

United States District Court
For the Northern District of California

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA

WAILEA PARTNERS, LP,)	Case No. 11-CV-3544 SC
a Delaware limited partnership,)	
)	ORDER GRANTING DEFENDANT'S
Plaintiff,)	<u>MOTION TO DISMISS</u>
)	
v.)	
)	
HSBC BANK USA, N.A.,)	
a national banking association,)	
)	
Defendant.)	
)	
)	

I. INTRODUCTION

In this action, Plaintiff Wailea Partners, LP ("Plaintiff" or "Wailea") seeks rescission of an investment contract entered into with Defendant HSBC Bank, USA, N.A. ("Defendant" or "HSBC USA"). See ECF No. 1 ("Compl."). Before the Court is Defendant's Motion to Dismiss Plaintiff's Complaint. ECF No. 23 ("Mot."). The Motion is fully briefed. ECF Nos. 35 ("Opp'n), 40 ("Reply").

II. BACKGROUND

As it must on a motion to dismiss under Federal Rule of Civil Procedure 12(b)(6), the Court assumes the veracity of Plaintiff's well-pleaded factual allegations. Wailea is an investment fund organized as a Delaware limited partnership. Compl. ¶¶ 1, 7. The majority of Wailea's investors are based in northern California, and these California-based investors contributed more than eighty

1 percent of Wailea's capital. Id. ¶ 7. HSBC USA is the U.S.
2 affiliate of an international banking company, and is a member of
3 HSBC Group, a worldwide organization of banks and financial
4 services companies parented by HSBC Holdings plc. Id. ¶ 8.

5 Wailea's investment objective was to achieve long-term capital
6 appreciation by investing in structured financial products linked
7 to the performance of hedge funds -- specifically, hedge funds that
8 utilize a particular risk-minimizing trading strategy known as the
9 "split-strike conversion" ("SSC") strategy. Id. ¶ 1. In and prior
10 to 2007, HSBC USA offered a variety of different structured
11 investment contracts linked to the performance of hedge funds using
12 the SSC strategy, including "total return swap contracts." Id. at
13 ¶¶ 10-11. A "swap" is a financial transaction created to swap the
14 value and cash flows of an asset or group of assets for the value
15 and cash flows of a different asset. Id. ¶ 11. HSBC USA swap
16 contracts offered counterparties the prospect of achieving the
17 return, or multiples of the return, generated by a reference asset
18 -- here, a hedge fund -- without having to own the asset itself.
19 Id.

20 In May 2007, Wailea and HSBC USA began negotiating the terms
21 of a swap contract to be linked to the performance of an investment
22 portfolio run by a mutual fund company named Senator Fund SPC
23 ("Senator"). Id. ¶ 13. The parties decided that a fund called the
24 Senator Equity Segregated Portfolio One (the "Senator Fund") was a
25 suitable reference fund because substantially all of the Senator
26 Fund's Capital was deposited with Bernard L. Madoff Investment
27 Securities LLC ("BLMIS") to be managed using the SSC strategy. Id.
28 ¶ 14. As stated in Senator's July 2006 Offering Memorandum for the

1 Senator Fund (the "2006 Senator Fund OM"), "substantially all of
2 the Fund's Portfolio One assets are managed by one Manager, who
3 utilizes a 'split-strike conversion strategy[.]'" Id. ¶ 14.

4 According to Wailea, "investment of Senator Fund's capital in
5 accordance with the SSC Strategy was an essential, core condition
6 of the parties' proposed swap transaction." Id. ¶ 15. Both Wailea
7 and HSBC USA demanded and received assurances from Senator that the
8 Senator Fund's capital would continuously be invested using the SSC
9 strategy. According to Wailea, "[t]he parties . . . conditioned
10 their own contractual rights and duties on the requirement that
11 Senator Fund would invest its capital in accordance with the
12 specified SSC Strategy." Id.

13 On July 10, 2007, HSBC USA sent Wailea and Senator a copy of
14 its portfolio guidelines for swaps and other investment products
15 (the "HSBC Investment Guidelines") and requested assurances from
16 Senator that these guidelines would be followed if HSBC USA and
17 Wailea were to enter into a swap contract linked to the Senator
18 Fund. Id. ¶ 17. The HSBC Investment Guidelines included the
19 following terms and conditions: "[t]he Reference Fund will invest
20 substantially all of its assets in a managed account . . . at all
21 times during the term of this Transaction," and "[t]he Investment
22 Manager will use a split-strike conversion strategy." Id. They
23 further provided that "[t]he Reference Fund will only invest in (1)
24 stocks in the S&P 100 index, (2) option on S&P 100 index, and/or
25 (3) Money Market/US Treasury Bills." Id.

26 On July 12, 2007, Senator sent Wailea a letter "confirm[ing]
27 that Senator is fully invested (with the exception of cash reserves
28 kept for payment of expenses) in the 'split-strike' hedged equity

1 strategy[.]" Id. ¶ 18.

2 On September 4, 2007, Wailea and HSBC USA entered into a swap
3 agreement linked to the performance of the Senator Fund. Id. ¶ 19.
4 The terms of the contract were set forth in a document entitled
5 Share Swap Transaction Confirmation (the "Swap Agreement"). A copy
6 of the Swap Agreement is attached to the Complaint. Compl. Ex. 1
7 ("Swap Agreement").¹ Section 7 of the Agreement, labeled
8 "Investment Guidelines" refers the reader to "Annex II," which
9 contains the same language set forth in the HSBC Investment
10 Guidelines quoted above, namely:

11 The [Senator] Fund will invest substantially all of its
12 assets in a managed account . . . at all times during the
13 term of this Transaction. The Investment Manager will use
14 a split-strike conversion strategy.

15 The [Senator] Fund will only invest in (1) stocks in the
16 S&P 100 index, (2) option on S&P 100 index, and/or (3)
17 Money Market/US Treasury Bills.

18 Swap Agreement, Annex II.

19 The Swap Agreement incorporates by reference the terms of the
20 1992 version of the Master Agreement of the International Swap
21 Dealers Association, Inc. ("ISDA Master Agreement") as well as
22 definitions contained in the 2000 ISDA Definitions and the 2002
23 ISDA Equity Derivatives Definitions. Id. at 1.

24 Pursuant to the terms of the Swap Agreement, Wailea paid HSBC

25 ¹ In ruling on a motion to dismiss, a court is generally limited to
26 the allegations of the complaint. Arpin v. Santa Clara Valley
27 Transp. Agency, 261 F.3d 912, 925 (9th Cir. 2001). However, the
28 Court may consider documents attached to the complaint, documents
upon which the complaint relies, and documents properly the subject
of judicial notice. Hal Roach Studios, Inc. v. Richard Feiner &
Co., 896 F.2d 1542, 1555 n.19 (9th Cir. 1990) (documents attached
to the complaint); Marder v. Lopez, 450 F.3d 445, 448 (9th Cir.
2006) (documents upon which the complaint relies); MGIC Indem.
Corp. v. Weisman, 803 F.2d 500, 504 (1986) (judicial notice).

1 USA \$8,870,000 in collateral, and in return HSBC USA made a
2 "synthetic investment" of \$31 million in the Senator Fund on
3 Wailea's behalf. Id. ¶ 21. Thus, in effect, HSBC USA provided
4 financing for a leveraged investment by Wailea in the Senator Fund.

5 On November 2, 2007, Wailea and HSBC USA amended and restated
6 the Swap Agreement as set forth in an Amended and Restated Share
7 Swap Transaction Confirmation. Id. ¶ 22. The parties increased
8 the "Maximum Notional Amount" from \$31 million to \$38 million,
9 meaning that Wailea could increase its synthetic investment in the
10 Senator Fund up to \$38 million if it chose to do so. Id. On July
11 18, 2008, Wailea and HSBC USA once again amended and restated their
12 agreement, as reflected in a Third Amended and Restated Share Swap
13 Transaction Confirmation.² The parties again increased the
14 "Maximum Notional Amount," this time to \$39 million. Id. ¶ 23.
15 The provisions of Annex II and all disclaimer provisions in the
16 original version of the Swap Agreement appear in identical form in
17 the amended and restated versions. See id. Exs. 1-3.

18 Between October 2007 and December 2008, Wailea periodically
19 adjusted the amount of collateral it provided to HSBC USA, which
20 had the effect of adjusting the amount of Wailea's synthetic
21 investment in the Senator Fund. Id. ¶ 24. In total, Wailea
22 transferred \$15,970,000 in collateral to HSBC USA. Id.

23 Each month from October 2007 through December 2008, HSBC USA
24 sent Wailea a Month-end Valuation Report that purportedly stated:
25 (1) the net asset value of individual units of the Senator Fund;

26 _____
27 ² For the sake of clarification, the Court notes that the parties
28 do not mention the existence of any second amended swap agreement.
Rather, it appears that the document entitled Third Amended and
Restated Share Swap Transaction Agreement was in fact only the
second amendment and restatement of the initial agreement.

1 (2) the net asset value of Wailea's swap investment for the
2 previous month; and (3) the amount of accrued interest Wailea owed
3 HSBC USA. Id. ¶ 25. Wailea alleges that each additional transfer
4 of collateral it made to HSBC USA was predicated on its belief that
5 the values reported in the Month-end Valuation Reports were
6 accurate, and but for the Month-end Valuation Reports, Wailea would
7 not have transferred any additional collateral to HSBC USA. Id. ¶
8 26.

9 On December 11, 2008, Bernard Madoff ("Madoff") was arrested
10 by federal agents for operating a Ponzi scheme through BLMIS's
11 investment advisory business. Id. ¶ 27. Madoff was the investment
12 "Manager" described in the 2006 Senator Fund OM. Id. He
13 subsequently pled guilty and acknowledged that he never invested
14 any of his clients' funds pursuant to the SSC strategy. Def.'s RJN
15 Ex. 6 ("Madoff Plea Hrg. Tr.") at 26:16-18.³

16 After Madoff's arrest, on December 15, 2008, the District
17 Court for the Southern District of New York granted an order
18 placing all BLMIS accounts, including the Senator Fund, under the
19 protections of the Securities Investor Protection Act and appointed
20 Irving Picard ("Picard") as trustee for liquidation of BLMIS

21 _____
22 ³ HSBC USA requests judicial notice of the transcript of Madoff's
23 plea hearing and five news articles pertaining to Madoff's fraud.
24 ECF No. 25 ("Def.'s RJN"). Under Rule 201, courts may take
25 judicial notice of facts contained in public records that are not
26 subject to reasonable dispute. Lee v. City of Los Angeles, 250
27 F.3d 668, 689-690 (9th Cir. 2001). Accordingly, the Court takes
28 judicial notice of Madoff's plea hearing transcript and its
contents. Courts may also take judicial notice of publications
introduced to indicate what was in the public realm at the time but
may not take judicial notice of whether the contents of those
articles are in fact true. Von Saher v. Norton Simon Museum of Art
at Pasadena, 592 F.3d 954, 960 (9th Cir. 2010). Accordingly, the
Court takes judicial notice of the news articles solely as an
indication of what information was in the public realm at the time.

1 accounts. Id. ¶ 29. The same day, Senator sent a letter to its
2 shareholders suspending the issue and redemption of shares until
3 further notice. Id.

4 Wailea alleges that HSBC USA had suspected Madoff's
5 involvement in fraud as early as 2005 and hid this information from
6 Wailea. Around September 2005, HSBC Group hired the auditing firm
7 KPMG to conduct a due diligence review of BLMIS for "fraud and
8 related operational risk." Id. ¶ 33. KPMG released its report in
9 February 2006, noting several risks of fraud with respect to the
10 investment of BLMIS clients' money, including failure to segregate
11 client funds from BLMIS funds and use of client funds to make
12 trades that deviated from the SSC strategy. Id. Around March
13 2008, HSBC Group hired KPMG to perform a second review of BLMIS,
14 which yielded a report noting the same fraud risks as the 2006
15 report, as well as risks of falsification of client mandates,
16 embezzlement of client funds, and diversion of client funds for
17 Madoff's personal gain. Id. ¶¶ 34-35.

18 As KPMG was completing its 2008 diligence review of BLMIS, and
19 during the months after the report was issued, "HSBC Group
20 affiliates began a massive liquidation of their global investments
21 in BLMIS hedge-fund clients." Id. ¶ 38. During the ninety days
22 immediately preceding Madoff's arrest, HSBC USA and its affiliates
23 allegedly redeemed more than \$400 million invested in BLMIS hedge-
24 fund clients and liquidated substantially all of their holdings in
25 the Senator Fund. Id. ¶¶ 38-39. When Wailea inquired about HSBC
26 Group's liquidation efforts, HSBC USA told Wailea "that there was
27 no reason for concern and that the redemptions were made for
28 'market reasons.'" Id. HSBC USA did not disclose any of the

1 contents of the KPMG reports.

2 On December 5, 2010, Picard, trustee for the liquidation of
3 BLMIS, filed suit against several HSBC Group affiliates, including
4 HSBC USA, alleging that they "enabled Madoff's Ponzi scheme by
5 encouraging investment into an international network of feeder
6 funds . . . in order to reap an extraordinary financial windfall."
7 Id. ¶ 41. Wailea alleges that it was not until the filing of the
8 Picard suit that Wailea discovered that: (1) HSBC USA lacked a good
9 faith basis for believing Madoff was complying with the SSC
10 strategy with respect to BLMIS's investment of the Senator Fund's
11 capital; and (2) HSBC USA itself may have engaged in wrongdoing
12 with respect to the Senator Fund. Id. ¶ 42.

13 Wailea filed this action on July 19, 2011, seeking rescission
14 of the Swap Agreement and return of the approximately \$15,970,000
15 in collateral that Wailea transferred to HSBC USA. See Compl.
16 Wailea asserts the following five claims for rescission: (1) mutual
17 mistake, alleging that Wailea and HSBC USA were mutually mistaken
18 in their belief that the Senator Fund's capital would be invested
19 pursuant to the SSC strategy; (2) unilateral mistake, alleging that
20 Wailea was unilaterally mistaken about the belief that the Senator
21 Fund was following an SSC investment strategy; (3) innocent
22 misrepresentation, alleging that HSBC USA made various
23 misrepresentations concerning the SSC strategy and the value of
24 Wailea's investment; (4) failure of condition precedent, alleging
25 that investment of the Senator Fund's capital pursuant to the SSC
26 strategy was an express condition of the formation of the Swap
27 Agreement that never occurred; and (5) violation of California
28 Corporations Code §§ 25401 et seq., alleging that HSBC USA made

1 misleading statements and omissions in connection with the sale of
2 securities. See id. ¶¶ 43-64.

3
4 **III. LEGAL STANDARD**

5 A motion to dismiss under Federal Rule of Civil Procedure
6 12(b)(6) "tests the legal sufficiency of a claim." Navarro v.
7 Block, 250 F.3d 729, 732 (9th Cir. 2001). Dismissal can be based
8 on the lack of a cognizable legal theory or the absence of
9 sufficient facts alleged under a cognizable legal theory.
10 Balistreri v. Pacifica Police Dep't, 901 F.2d 696, 699 (9th Cir.
11 1990). "When there are well-pleaded factual allegations, a court
12 should assume their veracity and then determine whether they
13 plausibly give rise to an entitlement to relief." Ashcroft v.
14 Iqbal, 129 S. Ct. 1937, 1950 (2009). However, "the tenet that a
15 court must accept as true all of the allegations contained in a
16 complaint is inapplicable to legal conclusions. Threadbare
17 recitals of the elements of a cause of action, supported by mere
18 conclusory statements, do not suffice." Iqbal, 129 S. Ct. at 1950
19 (citing Bell Atl. Corp. v. Twombly, 550 U.S. 544, 555 (2007)). A
20 complaint need not contain "detailed factual allegations," but it
21 must provide more than an "unadorned, the-defendant-unlawfully-
22 harmed-me accusation." Id. at 1949. The allegations in the
23 complaint "must be enough to raise a right to relief above the
24 speculative level." Twombly, 550 U.S. at 555. Thus, a motion to
25 dismiss should be granted if the plaintiff fails to proffer "enough
26 facts to . . . nudge[] [its] claims across the line from
27 conceivable to plausible." Id. at 570.

28

1 **IV. DISCUSSION**

2 **A. Choice of Law**

3 As an initial matter, HSBC USA argues that Wailea's first four
4 claims are governed by New York law because the Swap Agreement
5 contains a valid and enforceable choice of law clause specifying
6 that New York law shall govern the Agreement. Mot. at 5-6 (citing
7 Swap Agreement at 1 ("the governing law is the law of the State of
8 New York, without reference to choice of law doctrine.")).⁴ Wailea
9 argues that the clause does not control because Wailea seeks to
10 rescind, rather than enforce, the Swap Agreement. For the
11 following reasons, the Court agrees with HSBC USA and applies New
12 York law to Wailea's first four claims.

13 A district court sitting in diversity applies the choice of
14 law rules of the state in which it sits. Fields v. Legacy Health
15 Sys., 413 F.3d 943, 950 (9th Cir. 2005). California choice of law
16 rules therefore govern the Court's determination of which state's
17 law to apply to Plaintiff's claims. California law strongly favors
18 the application of contractual choice of law clauses. Wash. Mut.
19 Bank, FA v. Super. Ct., 24 Cal. 4th 906, 917 (Cal. 2001).
20 California courts will apply the parties' contractually chosen law
21 if: (1) the designated state has a substantial relationship to the
22 parties or the transaction, and (2) the chosen law would not
23 contravene a fundamental policy of California. Id. at 916.

24 Where, as here, one of the parties has its principal place of
25

26 ⁴ Nearly all provisions of the Swap Agreement remain unchanged in
27 the amended and restated versions of the agreement. Therefore,
28 when citing provisions that are identical in all three versions,
the Court refers simply to the "Swap Agreement."

1 business in the designated state,⁵ the substantial relationship
2 test is met. Expansion Pointe Props. Ltd. P'ship v. Procopio,
3 Cory, Hargreaves & Savitch, LLP, 152 Cal. App. 4th 42, 59 (Cal. Ct.
4 App. 2007). Moreover, because there is no significant difference
5 between California and New York law on rescission claims, applying
6 New York contract law in this case does not undermine the public
7 policy of California. See Peterson v. Highland Music, Inc., No. CV
8 93-4672 (WDK), 1995 U.S. Dist. LEXIS 22008, at *7 (C.D. Cal. June
9 20, 1995).

10 Finally, under California's choice-of-law rules, a valid
11 choice-of-law clause encompasses all claims arising from or related
12 to an agreement -- even claims seeking to rescind the agreement.
13 Seidman & Seidman v. Wolfson, 50 Cal. App. 3d 826, 830-31 (Cal.
14 1975). Seidman disposes of Wailea's argument that the choice-of-
15 law clause does not apply here because Wailea disputes the very
16 formation of the contract and "whether a contract was formed in the
17 first place . . . precedes the question whether the Court may
18 enforce its terms." Opp'n at 5 n.5. Like Wailea, the plaintiff in
19 Seidman sought to rescind a contract containing a choice-of-law
20 clause on the basis of mistake and misrepresentation. The court
21 held that the choice-of-law clause was valid and enforceable absent
22 a contention by the plaintiff that "the inclusion of the choice of
23 law clause itself was obtained by misrepresentation or mistake."
24 Id. at 831. Wailea does not contend that the choice-of-law clause
25 itself was included in the Agreement because of mistake or
26 misrepresentation, and therefore, the clause is valid and

27 _____
28 ⁵ Wailea alleges, and HSBC USA admits, that HSBC USA's principal
place of business is located in New York. Compl. ¶ 8; Mot. at 6.

1 enforceable under Seidman.

2 **B. Claims for Mutual and Unilateral Mistake**

3 HSBC USA argues that Wailea's claims for mutual and unilateral
4 mistake fail as a matter of law because Wailea expressly assumed
5 the risk of the alleged mistake under the plain language of the
6 Swap Agreement. Mot. at 10. Wailea responds that, although it did
7 assume certain specified risks under the terms of the Swap
8 Agreement, it did not assume the risk that the Senator Fund's
9 capital would not be invested pursuant to the SSC strategy. Opp'n
10 at 21.⁶ For the following reasons, the Court agrees with HSBC USA.

11 Under New York law, a mistake of material fact is not grounds
12 for rescission of a contract if the party seeking rescission bears
13 the risk of mistake. Albert Elia Bldg. Co., Inc. v. Am. Sterilizer
14 Co., 622 F.2d 655, 656-57 (2d. Cir. 1980). A party will be held to
15 bear the risk of mistake if: (1) the risk is so allocated by
16 agreement of the parties; (2) at the time the contract is made, the
17 party has only limited knowledge with respect to the facts relating
18 to the mistake, but the party treats that knowledge as sufficient;
19 or (3) the risk is allocated to that party by terms supplied by the
20 court on the ground that it is reasonable under the circumstances
21 to do so. Id. HSBC USA argues that all three circumstances apply
22 here. Mot. at 9. The Court agrees that the first two
23 circumstances apply here and accordingly finds that Wailea assumed
24 the risk mistake as to the Senator Fund's investment strategy.

25 ⁶ Wailea also responds by repeatedly emphasizing that the Senator
26 Fund's use of the SSC strategy was an absolutely essential pre-
27 condition to formation of the Swap Agreement. Id. at 20-21.
28 Because this argument is a reiteration of Wailea's failure of
condition precedent claim, the Court addresses it when discussing
that claim below.

1 First, the Swap Agreement consistently and unambiguously
2 allocates to Wailea the risk of mistake as to the Senator Fund's
3 performance, which alone suffices to defeat Wailea's claims for
4 rescission based on a mistake with respect to the Senator Fund.
5 See Beecher v. Able, 575 F.2d 1010, 1015 (2d Cir. 1978) (holding
6 that if "there is a term in a valid agreement that the risk as to
7 the existence of an assumed state of facts is to be upon one of the
8 contracting parties, there can be no rescission of the transaction
9 for mistake as to such facts") (internal quotation omitted).
10 Under the Section 12 of the Swap Agreement, Wailea affirmed that it
11 understood and assumed the financial risks of "the Transaction":

12 Each party has the capability to make its own legal,
13 regulatory, tax, investment, financial, accounting and
14 business evaluation of and to understand, and has
15 evaluated and does understand on its own behalf, the
16 terms, conditions and risks of entering into this
Transaction and is willing to accept those terms and
conditions and to assume (financially and otherwise)
those risks.

17 Swap Agreement, § 12(b). Wailea also agreed that HSBC would not be
18 liable to it if the financial effects of "the Transaction" turned
19 out differently than Wailea expected:

20 Neither party or any affiliate thereof will bear any
21 responsibility or liability if the legal, regulatory,
22 tax, investment, financial, accounting, business or
23 credit effects or consequences of this Transaction are
other than those contemplated by the other party.

24 Id. § 12(c).

25 Wailea further agreed that it was "solely responsible for
26 making an independent appraisal of[,] and investigation into[,] the
27 financial condition, prospects, creditworthiness, status and
28 business of [the Senator Fund]," id. § 12(f), and that Wailea was

1 not relying on any representations or warranties made by HSBC USA
2 regarding the Senator Fund, id. §§ 12(d),(g).

3 Wailea concedes that it assumed "specified risks 'of entering
4 into this Transaction,'" but argues that it did not assume the risk
5 of the particular mistake alleged here. Opp'n at 21 (quoting Swap
6 Agreement § 12(b)). Wailea argues that "the term 'Transaction' is
7 defined to be a share swap transaction with certain
8 specifications," including the specification that the investment
9 manager of the Senator Fund would use the SSC strategy and would
10 only invest in certain low-risk assets. Id.

11 The definition of the "Transaction" provided in the Swap
12 Agreement does not assist Wailea's argument. See Swap Agreement
13 preamble (defining the "Transaction" simply as "the Share Swap
14 Transaction entered into between [HSBC USA] and [Wailea] on the
15 Trade Date specified below"). Moreover, in light of the language
16 in Sections 12(b)-(f) of the Agreement cited above, especially
17 section 12(f), Wailea's argument that the risks it assumed under
18 the Agreement did not include the risk that the Senator Fund would
19 not follow the SSC strategy is inconsistent with the plain meaning
20 of the Swap Agreement.

21 Second, even if the Swap Agreement did not allocate the risk
22 of the alleged mistake to Wailea, Wailea nevertheless assumed this
23 risk under the second prong set forth in Albert Elia because it
24 chose to treat the limited knowledge it had concerning the Senator
25 Fund as sufficient and disclaimed reliance on any representations
26 made by HSBC USA. See 622 F.2d at 656-657. Wailea alleges that it
27 was aware of, and concerned about, the risk that the Senator Fund
28 would not follow the SSC strategy. Wailea alleges that it sought

1 repeated assurances about the Senator Fund's investment strategy
2 and was even able to persuade the Senator Fund to amend its
3 offering memorandum to describe its investment strategy more
4 clearly. Compl. ¶¶ 15-18. Nevertheless, despite its concerns,
5 Wailea agreed that it had read and received "all relevant documents
6 with respect to [the Senator Fund]," and that it "underst[ood] the
7 nature of making an investment in [the Senator Fund], and has
8 concluded that such an investment would be suitable for it in light
9 of its own investment objectives, financial capabilities, and
10 expertise." Swap Agreement § 12(i). Because Wailea elected to
11 treat whatever knowledge it had regarding the Senator Fund as
12 sufficient and expressly disclaimed reliance on any representations
13 made by HSBC, Swap Agreement §§ 12(d),(g), Wailea agreed to assume
14 the risk of mistake as to the Senator Fund's investment strategy.
15 See Beecher, 575 F.2d at 1015 ("[I]n determining whether rescission
16 is warranted in a given circumstance, there must be excluded from
17 consideration mistakes as to matters which the contracting parties
18 had in mind as possibilities and as to the existence of which they
19 took the risk.") (internal quotation omitted).

20 Accordingly, the Court finds that Wailea assumed the risk that
21 the Senator Fund's assets would not be invested pursuant to the SSC
22 strategy, and the Court DISMISSES WITH PREJUDICE Wailea's first and
23 second claims for rescission due to mutual and unilateral mistake.

24 **C. Innocent Misrepresentation Claim**

25 A claim for rescission due to innocent misrepresentation under
26 New York law requires a plaintiff to "set forth the circumstances
27 in detail showing that a false material representation was made and
28 that [it] relied on the representation to [its] detriment," Albany

1 Motor Inn Rest., Inc. v. Watkins, 85 A.D.2d 797, 798 (N.Y. App.
2 Div. 1981), and that its reliance was justified. Steen v. Bump,
3 A.D.2d. 583, 584 (N.Y. App. Div. 1996).

4 As the basis for its third claim, Wailea alleges that it
5 relied on two distinct sets of representations made by HSBC USA:
6 (1) oral and written representations that the Senator Fund had
7 historically followed the SSC strategy and would continue to do so;
8 and (2) representations in each Month-end Valuation Report that
9 misstated the value of Wailea's investment. Compl. ¶¶ 51-55.
10 Wailea alleges that these representations induced it to enter into
11 the Swap Agreement and to deliver its initial collateral payment
12 and subsequent collateral payments. Id. ¶ 55.

13 HSBC USA argues that disclaimer provisions in the Swap
14 Agreement and in the Month-end Valuation Reports preclude Wailea
15 from asserting that it justifiably relied on the alleged
16 misrepresentations. Mot. at 14; Reply at 11-13. Specifically,
17 with regard to any representations allegedly made prior to the
18 parties' final amendment and restatement of the Swap Agreement on
19 July 18, 2008, HSBC USA argues that Wailea disclaimed reliance on
20 such representations by repeatedly reaffirming Section 12 of the
21 Swap Agreement. Mot. at 14 (citing Swap Agreement § 12(g)
22 ("Neither [HSBC USA or its affiliates] is making, and has not made,
23 in connection with this Transaction any representation or warranty
24 whatsoever as to the Reference Fund[.]"); id. § 12(d) ("Neither
25 party is relying on any communication (written or oral) from the
26 other party . . . as investment or other advice or as a
27 recommendation to enter into this Transaction[.]"). With regard to
28 any representations contained in Month-end Valuation Reports sent

1 after the parties' final amendment and restatement of the
2 Agreement, HSBC USA argues that: (1) sections 12(f) and 20(b) of
3 the Agreement confer a continuing obligation upon Wailea to
4 evaluate the financial condition of the Senator Fund and provide
5 that HSBC USA had no duty to apprise Wailea of information in its
6 possession; and (2) disclaimer language contained in the Month-end
7 Valuation Reports themselves precludes any viable claim of
8 reliance.

9 In response, Wailea argues that the aforementioned disclaimers
10 do not defeat its claim because "the subject matter of the
11 misrepresentation -- investment of the [Senator] Fund's capital in
12 accordance with the SSC Strategy -- is not specifically
13 disclaimed." Opp'n at 19. Wailea also argues that neither
14 disclaimer defeats its claim because Section 3(a)(v) of the ISDA
15 Master Agreement provides that enforcement of the Swap Agreement is
16 "subject . . . to equitable principles of general application."
17 Id.; see Patchen Decl. Ex. A ("ISDA Master Agreement") § 3(a)(v).⁷

18 The Court agrees with HSBC USA and finds that Wailea cannot as
19 a matter of law establish that it reasonably relied upon the
20 alleged misrepresentations. Sections 12(g) and 12(d), which Wailea
21 reaffirmed each time it agreed to amend and restate the Swap
22 Agreement, precludes any viable claim of reliance on
23 representations made by HSBC USA prior to July 18, 2011 -- the date
24

25 ⁷ Jonathan A. Patchen ("Patchen"), attorney for Defendant, filed a
26 declaration in support of the Motion. ECF No. 24 ("Patchen
27 Decl."). The Court properly takes judicial notice of the ISDA
28 Master Agreement, which both parties quote from in their briefs,
because the Plaintiff's claims depend on the contents of the
document and the parties do not dispute its authenticity. See
Knievel v. ESPN, 393 F.3d 1068, 1076 (9th Cir. 2005).

1 on which the parties executed their final amendment and restatement
2 of the Agreement. Wailea's argument that the disclaimers do not
3 specifically address the Senator Fund's failure to follow the SSC
4 strategy fails because, although a vague "omnibus statement"
5 disclaiming representations will not preclude a claim for
6 misrepresentation, when a contract disclaims "reliance on specified
7 representations," a party will not be allowed to assert that it
8 relied on those specified representations. See CDO Plus Master
9 Fund v. Wachovia Bank, N.A., No. 07-Civ-11078(LTS)(AJP), 2009 U.S.
10 Dist. LEXIS 59540, at *10-11 (S.D.N.Y. July 13, 2009). "The
11 disclaimer does not have to identify precisely the alleged
12 misrepresentation, but the disclaimer must track the substance of
13 the misrepresentation." Id. at *11. Courts are more inclined to
14 enforce a disclaimer clause where, as here, the clause is the
15 product of negotiations between "sophisticated business people."
16 Id.

17 Here, the Swap Agreement specifically disclaims
18 representations relating to the Senator Fund and provides that
19 Wailea is solely responsible for making an independent appraisal of
20 the financial condition and business of the Senator Fund. Swap
21 Agreement §§ 12(f),(g). These disclaimers adequately "track the
22 substance" of the misrepresentations Wailea alleges. Accordingly,
23 they preclude a viable claim for reliance on any misrepresentations
24 allegedly made prior to the parties' final amendment and
25 restatement of the Swap Agreement. See CDO Plus, 2009 U.S. Dist.
26 LEXIS 59540, at *11-12 (holding that similar disclaimer in an ISDA-
27 based swap agreement precluded hedge fund's claim of reliance on
28 bank's alleged misrepresentations); Republic Nat'l Bank v. Hales,

1 75 F. Supp. 2d 300, 316 (S.D.N.Y. 1999) (same).

2 Both the Swap Agreement and the Month-end Valuation Reports
3 also preclude any viable claim of reliance on alleged
4 misrepresentations contained in Month-end Valuation Reports that
5 were issued subsequent to the final amendment and restatement of
6 the Swap Agreement. Section 12(f) of the Agreement provides that
7 Wailea "will at all times continue to be" solely responsible for
8 making an independent appraisal of the Senator Fund's financial
9 condition. Section 20(b) of the Agreement provides that HSBC USA
10 may be in possession of material, non-public information relating
11 to the Senator Fund but shall be under no obligation to disclose
12 such information to Wailea. Additionally, the Month-end Valuation
13 Reports contain a disclaimer providing that they are for
14 "informational purposes only" and stating that "HSBC USA expressly
15 disclaims . . . responsibility for any loss or damage arising out
16 of the provision or use of this information[.]" Patchen Decl. Ex.
17 D ("Oct. 31, 2008 Valuation Report") at 4.⁸ In light of these
18 clear and specific disclaimers, Wailea cannot, as a matter of law,
19 establish reasonable reliance in connection with its innocent
20 misrepresentation claim.

21 Lastly, Wailea's bare assertion that the disclaimer provisions

22 _____
23 ⁸ The Court may properly take judicial notice of the October 31,
24 2008 Valuation Report because the Complaint expressly relies on
25 such reports and the parties do not dispute its authenticity. See
26 Knievel, 393 F.3d at 1076 (9th Cir. 2005). Wailea does not oppose
27 judicial notice of the report, but states that the report is not
28 exemplary of all such reports. ECF No. 34 ("Pl.'s Resp. to Def.'s'
RJN") at 2. Plaintiff therefore asks the Court to take judicial
notice of a Month-end Valuation Report dated December 10, 2008.
Id. However, the December 10, 2008 Report contains nearly
identical disclaimer provisions. See id. Ex. A ("December 10,
2008") at 3.

1 of the Swap Agreement do not bar its claim because enforcement of
2 the Swap Agreement is "subject . . . to equitable principles of
3 general application" does not salvage its claim. Wailea does not
4 explain how this language relieves it of having to establish the
5 elements of a proper innocent misrepresentation claim. As HSBC USA
6 notes, equitable principles of general application do not convert
7 invalid claims into valid ones. Reply at 5.

8 Accordingly, the Court DISMISSES WITH PREJUDICE Plaintiff's
9 third claim for innocent misrepresentation.

10 **D. Claim for Failure of Condition Precedent**

11 In its fourth claim, Wailea seeks to rescind the Agreement on
12 the grounds that a condition precedent to the Agreement -- namely,
13 that the Senator Fund would invest its assets pursuant to the SSC
14 strategy -- failed to occur. Compl. ¶¶ 56-60. HSBC USA argues
15 that the Senator Fund's following a particular investment strategy
16 was not, as a matter of law, a condition precedent to the
17 agreement. The Court agrees.

18 "Conditions are not favored under New York law, and in the
19 absence of unambiguous language, a condition will not be read into
20 [an] agreement." Ginett v. Computer Task Grp., Inc., 962 F.2d
21 1085, 1099-1100 (2d Cir. 1992). To obtain rescission based on a
22 failure of condition, Wailea must point to express language on the
23 face of the Swap Agreement that establishes the parties'
24 unambiguous intent to condition the Swap Agreement's formation on
25 the Senator Fund's capital being invested pursuant to the SSC
26 strategy. See Rest. Creative Concepts Mgmt., LLC v. Ne. Rest.
27 Dev., LLC, 83 A.D.3d 1189, 1191 (N.Y. App. Div. 2011) (holding that
28 contract terms did not create a condition precedent to formation

1 because they lacked "unmistakable language of condition").

2 Here, Wailea claims that Section 7 and Annex II set forth the
3 following "express and explicit conditions" to the Agreement:

4 The [Senator] Fund will invest substantially all of its
5 assets in a managed account (the "Managed Account") at
6 all times during the term of this Transaction. The
Investment Manager will use a split-strike conversion
strategy.

7 The [Senator] Fund will only invest in (1) stocks in the
8 S&P 100 index, (2) option on S&P 100 index, and/or (3)
Money Market/US Treasury Bills.

9 Compl. ¶¶ 57-58. These provisions cannot be construed as
10 conditions because they lack the "'unmistakable language of
11 condition' such as 'if,' 'unless and until' and/or 'null and
12 void,'" which would establish the parties' clear intent to
13 expressly condition the existence of the Agreement upon the Senator
14 Fund's investment strategy. Rest. Creative Concepts, 83 A.D.3d at
15 1191.⁹

16 Despite the allegations in the Complaint to the contrary,
17 Wailea argues in its Opposition that it is not asking the Court to
18 interpret any language contained in the written Swap Agreement as a
19 condition precedent. Opp'n at 17. Instead, Wailea appears to
20 argue that the parties agreed to an oral condition precedent as to
21 the Senator Fund's investment strategy. Id. at 14-16. Nowhere in
22 its Complaint does Wailea allege an oral condition precedent to
23 contract formation.¹⁰ Moreover, even if its Complaint were amended

24 ⁹ Wailea attempts to distinguish Rest. Creative Concepts on the
25 ground that it dealt with a summary judgment motion rather than a
26 motion to dismiss. Opp'n at 15. However, that distinction is
irrelevant to the pure statement of law for which the case is cited
here.

27 ¹⁰ Nor does Wailea even state in its Opposition that any such oral
28 agreement was made. However, it relies heavily on case law
addressing oral agreements precedent to formation.

1 to include such allegations, Wailea's claim would still fail as a
2 matter of law as explained below.

3 Wailea relies on numerous cases stating that parol testimony
4 may be used to prove a condition precedent to formation of a
5 written agreement if the condition does not contradict the express
6 terms of the agreement. Opp'n at 14, 16 (citing, e.g., Hicks v.
7 Bush, 10 N.Y.2d 488, 491 (N.Y. 1962)). While this is a true
8 statement of law, it does not save Wailea's claim because, even if
9 the parties orally conditioned the formation of the Swap Agreement
10 on the Senator Fund using the SSC strategy, as Wailea now argues,
11 such a condition would contradict the express provisions of the
12 Swap Agreement. First, as noted above, the Agreement states that
13 HSBC was not making any representations, oral or written, with
14 respect to the Senator Fund. Swap Agreement § 12(g) ("Neither
15 [HSBC USA or its affiliates] is making, and has not made, in
16 connection with this Transaction any representation or warranty
17 whatsoever as to the Reference Fund[.]"); id. § 12(d) ("Neither
18 party is relying on any communication (written or oral) from the
19 other party . . . as investment or other advice or as a
20 recommendation to enter into this Transaction[.]"). Addressing
21 claims similar to those advanced by Wailea here, New York's highest
22 court has held that allegations of an oral condition precedent
23 cannot be reconciled with an express disclaimer covering the same
24 subject matter. See Citibank, N.A. v. Plapinger, 66 N.Y.2d 90, 95-
25 96 (N.Y. 1985).

26 Second, pursuant to the terms of the underlying ISDA Master
27 Agreement, Wailea and HSBC agreed that the terms of the Agreement
28 "constitute [the parties'] legal, valid and binding obligations,

1 enforceable in accordance with their respective terms[.]" ISDA
2 Master Agreement § 3(a)(v).¹¹ An oral condition precedent to
3 formation such as that alleged by Wailea, which would prevent the
4 Swap Agreement from becoming the parties' legal and binding
5 obligation, is expressly contradicted by this language. See Morgan
6 Stanley High Yield Secs., Inc. v. Seven Circle Gaming Corp., 296 F.
7 Supp. 2d 206, 220 (S.D.N.Y. 2003) ("It simply defies logic to
8 contend that a condition precedent, which would be introduced for
9 the purpose of proving that the Agreement never became a legally
10 valid and binding document, would not contradict a term, agreed to
11 by both parties, stating that 'this Agreement is (the signing
12 party's) legal, valid and binding obligation enforceable against it
13 in accordance with its terms.'").

14 Third, this is not a case, like Hicks, where the agreement is
15 silent as to the subject matter of the alleged condition. Rather,
16 the Swap Agreement explicitly mentions the SSC strategy in Annex
17 II, as discussed above, without using conditional language. See
18 Hicks, 10 N.Y.2d at 492 (noting that agreement was silent as to the
19 subject of the alleged condition precedent); see also Torres v.
20 D'Alesso, 80 A.D.3d 46, 57 (N.Y. App. Div. 2010) (rejecting alleged
21 oral condition precedent where condition did not merely deal with a
22 matter on which the contract was silent). This fact supports the

23 ¹¹ Section 3(a)(v) of the ISDA Master Agreement provides in full
24 that each party represents to the other party that: "Its
25 obligations under this Agreement and any Credit Support Document to
26 which it is a party constitute its legal, valid and binding
27 obligations, enforceable in accordance with their respective terms
28 (subject to the applicable bankruptcy, reorganization, insolvency,
moratorium or similar laws affecting creditors' rights generally
and subject, as to enforceability, to equitable principles of
general application (regardless of whether enforcement is sought in
a proceeding in equity or law))."

1 inference that, if sophisticated parties such as those in this case
2 desired that formation of the Swap Agreement be conditioned upon
3 Annex II, they would have included conditional language stating
4 that intention.

5 Wailea again argues that the language in Section 3(a)(v) of
6 the ISDA Master Agreement, stating that the enforceability of the
7 Swap Agreement is "subject . . . to equitable principles of general
8 application," entitles it to the equitable remedy of rescission.
9 Opp'n at 16. Again, this language does not convert an invalid
10 claim into a meritorious one.

11 Accordingly, the Court DISMISSES WITH PREJUDICE Plaintiff's
12 fourth claim for failure of condition precedent.

13 **E. Claim for Violation of California Corporations Code**

14 In its fifth claim, Wailea alleges that HSBC USA violated
15 Section 25401 of the California Corporations Code ("Section
16 25401"), thereby entitling Wailea to rescission of the Swap
17 Agreement under Section 25501 of the Code ("Section 25501").
18 Compl. ¶¶ 61-64. Section 25401 provides, in relevant part, that it
19 is unlawful for any person to sell a security by means of a
20 communication involving an "untrue statement of a material fact or
21 [omissions of] a material fact necessary in order to make the
22 statements made, in the light of the circumstances under which they
23 were made, not misleading." Section 25501 provides that the
24 purchaser of a security sold in violation of Section 25401 may sue
25 the seller for rescission, unless the seller can prove that it
26 exercised reasonable care and did not have knowledge of the untruth
27 or omission.

28 Wailea alleges that HSBC made "materially misleading

1 statements and omissions" of two types: (1) oral and written
2 representations that the Senator Fund had historically been
3 invested and would be invested pursuant to the SSC strategy; and
4 (2) month-end summary valuations that misstated the net asset value
5 of Wailea's investments. HSBC USA argues that Wailea's claim fails
6 because it is time-barred, and because Wailea cannot point to any
7 actionable statements or omissions subject to Section 25401. The
8 Court agrees with the latter argument and therefore need not
9 address the statute of limitations issue.

10 According to the Complaint, HSBC "represented" that the
11 Senator Fund had historically followed an SSC strategy and had not
12 breached HSBC's Investment Guidelines. Compl. ¶¶ 17, 32, 63(a).
13 HSBC also allegedly failed to disclose material information about
14 BLMIS contained in the 2006 KPMG report. Id. ¶ 33. Wailea's
15 Complaint also refers to various representations made by the
16 Senator Fund itself, id. ¶¶ 14-16, 18, and representations in the
17 Month-end Valuation Reports, id. ¶¶ 25, 63(b). HSBC USA argues
18 that none of these is an actionable representation. Wailea does
19 not respond to this argument, and the Court agrees with HSBC USA.
20 All of the alleged representations and omissions are either
21 expressly disclaimed in aforementioned provisions of the Swap
22 Agreement or are not cognizable under Section 25401.

23 Wailea expressly agreed that HSBC had not made any
24 representations whatsoever about the Senator Fund, Swap Agreement §
25 12(g); that HSBC was not responsible for any statements made by the
26 Senator Fund, id.; that Wailea had the sole responsibility to
27 investigate the Senator Fund, id. § 12(f); and that HSBC had no
28 obligation to disclose any material information in its possession

1 about the Senator Fund, even if such information was not public and
2 was not known to Wailea, id. § 20(b). This plain language of the
3 disclaimers is clear and precludes Wailea from now alleging that
4 HSBC USA made representations or omissions about the Senator Fund,
5 as that would directly contradict the bargained-for language of the
6 Swap Agreement. See Paracor Fin., Inc. v. Gen. Elec. Capital
7 Corp., 96 F.3d 1151, 1159 (9th Cir. 1996) (holding that investors'
8 contractual representation that they did not rely on any other
9 person in purchasing their investment defeated their securities
10 fraud claim); see also Bank of the West v. Valley Nat'l Bank, 41
11 F.3d 471, 477-78 (9th Cir. 1994) (holding that the "plain and
12 strong words" of a disclaimer of reliance defeated fraud claim
13 because "the [parties] expressly agreed to a relationship in which
14 each would investigate independently and exercise independent
15 judgment[, and] [t]here was no lack of clarity in the contract, no
16 mutual mistake, no reason to suppose that the parties mutually
17 intended any relationship other than what the contract said.")

18 The remaining purported actionable representations Wailea
19 alleges -- the statements in the Month-end Valuation Reports -- do
20 not support a claim under Section 25401 because they are not
21 communications made by Wailea in connection with the sale of a
22 security and therefore are not covered by Section 25401.

23 Accordingly, the Court DISMISSES WITH PREJUDICE Plaintiff's
24 fifth claim for violation of the California Corporations Code.

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V. CONCLUSION

For the foregoing reasons, the Court GRANTS the Motion to Dismiss filed by Defendant HSBC Bank USA, N.A., against Plaintiff Wailea Partners, LP. Plaintiff's Complaint is hereby DISMISSED WITH PREJUDICE.

IT IS SO ORDERED.

Dated: December 15, 2011

UNITED STATES DISTRICT JUDGE