactic provision. (See ACA,

[7] The Court of Appeals has held that "where a plaintiff has gone to the trouble to insist on a written representation that certain facts are true, it will often be justified in accepting that representation rather than making its own inquiry." (DDJ, 15 NY3d at 154.) As the caveat "often" suggests, however, there are circumstances under which a party's reliance may be unjustified even where it secured a written representation regarding the matter, as where the party "actually knew that the warranty in question was false." (Id., at 155 [distinguishing Ponzini v Gatz, 155 AD2d 590 (2d Dept 1989)].)

25 NY3d at 1045.)[8]

As the Court of Appeals has emphasized, "the question of what constitutes reasonable reliance is not generally a question to be resolved as a matter of law on a motion to dismiss." (ACA, 25 NY3d at 1045; DDJ, 15 NY3d at 155 ["The question of what constitutes reasonable reliance is always nettlesome because it is so fact-intensive" (internal quotation marks and citation omitted)].)

Disclosures in the Offering Documents

As a threshold matter, the court rejects Countrywide's contention that the disclosures in the Offering Documents bar Ambac's claim of justifiable reliance as a matter of law.[9] The disclosures on which Countrywide relies were set forth in the Prospectuses and Prospectus Supplements for the Transactions. They included, among other things, representations that mortgage loans will generally be originated in accordance with underwriting guidelines but that exceptions will be made "from time to time and in the ordinary course of business,"[10] or that

[8] In ACA, a CDO [collateralized debt obligation] securitizer affirmatively represented to the plaintiff monoline insurer, in response to the insurer's inquiries, that the entity that selected the collateral would be an equity investor in the transaction, while concealing its knowledge that that entity planned to take a short position contrary to the insurer's interests. (25 NY3d at 1044-1045.) The Court of Appeals held that the insurer had sufficiently pleaded justifiable reliance even though it had not secured a "prophylactic provision" (id., at 1045) or even, as the dissent would have required, "simply asked [the collateral selection agent] directly what its investment position was . . . ." (Id., at 1047.) The Court also noted that, unlike in Centro, "there was no written agreement between plaintiff and defendant in which a 'prophylactic provision' could have been inserted." (Id., at 1045.) The dissent disagreed, writing that "if assurance that [the collateral selection agent] was taking a net long position in [the CDO] was as critical to ACA's commercial decision-making as it now claims, ACA surely could have and would have conditioned its financial guaranty on [the defendant or the agent] entering into an agreement containing written representations and covenants." (Id., at 1049.)

[9] Representative quotations from the Offering Documents are set forth below. The disclosures are also summarized in a chart prepared by Countrywide's counsel. (See Aff. of Christina A. Hoffman In Supp. [Hoffman Aff.], Exh. J.) Ambac does not contest the accuracy of Countrywide's summaries.

[10] E.g. Harborview 2006-9 Prospectus (Swanson Aff. In Opp., Exh. 4), at 14 ("Although mortgage originators generally underwrite mortgage loans in accordance with their pre-determined loan underwriting guidelines, from time to time and in the ordinary course of business, originators will make exceptions to these guidelines. Loans originated with exceptions may result in a higher number of delinquencies and loss severities than loans originated in strict compliance with the designated underwriting guidelines").

"[e]xceptions to Countrywide's underwriting guidelines may be made if compensating factors are demonstrated by a prospective borrower."[11] Additional disclosures were made that a substantial percentage of the mortgage loans provided by Countrywide had been originated or reviewed pursuant to underwriting programs under which "certain documentation requirements concerning income/employment and asset verification are reduced or excluded."[12] The Offering Documents also warned of the possibility of inaccurate or inflated appraisals, borrower fraud, and inaccuracies in other data about the loans, including data about owner occupancy.[13]

Consistent with the weight of authority, this court has held that substantially similar disclosures are ineffective to notify investors in RMBS securitizations of the systematic or wholesale abandonment of underwriting standards. (See e.g. Allstate Ins. Co. v Credit Suisse Secs. (USA) LLC, 2014 WL 432458, * 7-9, 10, 12 [Sup Ct, NY County, Jan. 24, 2014, No. 650547/2011] [Allstate] [this court's prior decision, collecting state and federal authorities holding similar disclosures ineffective to bar investor fraud claims as to wholesale abandonment].) The court holds—and Countrywide does not argue otherwise—that this authority is equally applicable in the monoline insurer context. The disclosures at issue do not

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[11] E.g. Harborview 2005-16 Prospectus Supplement (Swanson Aff. In Opp., Exh. 3), at S-70.

[12] E.g. Harborview 2005-16 Prospectus Supplement, at S-68; see also id., at S-33 (disclosing that 73.89% of the "initial" mortgage loans were originated or reviewed pursuant to a reduced documentation program).

[13] E.g. Harborview 2006-9 Prospectus, at 13 ("The quality of [] appraisals may vary widely in accuracy and consistency. Because in most cases the appraiser is selected by the mortgage loan broker or lender, the appraiser may feel pressure from that broker or lender to provide an appraisal in the amount necessary to enable the originator to make the loan, whether or not the value of the property justifies such an appraised value"), & 14-15 ("Fraud committed in the origination process may increase delinquencies and defaults on the mortgage loans. For example, a borrower may present fraudulent documentation to a lender during the mortgage loan underwriting process, which may enable the borrower to qualify for a higher balance or lower interest rate mortgage loan than the borrower would otherwise qualify for. . . . You should consider the potential effect of fraud by borrowers, brokers and other third parties on the yield on your securities"); Harborview 2006-9 Pro Supp, at S-63 ("No assurance can be given that the value of any mortgaged property has remained or will remain at the level that existed on the appraisal or sales date") & S-29 ("'[S]tated occupancy status' refers to the intended use of the mortgaged property as represented by the borrower when the related mortgage loan was originated").

bar Ambac's claim that Countrywide completely abandoned its underwriting standards.

Countrywide's disclosures as to the underwriting of the negative amortization loans, in particular, do not bar Ambac's claim of justifiable reliance based on alleged misrepresentations with respect to such loans, because the disclosures do not relate with sufficient specificity to the misrepresented matters. For example, Countrywide disclosed in the Offering Documents that special features of such loans may or will "affect the rate at which principal on these mortgage loans is paid" or "create a greater risk of default if the borrowers are unable to pay the monthly payments on the related increased principal balances."[14] In the case of the Lehman Transactions, Countrywide also disclosed that the loans "may have been originated according to underwriting guidelines that do not comply with Fannie Mae or Freddie Mac guidelines," and that "[a] significant portion of the mortgage loans in the trust fund may have been classified" in relatively low credit categories, such as subprime, with borrowers that "may have imperfect credit histories . . . ."[15]

These disclosures fall far short of informing Ambac of the extent of the risk associated with Countrywide's negative amortization product, or that Countrywide purposefully off-loaded the negative amortization loans into RMBS securitizations in order to keep these "toxic" loans off its own books, as Ambac alleges here. (See supra, at 4; Aozora Bank, Ltd. v J.P. Morgan Secs. LLC, ___ AD3d ___, 2016 WL 6496932 [1st Dept, Nov. 3, 2016] [holding on motion to dismiss that, "[g]iven defendants' alleged knowledge of the toxicity of the assets going into the

[14] E.g. Prospectus Supplement for CWALT 2005-81 (Swanson Aff. In Opp., Exh. 5), at S-11; see also Prospectus Supplement for Lehman XS 2005-7N (Swanson Aff. In Opp., Exh. 7), at S-39 (disclosing that, "[w]hen interest due on a mortgage loan is added to the principal balance of the mortgage loan through negative amortization, the mortgaged property provides proportionally less security for the repayment of the mortgage loan. Therefore, if the mortgagor defaults on the mortgage loan there is a greater likelihood that a loss will be incurred upon the liquidation of the mortgaged property. Furthermore, the loss will be larger than would otherwise have been recognized in the absence of negative amortization.")

[15] E.g. Hoffman Aff. In Supp., Exh. 7.1, quoting from the Prospectus for Lehman XS 2006-2N, at 2.

CDO, the fact that the assets technically met the criteria for eligibility in the offering materials did not, as a matter of law, make the representation of the assets as 'high grade' true"]; Basis Yield Alpha Fund (Master) v Goldman Sachs Group, Inc., 115 AD3d 128, 136, 138 [1st Dept 2014] [Basis Yield (Goldman)] [holding on motion to dismiss that investor fraud claim against defendant securitizer was not barred by "boilerplate statements [in offering documents] regarding the speculative and risky nature of investing in mortgage-backed CDOs and the possibility of market turns," or even by disclosure that defendant "was taking a 'short' position in the securities," where defendant "knew that it was selling toxic assets" to the CDO]; compare HSH Nordbank AG v UBS AG, 95 AD3d 185, 199 [1st Dept 2012] [HSH] [dismissing CDO investor's fraud claim at pleading stage, upon finding that disclosures and disclaimers in the transactional documents "relate[d] directly or indirectly . . . to the very matter as to which HSH . . . claim[ed] it was defrauded [there, the reliability of credit ratings] and therefore destroy[ed] the allegations that the agreement was executed in reliance upon contrary oral representations" (internal quotation marks, citations, and ellipses omitted)].)[16]

As this court holds that Countrywide's disclosures do not bar Ambac's justifiable reliance claim as a matter of law, the court turns to the remaining issue of whether the complaint adequately pleads that Ambac performed due diligence or otherwise took "reasonable steps to protect itself against deception" before issuing the Policies. (See generally DDJ, 15 NY3d at 154.)

Due Diligence & Other Protective Measures

[16] As the Court in Basis Yield (Goldman) (115 AD3d 128, supra) held, even if disclaimers and disclosures are "sufficiently specific, a purchaser may not be precluded from claiming reliance on misrepresentations of facts peculiarly within the seller's knowledge." (Id., at 139 [internal quotation marks and citations omitted].) The Court distinguished HSH (95 AD3d 185, supra) not only on the ground that the disclaimers and disclosures there were "sufficiently specific to the particular type of information allegedly misrepresented," but also on the ground that "the alleged misrepresentation [in HSH] did not concern facts peculiarly within the seller's knowledge." (115 AD3d at 139-140.)

As further detailed below, Ambac alleges due diligence in the form of operational due diligence meetings, review of Offering Documents for the Transactions, review of loan-level information in loan tapes provided by Countrywide, modeling of the Transactions, and consideration of shadow ratings for the Transactions. Ambac did not enter into a contract with Countrywide and did not obtain written contractual representations and warranties from Countrywide as to its compliance with underwriting standards or as to the quality and characteristics of the loans. Ambac pleads, rather, that it relied on written contractual representations that were made by Countrywide to other parties and summarized in the Offering Documents for the Transactions.

The complaint pleads that Ambac had an "extensive history of dealing with," and "conducted comprehensive operational due diligence of Countrywide," attending at least eight face-to-face meetings with Countrywide executives between July 2004 and February 2007. At these meetings, the parties discussed Countrywide's loan origination processes, appraisal practices, quality control procedures, and legal and regulatory compliance. (Id., ¶¶ 42-44; see also id., ¶ 46 [describing meetings with executives from Countrywide's Compliance, Credit Risk, Product Management, and Servicing departments].) Although not all of these meetings concerned the specific Transactions at issue, Ambac allegedly inquired at several of the meetings as to the standards for, and performance of, Countrywide's "PayOption ARM NegAm" (negative amortization) program, from which Countrywide supplied all of the collateral for the Transactions. (Id., ¶¶ 46-52; see also id., ¶¶ 11-12.) The complaint pleads that, prior to an April 4, 2005 due diligence meeting with Countrywide, "Ambac requested the performance history of Countrywide's negative amortization products" and that, after that request was made, Countrywide continued to provide such information to Ambac. (Id., ¶ 52.) Ambac also

"requested various manuals and reports, including Countrywide's underwriting guidelines, which Ambac underwriters reviewed." (Id., ¶ 46.)

In addition to performing operational due diligence on Countrywide, Ambac allegedly relied upon the representations made by Countrywide in the Prospectus Supplements for the Transactions. These representations included "thorough summaries of loan origination practices and underwriting guidelines," and "detailed descriptions of the securitized loans, including group-level information about the occupancy status of borrowers, loan-to-value ratios and, in some cases, debt-to-income ratios." (Id., ¶ 55.)

Ambac also allegedly reviewed "the detailed, loan-level information provided by Countrywide in mortgage loan 'tapes.'" (Id., ¶ 56.) As described in the complaint, loan tapes are large spreadsheets containing data about the proposed loan pools for a securitization, "including key metrics for assessing the borrowers' ability to repay their loans and the sufficiency of the underlying properties as collateral." (Id.) Ambac pleads that "[i]t is widely understood in the industry that these loan tapes are used by all market participants – investors, rating agencies, and insurers – to model and understand the collateral that is backing a given transaction, as well as the transaction's structural elements." (Id.)

Ambac allegedly used the loan-level information provided by Countrywide in the loan tapes to perform "both qualitative and quantitative analysis, the latter of which included running two models to estimate the expected performance of the Transactions." (Id., ¶ 231-234.) Ambac first employed a proprietary "'CAS Model[]' to make an initial estimation of the expected loss associated with the related [loan] pool." (Id., ¶ 233.) The complaint pleads that "[t]he CAS Model was a deterministic model that applied a foreclosure frequency and loss severity estimate to each loan based on the information provided by Countrywide in the loan tapes." (Id.) Ambac

also used a third party "stochastic model called the Loan Performance Model ('LPS Model')," which "used Countrywide's mortgage loan data, but rather than generating a single modeled loss, the LPS Model ran 3,000 different scenarios with varying macroeconomic conditions and adjusting for a range of pool characteristics to determine expected performance." (Id., ¶ 234.)

Finally, Ambac considered "shadow ratings" issued by the ratings agencies as part of the securitization process. (Id., ¶ 215.) These ratings "represented the rating agencies' expectations of the performance of the securities to be issued, assuming that no financial guaranty policy [wa]s secured." (Id.) The complaint pleads that the rating agencies "determined that the certificate classes in the Transactions . . . posed the lowest possible risk of having shortfalls in the cash flow used to pay noteholders, with Standard & Poor's rating each as 'AAA' even without the benefit of Ambac's insurance policies." (Compl., ¶¶ 10, 58, 215.) These ratings meant that the Transactions "were viewed by market participants as being comparatively safe relative to other structured finance investments." (Id., ¶ 10.)

The court holds that whether Ambac was required to perform a heightened degree of, or ordinary, due diligence, Ambac's allegations of due diligence are sufficient, at the pleading stage, to support its claim of justifiable reliance. In so holding, the court rejects Countrywide's contention that Ambac's pleading of justifiable reliance is insufficient as a matter of law because Ambac does not allege that its due diligence included a request for the loan files, an audit of a sample of the loans or, at a minimum, the performance of a forensic analysis of the type that Ambac performed before commencing this action based on the loan tapes. The court also rejects Countrywide's contention that Ambac's pleading of justifiable reliance is deficient as a matter of law because Ambac does not allege that it obtained written representations and warranties from Countrywide.

Recent appellate decisions in the RMBS litigation have consistently held that so long as investors and insurers otherwise allege that they conducted reasonable investigations of the transactions they entered, they are not required, in order to avoid dismissal at the pleading stage, to allege that they requested and reviewed the loan files for the mortgage loans underlying the securitizations or obtained direct written representations and warranties. Thus, in Phoenix Light SF Ltd. v Credit Suisse AG (2016 WL 6782900 [1st Dept, Nov. 17, 2016] [Phoenix Light (Credit Suisse)]), its most recent decision on this issue, the Appellate Division of this Department expressly upheld an RMBS investor's pleading of a fraud claim, reasoning as follows:

> "The allegations that with respect to their purchase of residential mortgage-backed securities plaintiffs relied on misrepresentations and omissions made by defendants in the offering documents are sufficient to state the justifiable reliance element of the fraud claims; plaintiffs are not required to allege that they requested from defendants the actual loan files or due diligence reports or that they obtained representations and warranties made directly by defendants about the quality of the loans, as opposed to those made to defendants by other parties with direct access to the relevant information."[17]

Similarly, in IKB (Morgan Stanley) (142 AD3d 447, supra), the Appellate Division upheld RMBS investors' pleading of a fraud claim, citing allegations that "plaintiffs' investment advisors analyzed the RMBS based on information in the prospectuses, prospectus supplements and other offering documents and that plaintiffs lacked access to the underlying mortgage loan files." (Id., at 449.) The Court rejected defendant securitizers' argument that "in order to establish justifiable reliance, plaintiffs were required to allege that they sought additional information from defendants about the truthfulness of the representations made in the offering documents or that they requested the loan files for the loans underlying the RMBS." (Id., at 449-

[17] As the lower Court decision in Phoenix Light (Credit Suisse) makes clear, the plaintiffs alleged that the third-party representations and warranties were described in the offering documents for the securitizations. (2015 WL 1850509, * 6 [Sup Ct, NY County, Apr. 16, 2015, No. 653123/2013, Ramos, J.], revd 2016 WL 6782900.)

450.)

In CIFG Assurance North America, Inc. v Goldman, Sachs & Co. (106 AD3d 437 [1st Dept 2013] [CIFG]), the Appellate Division addressed the sufficiency of a monoline insurer's pleading of justifiable reliance in the RMBS context, holding that the insurer "was not required, as a matter of law, to audit or sample the underlying loan files." (Id., at 438.) The Court found "a question of fact as to whether plaintiff [insurer] reasonably relied on defendants' representations," where "[p]laintiff conducted its own due diligence, utilizing an outside consultant to analyze the characteristics of the underlying loans," and "[t]he characteristics analyzed by plaintiff's consultant were the subject of written warranties that were not demonstrably known by plaintiff to be false when made." (Id., at 437-438.)

Although the plaintiffs in Phoenix Light (Credit Suisse) and IKB (Morgan Stanley) did not obtain direct written representations and warranties or allege due diligence of the extent alleged in CIFG, the Appellate Division in both cases relied on CIFG in holding that the plaintiffs' failure to seek loan files did not vitiate their pleading of justifiable reliance. (Phoenix Light [Credit Suisse], 2016 WL 678900, at * 1-2; IKB [Morgan Stanley], 142 AD3d at 449-450; see also HSH Nordbank AG v Goldman Sachs Group, Inc., 2013 WL 8476977, * 9 [Sup Ct, NY County, Nov. 26, 2013, No. 652991/2012, Schweitzer, J.] [citing CIFG for its holding that "[a]s long as it otherwise conducted a reasonable investigation, [plaintiff investor] was under no duty to request the underlying loan files"].)

Unlike the insurer in CIFG, Ambac does not allege that it hired a third-party due diligence provider or procured written representations and warranties before issuing the financial guaranty policies in question. Moreover, review of other RMBS actions brought by Ambac in this Court shows that, in connection with the securitizations at issue there, Ambac in fact

obtained written representations and warranties or performed arguably more extensive due diligence than that alleged here. (See e.g. Ambac Assur. Corp. v Countrywide Home Loans, Inc., 2015 WL 6471943 * 3 [Sup Ct, NY County, Oct. 22, 2015, No. 651612/10, Bransten, J.] [in an alternative holding, finding an issue of fact as to justifiable reliance, where Ambac disputed that it had access to the loan files before the securitization closed, alleged due diligence based on its visits to Countrywide's headquarters to review underwriting practices and its "perform[ance] [of] loan-level computer analysis of the various securitizations," and obtained representations and warranties in Insurance and Indemnity Agreements with Countrywide]; Ambac Assur. Corp. v First Franklin Fin. Corp., 2013 WL 3779636, * 2-3, 8 [Sup Ct, NY County, July 18, 2013, No. 651217/2012, Schweitzer, J.] [upholding Ambac's pleading of justifiable reliance where Ambac visited defendant-originator's offices to review its loan origination and underwriting procedures, twice requested access to a sample of the originator's loan files, performed "[m]odeling [of] the risk of loss on the Transaction" based on loan characteristics represented on the loan tapes, reviewed offering documents, obtained defendant securitizer's due diligence of 1,968 loans in the transaction, and entered into an Insurance and Indemnity agreement containing written representations and warranties]; Ambac Assur. Corp. v EMC Mtge. LLC, 2013 WL 2919062, * 5 [Sup Ct, NY County, June 13, 2013, No. 651013/2012, Ramos, J.], affd on other grounds 121 AD3d 514 [1st Dept 2014] [upholding Ambac's pleading of justifiable reliance where Ambac admittedly "failed to conduct loan-level due diligence in advance of the transactions," but "insisted on written representations and warranties that certain facts relating to the mortgage loans were true"].)

Bearing in mind the Court of Appeals' emphasis on the fact-intensive nature of the justifiable reliance inquiry, however, the court holds that the adequacy of the pre-transaction

investigations that Ambac alleges it did perform presents a question of fact that is not properly determined on this motion addressed to the face of the pleadings. Put another way, this court cannot find as a matter of law that Ambac's allegations of due diligence, taken as a whole, will be insufficient, if proved, to support Ambac's claim of justifiable reliance.

More particularly, the complaint does not plead, and there is no evidence in the record of this motion that addresses, let alone establishes, the time and expense that would have been required for Ambac to conduct an audit of the loan files, even if it had had access to such files. Moreover, Ambac in fact disputes that it had access to the underlying loan files. (See Pls.' Memo. In Opp., at 23.)[18] As this court has previously held in RMBS fraud cases involving plaintiff investors, lack of access to loan files is a factor to be considered in determining whether the plaintiffs have otherwise alleged reasonable steps to protect their investments. (See e.g. Deutsche Zentral-Genossenschaftsbank AG v UBS AG, 2014 WL 1495632, * 1 [Sup Ct, NY County, Apr. 17, 2014, No. 652575/2012]; HSH Nordbank AG v Barclays Bank PLC, 2014 WL 841289, * 20 [Sup Ct, NY County, Mar. 3, 2014, No. 652678/2011]; Allstate, 2014 WL 432458, at * 12 [citing additional authorities].)

The record is also undeveloped as to the time and expense that would have been required for Ambac to compare data from the loan tapes in its possession to publicly available information before issuing the Policies. The fact that Ambac chose to perform a forensic review

[18] The complaint pleads that Countrywide, rather than Ambac, "owned and held the loan files, which afforded it access and control over information required to evaluate the loans" before the closing of the Transactions. (Compl., ¶ 220.) Countrywide counters that Ambac possessed a contractual right to demand access to the loan files from the securitization Trustees prior to the closing, and could therefore have conducted an audit of the loans before issuing its Policies. This contention is not, however, supported by the contractual provisions cited by Countrywide. (See Defs.' Memo. In Supp., at 11 n 14.) The cited provisions contemplated that the Trustees would not acquire the loans files from Countrywide until the closing of the Transactions. (See Pls.' Memo. In Opp., at 23; see e.g. CWALT 2005-81 PSA § 2.01 [a] [Swanson Aff. In Opp., Exh. 15] [providing that "[o]n or prior to the Closing Date, Countrywide shall deliver to the Depositor or, at the Depositor's direction, to the Trustee or other designee of the Depositor, the Mortgage File for each Mortgage Loan . . . ."].)

of the collateral after it allegedly became aware of the likelihood of pervasive defects in the loan pool (see Compl., ¶¶ 275-280), does not support Countrywide's contention that Ambac had the obligation to conduct such a review at the time it agreed to insure the Transactions and before it was allegedly put on notice of the fraud.

Further, in contending that Ambac was required either to have requested and audited loan files or performed a forensic review based on the loan tapes, Countrywide fails to address the modeling that Ambac alleges it performed before issuing the Policies. There is no evidence in the record of this motion to dismiss as to the extent and results of the modeling or as to the reasonableness of the modeling in light of the risk posed to Ambac by these Transactions.

The complaint pleads that "Countrywide and Ambac assumed risk and undertook due diligence consistent with their respective roles in the Transactions." (Compl., ¶ 219.) Countrywide allegedly "assumed the risk . . . of assessing the validity of the represented attributes of the mortgage loans" conveyed to the Trusts, while Ambac allegedly assumed the risk "of evaluating whether the loans bearing the attributes represented by Countrywide would perform after the closing of the Transactions." (Id.) Assuming arguendo that the allocation of risk is a critical factor in assessing the sufficiency of a plaintiff monoline insurer's due diligence (see Assured Guar. Mun. Corp. v DLJ Mtge. Capital, Inc., 2014 WL 3288335 [Sup Ct, NY County, July 3, 2014, No. 652837, Kornreich, J.]), the due diligence proper to any such allocation here involves a mixed question of fact and law, which is not properly addressed on this motion addressed to the face of the pleadings.[19]

[19] In arguing that Ambac's pleading of due diligence is insufficient, Countrywide focuses on Ambac's failure to review loan files or to perform a forensic review of the loans using information on the loan tapes, rather than on Ambac's failure to investigate the reliability of the shadow ratings for the Transactions. (Defs.' Memo. In Supp., at 3-4.) It is noted, however, that since HSH (95 AD3d 186, supra), the Appellate Division has held that, in order to plead compliance with its due diligence obligation, even a sophisticated investor in a CDO or RMBS transaction need not allege that it has investigated non-public information, such as guidelines used to underwrite the RMBS in a CDO collateral portfolio, or methodologies used by a rating agency to generate ratings. (Basis Yield Alpha Fund

In sum, the record must be developed on the sufficiency of Ambac's due diligence. It is not for this court to "increase transaction costs by judicial fiat or to mandate particular acts of due diligence based on the court's, or any party's, hindsight opinion as to what inquiries would have been useful. (See Syncora Guar. Inc. v Alinda Capital Partners LLC, 2013 WL 3477133, n 1 [Sup Ct, NY County, July 1, 2013, No. 651258/2012, Schweitzer, J.] [Syncora Guar. (Alinda)].)

In this massive litigation that continues in the wake of the 2008 financial crisis, the case law continues to develop on the factors relevant to the reasonableness of both insurers' and investors' due diligence on RMBS and other complex securitizations. In applying the test of reasonableness, the court must determine whether the plaintiff availed itself of the "means available to it" (ACA, 25 NY3d at 1044), given its "size and sophistication." (HSH, 95 AD3d at 188-189, 197.) Factors to be considered in making this determination may include the particular parties' prior course of dealing, the roles of other participants in the transaction, the time and

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(continuation of fn 19)
Master v Morgan Stanley, 136 AD3d 136, 141-145 [1st Dept 2015] [Basis Yield (Morgan Stanley)] [upholding CDO investor's pleading of justifiable reliance where investor did not allege investigation into the reliability of credit ratings for senior tranches of CDO, and distinguishing HSH based on the allegation in Basis Yield (Morgan Stanley) that the defendant CDO securitizer had obtained its knowledge of the unreliability of credit ratings "not from information generally available in a given market, but from its role in creating and marketing the relevant securities"]; accord IKB (Morgan Stanley), 142 AD3d at 449-450 [rejecting claim that investor was required to "verify [credit ratings] through a detailed retracing of the steps undertaken by the underwriter and the credit rating agency. We do not require this heightened due diligence standard to support justifiable reliance in a pleading concerning such sales of securities by prospectus"].)

The same result applies here. Ambac pleads that the shadow ratings on which it relied were based on information in loan tapes provided by Countrywide, which Countrywide knew to be false. The complaint in HSH pleaded that the unreliability of the ratings was understood in the market and that "a study of the market . . . would have revealed that the credit rating conferred on a security by a rating agency did not necessarily correspond to the security's risk level as perceived by the market." (95 AD3d at 193, 196.) The Ambac complaint, in contrast, pleads that market participants, based on or consistent with the ratings, viewed the Transactions as "comparatively safe." (Compl., ¶ 10.) Moreover, Ambac pleads that the ratings were but one source of information on which it relied, whereas, in HSH, the Appellate Division found that the "core subject of the complained-of-representations was the reliability of the credit ratings used to define the permissible composition of the [CDO] reference pool," and that "[t]he reliability of those ratings was the premise on which the entire deal was sold to HSH." (95 AD3d at 196.)

expense of the investigation, the feasibility of "practical[ity]" of the plaintiff's performance of a particular type of investigation before entering into the transaction (see generally TIAA Global Invs., LLC v One Astoria Sq. LLC, 127 AD3d 75, 88 [1st Dept 2015]), the foreseeable risk to the plaintiff of failing to undertake the investigation, and responsible industry custom (Syncora Guar. [Alinda], 2013 WL 3477133, supra). The court does not purport here to formulate a comprehensive list of factors to be considered in assessing the reasonableness of Ambac's due diligence. Nor, on this motion addressed to the face of the pleadings, should the court determine the extent to which these various factors may be applicable or the weight to be given to them. Rather, it is for the trier of fact to determine, on a fully developed record, whether Ambac justifiably relied on Countrywide's representations or, instead, in an unprecedented market for risky complex securities, adopted irresponsible diligence practices.

Damages

Ambac seeks damages in the amount of "[a]ll claims paid and accrued under the Policies to date and all claims due for payment in the future under the Policies." (Compl., Prayer For Relief.) Countrywide contends that this formulation of damages is effectively a request for rescissory damages, which are unavailable to Ambac under First Department precedent. Countrywide acknowledges, however, that Ambac may be entitled to "the out-of-pocket losses Ambac sustained as a direct and proximate result of the alleged fraud." (Defs.' Memo. In Supp., at 29.) Ambac counters that it does not seek rescissory damages, and does not dispute that it is barred from recovering rescissory damages. Rather, Ambac disputes that damages in the amount of all claims paid and due in the future under the Policies constitute rescissory damages or their equivalent. Ambac contends that it is "entitled to seek damages that will make it whole." (Pls.' Memo. In Opp., at 30.)

The First Department has held that where, as here, a monoline insurer has voluntarily given up the right to rescission by issuing an irrevocable policy, rescissory damages are unavailable as a matter of law. (MBIA Ins. Corp. v Countrywide Home Loans, Inc., 105 AD3d 412, 413 [1st Dept 2013] [MBIA], modifying 34 Misc 3d 895 [Sup Ct, NY County, Jan. 3, 2012, No. 602825/08, Bransten, J.]); see also Financial Guar. Ins. Co. v Credit Suisse Secs. (USA) LLC, 2015 WL 4627744, * 9 [Sup Ct, NY County, Aug. 3, 2015, No. 651178/2013] [this court's prior decision holding on the authority of MBIA, in an insurer breach of contract case, that rescissory damages were unavailable because the policy was irrevocable]; Ambac Assur. Corp. v Nomura Credit & Capital, Inc., 2015 WL 3490753, * 8 [Sup Ct, NY County, June 2, 2015, No. 651359/2013] [same].)

Courts considering requests by monoline insurers for damages in the form of all claims paid and due in the future under irrevocable insurance policies have concluded that such damages are, in effect, rescissory damages. (See Ambac Assur. Corp. v Countrywide Home Loans, Inc., 2015 WL 6471943, * 8 [Sup Ct, NY County, Oct. 22, 2015, No. 651612/2010, Bransten, J.] [holding that "damages in the form of all past and future claims payments that Ambac makes arising from the securitizations at issue here" were "effectively equivalent to rescissory damages"]; Assured Guar. Mun. Corp. v RBS Secs. Inc., 2014 WL 1855766, * 2-3 [SD NY, May 8, 2014, No. 13 Civ 2019, Koeltl, J.] [reaching same conclusion with respect to "'damages in the amount of all payments [the plaintiff] has made and will make pursuant to the Policy'"]; see also MBIA,105 AD3d 412, supra [holding that monoline insurer gave up claim for rescissory damages, which the trial court decision (34 Misc 3d at 908) described as damages that were sought "in the amount that [the insurer] has been required to pay pursuant to the insurance policies, less premiums [the insurer] received under the policies"].)

The unavailability of rescissory damages does not, however, resolve the more difficult issue—and one of critical importance in the RMBS litigation—of what damages will be available if Ambac prevails on its fraudulent inducement cause of action. As Ambac correctly argues, at the pleading stage "[i]t is not necessary . . . that the measure of damages be pleaded, so long as facts are alleged from which damages may properly be inferred." (Black v Chittenden, 69 NY2d 665, 668 [1986] [internal quotation marks and citations omitted].) This pleading standard is met here.

In Laub v Faessel (297 AD2d 28 [1st Dept 2002]), a case often cited for its discussion of pleading and proof of damages on a common law fraud claim, the Court held that in order to prevail upon a fraud cause of action, the "plaintiff must establish that the alleged misrepresentations or other misconduct were the direct and proximate cause of the losses claimed." (Id., at 30.) As the Court further explained:

> "To establish causation, plaintiff must show both that defendant's misrepresentation induced plaintiff to engage in the transaction in question (transaction causation) and that the misrepresentations directly caused the loss about which plaintiff complains (loss causation). Loss causation is the fundamental core of the common-law concept of proximate cause: 'An essential element of the plaintiff's cause of action for . . . any . . . tort, is that there be some reasonable connection between the act or omission of the defendant and the damage which the plaintiff has suffered.'"

(Id., at 31 [quoting Prosser and Keeton, Torts § 41, at 263 (5th ed), other internal citations omitted].) In elucidating the concept of causation applicable to a fraud claim, the Court of Appeals has approvingly quoted the Restatement (Second) of Torts § 548A for the proposition that "[a] fraudulent misrepresentation is a legal cause of pecuniary loss resulting from action or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from

the reliance." (Stutman v Chemical Bank, 95 NY2d 24, 30 [2000];[20] see also Continental Cas. Co. v PricewaterhouseCoopers, LLP, 15 NY3d 264, 271 [2010] ["In a fraud action, a plaintiff may recover only the actual pecuniary loss sustained as a direct result of the wrong"].)

In MBIA Insurance Corp. v Countrywide Home Loans, Inc. (87 AD3d 287 [1st Dept 2011] [2011 MBIA decision]), the Appellate Division expressly applied the concept of loss causation in the RMBS monoline insurer context. Citing Laub and Stutman, the Court held that in order to prevail on a fraud claim, the plaintiff must demonstrate that the "defendant's misrepresentations were the direct and proximate cause of the claimed losses," and that a fraudulent misrepresentation is the legal cause of loss only if "the loss might reasonably be expected to result from the reliance." (Id., at 295 [internal quotation marks omitted].) The Court then concluded that allegations substantially similar to those made in the instant action as to compliance with underwriting standards and the quality of the loans were "sufficient to show loss causation since it was foreseeable that MBIA would suffer losses as a result of relying on Countrywide's alleged misrepresentations about the mortgage loans." (Id., at 295-296.) The Court also reasoned that "[i]t cannot be said, on this pre-answer motion to dismiss, that MBIA's losses were caused, as a matter of law, by the 2007 housing and credit crisis." (Id., at 296.)

Similarly, in Financial Guaranty Insurance Co. v Putnam Advisory Co. (783 F3d 395 [2d Cir. 2015] [FGIC (Putnam)]), the Second Circuit considered the sufficiency of a monoline insurer's pleading of a New York common law fraud claim in the CDO context.[21] The Court

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[20] Restatement (Second) of Torts § 548A, comment b further states: "Pecuniary losses that could not reasonably be expected to result from the misrepresentation are, in general, not legally caused by it and are beyond the scope of the maker's liability. This means that the matter misrepresented must be considered in the light of its tendency to cause those losses and the likelihood that they will follow."

[21] The fraud claim was brought against a collateral manager, based on its alleged misrepresentation that it would independently select the collateral in the CDO, although it in fact permitted a hedge fund that maintained significant short positions in the CDO to control the collateral selection. (783 F3d at 398.)

distinguished between transaction causation, which requires the plaintiff to allege that the "defendant's misrepresentation induced plaintiff to engage in the transaction in question," and loss causation, which requires the plaintiff to allege "that the misrepresentations directly caused the loss about which plaintiff complains." (783 F3d at 402, quoting Laub, 297 AD2d 28, supra [internal quotation marks omitted].)[22] As the Court further reasoned, loss causation "is the causal link between the alleged misconduct and the economic harm ultimately suffered by the plaintiff. To plead loss causation, FGIC [the insurer] must allege that the subject of the fraudulent statement or omission was the cause of the actual loss suffered." (Id. [internal quotation marks and citations omitted].) The Court then held that "FGIC has alleged particular facts that, when considered as a whole, plausibly allege that Putnam's alleged misrepresentations and omissions caused at least some of the economic harm it suffered." (Id., at 403.) The complaint "alleges a causal connection between [defendant's] fraudulent misrepresentations and FGIC's losses under the [] Guaranty such that FGIC would have been spared all or an ascertainable portion of that loss absent the fraud." (Id., at 404 [internal quotation marks and citation omitted].) Finally, the Court held that the insurer was not "required to allege that its losses were caused solely by [the defendant's] misrepresentations," that "if the loss was caused by an intervening event [here, the market downturn] . . . the chain of causation will not have been established," and that determination of this issue must await proof at trial. (Id., at 404-405.)

In the 2011 MBIA decision (87 AD3d 287, supra), which was issued relatively early in the New York State Court RMBS litigation, there is no indication that the insurer raised a claim, as it does here, that the common law fraud claim was "informed by" New York Insurance Law §

[22] In a subsequent decision, Loreley Financing (Jersey) No. 3 Ltd. v Wells Fargo Securities, LLC (797 F3d 160, 184 [2d Cir. 2015]), the Second Circuit clarified that, for purposes of common law fraud, loss causation and proximate cause are "separate" concepts, but that transaction causation and loss causation both require "the additional element of proximity."

3105. In FGIC (Putnam), the insurer did argue that Insurance Law § 3105 does not require an insurer to establish loss causation in a claim for fraud in the inducement of an insurance contract. The Court declined to reach this issue, holding that the allegations were sufficient to state a fraud claim even if loss causation were required to be pleaded. (783 F3d at 402.)

Subsequent to the 2011 MBIA decision, Courts in the RMBS and CDO litigations have authorized pleadings by monoline insurers alleging not only common law fraud, but also material misrepresentation in the inducement of an insurance contract pursuant to New York Insurance Law § 3105, and/or common law fraud "informed by" the Insurance Law. (CIFG Assur. N.A., Inc. v J.P. Morgan Secs. LLC, ___ AD3d ___, 2016 WL 6954098, * 5 [1st Dept Nov. 29, 2016] [CDO]; MBIA Ins. Corp. v J.P. Morgan Secs., LLC, ___ AD3d ___, 2016 WL 6465453, * 2 [2d Dept Nov. 2, 2016]; MBIA, 105 AD3d at 412-413.)

Of these appellate cases, only MBIA has rendered a holding on causation. In MBIA, the insurer pleaded fraud and breach of contract causes of action, which the trial court held were informed by Insurance Law §§ 3105 and 3106. (34 Misc 3d at 905.) The Appellate Division reasoned that "the motion court was not required to ignore the insurer/insured nature of the relationship to the contract in favor of an across the board application of common law." (105 AD3d at 412.) As noted above (supra, at 9 n 6), the Court reversed the trial court's holding, on a summary judgment motion, that the insurer was entitled to rescissory damages, but affirmed the trial court's holding on causation, which the Court characterized as concluding that "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." (Id., at 412-413.)

The Appellate Division's decision in MBIA did not set forth the basis for affirmance of the trial court's causation holding. The decision did not discuss loss causation and did not

otherwise discuss the standards for proof of causation of damages in a fraud or breach of warranty claim, whether brought under the common law or pursuant to Insurance Law § 3105 or §3106. Review of the MBIA trial court's decision is therefore necessary.

In the context of determining whether the policy could be rescinded based on a material misrepresentation made to induce issuance of the policy, the MBIA trial court held that MBIA was not required to "establish a direct causal link between the misrepresentations allegedly made by Countrywide and claims made under the policy." (34 Misc3d at 906.) The court further held, however, that "MBIA must prove all elements of its claims," and must "prove that it was damaged as a direct result of the material misrepresentations." (Id.) In a subsequent decision (Ambac Assur. Corp. v Countrywide Home Loans, Inc., 2015 WL 6471943 [Sup Ct, NY County, Oct. 22, 2015, No. 651612/2010, Bransten, J.]), the same trial court elaborated on its MBIA trial court decision. Distinguishing between proof of liability and proof of damages, the trial court explained: "[A]lthough causation is not necessary to demonstrate Countrywide's liability, Ambac's damages can only be calculated by reference to claims payments made because of the breach of the R&Ws (representations and warranties)." (2015 WL 6471943, at * 8.) The Court quoted its holding in the MBIA trial court decision that "'Ambac must [] prove that it was damaged as a direct result of the material misrepresentation.'" (2015 WL 6471943, at * 9, quoting 34 Misc3d at 906.) The Court then opined: "The First Department affirmed this portion of the opinion." (2015 WL 6471943, at * 9.)

It thus appears that the MBIA trial court—albeit, without using the terminology—applied the concept of loss causation to proof of damages of a common law fraud claim "informed by" Insurance Law § 3105. (See also Assured Guar. Mun. Corp. v DLJ Mtge. Capital, Inc., 2014 WL 3288335, * 9 [Sup Ct, NY County, July 3, 2014, No. 652837/2011, Kornreich, J.] [holding

that the "applicability of §§ 3105 & 3106 does not affect the need to prove basic proximate causation" as to losses].)[23]

This court need not decide on this motion whether Insurance Law § 3105 dispenses with the loss causation element of a common law fraud claim, as the court holds that loss causation is adequately pleaded here. (See FGIC (Putnam), 783 F3d at 402 [same].) In particular, the complaint adequately alleges that Countrywide's misrepresentations were a direct and proximate cause of at least some of Ambac's actual losses under the Policies for claims payments. (See supra, at 27 [discussing the 2011 MBIA decision, which upheld the pleading of loss causation based on allegations substantially similar to those pleaded here].) Moreover, Countrywide acknowledges that Ambac will be entitled to some damages if it prevails, although it contends that Ambac will not be entitled to recover all past payments and future payments on the Policies. (Defs.' Memo. In Supp., at 29.)

The precise measure of, or limits upon, Ambac's potential damages cannot properly be determined on this motion to dismiss. At the pleading stage, Ambac does not, and is not required to, address the proof it must offer in order to meet the legal standard for demonstrating a causal connection between the alleged misrepresentations and its damages. The parties also do not, and are not required to, address the quantum of proof necessary to demonstrate an intervening cause or the burden of proof on that issue. Each Transaction involves thousands of loans. (Compl., ¶ 9.) In three of the Transactions, Countrywide originated all of the loans. In four (the Lehman Transactions), Countrywide originated less than 50 percent of the loans and in one, it originated a substantial percentage but not all of the loans. (Hoffman Aff. In Supp., Exh. J.1.) These

[23] This decision also held that "[e]ven though Assured does not have to parse out losses caused by non-conformance from losses caused by market forces, it still must prove that its losses were caused by non-conforming, as opposed to conforming loans." (2014 WL 3288335, at * 9.)

circumstances, among others, present complex issues of fact and law as to what proof will be sufficient to demonstrate that Countrywide's misrepresentations caused Ambac's losses. The indisputable fact that the losses occurred in a declining, then collapsing, market further raises a significant issue of fact and law as to whether or to what extent the market downturn was an intervening cause of the losses. These issues must be determined on a factually developed record. Further, Countrywide does not argue that future damages are unavailable as a matter of law if Ambac prevails. On this record, the parties have not briefed, and the court does not decide, whether or to what extent Ambac can prove future damages with the reasonable certainty required by New York law. (See generally Matter of Rothko, 43 NY2d 305, 323 [1977].)

Thus, even assuming that the prayer for relief in this action is defective because it seeks—albeit, without expressly requesting—the equivalent of rescissory damages, the complaint itself pleads a basis for inferring damages. The damages claim is therefore maintainable at the pleading stage.

It is accordingly hereby ORDERED that the motion of defendants Countrywide Home Loans, Inc., Countrywide Securities Corporation, and Countrywide Financial Corporation to dismiss the complaint is granted solely to the extent of striking the prayer for relief to the extent that it seeks rescissory damages. Provided that: Damages consistent with this decision will be permitted in the event that plaintiffs prevail on their fraud claim.

This constitutes the decision and order of the court.

Dated: New York, New York
December 19, 2016

MARCY FRIEDMAN, J.S.C.