SUPREME COURT OF THE STATE OF NEW YORK
NEW YORK COUNTY

PRESENT: HON. EILEEN BRANSTEN J.S.C.
Justice

PART 3

Index Number : 651360/2012
METROPOLITAN LIFE INSURANCE
vs.
MORGAN STANLEY
SEQUENCE NUMBER : 002
DISMISS ACTION

INDEX NO. 651360/2012
MOTION DATE 3/13/13
MOTION SEQ. NO. 002

The following papers, numbered 1 to 3, were read on this motion to/for dismiss

Notice of Motion/Order to Show Cause — Affidavits — Exhibits | No(s). 1
Answering Affidavits — Exhibits | No(s). 2
Replying Affidavits | No(s). 3

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

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 7-8-13

Eileen Bransten, J.S.C.
EILEEN BRANSTEN
J.S.C.

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

[* 2]

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 3

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METROPOLITAN LIFE INSURANCE COMPANY, METLIFE INSURANCE COMPANY OF CONNECTICUT, METLIFE REINSURANCE COMPANY OF SOUTH CAROLINA, GENERAL AMERICAN LIFE INSURANCE COMPANY, and METLIFE INVESTORS USA INSURANCE COMPANY,

Plaintiffs,

Index No. 651360/2012
Motion Seq. No. 002
Motion Date: 3/13/13

-against-

MORGAN STANLEY, MORGAN STANLEY & CO., INC., MORGAN STANLEY ABS CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL INC., MORGAN STANLEY CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC, SAXON CAPITAL INC., SAXON ASSET SECURITIES COMPANY, and SAXON FUNDING MANAGEMENT LLC,

Defendants.

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BRANSTEN, J.:

This action for fraud arises out of the MetLife Plaintiffs' purchase of over $758 million in residential mortgage backed securities ("RMBS") from the Morgan Stanley and affiliated Defendants in nine offerings from 2006 and 2007. Essentially, the MetLife Plaintiffs claim that Morgan Stanley misrepresented that the loans met stated origination standards, loan to value ratios, and debt to income limits, that the collateral was appraised in accord with industry standards, and procured inflated credit ratings. Morgan Stanley moves to dismiss, pursuant to CPLR 3211(a)(5) and (7), contending that certain claims are untimely, and that it cannot be held liable because MetLife cannot plead justifiable reliance or scienter; MetLife purchased $120 million of the securities before the alleged misrepresentations were in prospectus supplements; and for six of the nine offerings, Morgan Stanley served only as the underwriter, and, therefore, was not responsible for misstatements, and, in any event, there were ample warnings in the offering documents.

I. Background

The following facts are taken from the Amended Complaint, and are taken as true with all reasonable inferences drawn in Plaintiffs' favor for purposes of this motion to dismiss. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 290 n.2 (1st Dep't 2011); *Skillgames, LLC v. Brody*, 1 A.D.3d 247, 250 (1st Dep't 2003).

Plaintiff Metropolitan Life Insurance Company ("MLIC") is an insurance company, operated as a subsidiary of MetLife, Inc., and is headquartered in New York. Plaintiff MetLife Insurance Company of Connecticut ("MLCT") is a Connecticut insurance company, operating as a subsidiary of First MetLife Investors Insurance Company, which in turn is a subsidiary of MetLife, Inc., with its principal place of business in Connecticut. Plaintiff MetLife Reinsurance Company of South Carolina ("MLSC") is a South Carolina insurance company, a wholly owned subsidiary of MetLife, Inc., with its principal place of business in South Carolina. Plaintiff General American Life Insurance Company is a

Missouri insurance company, and is a subsidiary of GenAmerica Financial LLC, which is a subsidiary of MLIC and MetLife, Inc. Plaintiff MetLife Investors USA Insurance Company ("MLIUSA") is a Delaware corporation with its principal place of business in California, and is a subsidiary of MLCT. (Am. Compl. ¶¶ 17-22.) For this motion, these Plaintiff entities will be referred to as "MetLife," unless a distinction needs to be made, and Defendants will be collectively referred to as Morgan Stanley.

From April 2006 through to August 1, 2007, MetLife purchased nearly $758 million in RMBS from the Morgan Stanley Defendants in nine offerings: CWALT 2005-47CB, CWALT 2005-86CB, CMALT 2007-A4, FHAMS 2007-FA3, CWALT 2006-20CB, CWALT 2007-17CB, IXIS 2006-HE3, MSM 2006-11, and SAST 2007-3 (the "Certificates"). *Id.* ¶¶ 2, 14, 42. These RMBS are securities, represented by the Certificates, which pool residential mortgages, and which use the borrowers' monthly mortgage interest and principal payments to pay the holders of the Certificates. The Certificates themselves represent an interest in an "issuing trust" that holds the designated mortgage pools. *Id.* ¶ 32.

RMBS certificates are created in a multi-step process. First the "depositor" acquires an inventory of loans from a seller or "sponsor," which either originates the loans or acquires them from other mortgage originators. *Id.* ¶ 34. The depositor divides the cash flow and risks in the loan pool among different investment levels or tranches, with the senior tranches carrying the least risk, earning the lowest returns, and having the highest credit rating, and any losses to the loan pool are applied first to the most junior tranches. *Id.* ¶ 35. Most of the RMBS purchased by MetLife were among the most senior, risk-averse tranches rated by the rating agencies as a "AAA/Aaa." *Id.* ¶ 36. The sponsor and the depositor work together to create the structure of the securitization, including determining the collateral for each tranche. *Id.* ¶¶ 35-36. Once the tranches are established, the depositor then deposits the acquired pool of loans into an issuing trust, and passes the RMBS to the underwriter, who sells them to investors. *Id.* ¶¶ 24, 37, 39.

Defendant Morgan Stanley & Co., Inc. acted as underwriter for all of the nine Morgan Stanley RMBS offerings purchased by MetLife. *Id.* ¶ 24. Defendants Morgan Stanley Mortgage Capital Inc. ("MSMC") and Morgan Stanley Mortgage Capital Holdings LLC served as sponsor for the MSM 2006-11 RMBS purchased by MetLife. *Id.* ¶ 25. With regard to two of the nine offerings, SAST 2007-3 and MSM 2006-11, the Morgan Stanley entities acted as both sponsor and depositor of the RMBS securitization purchased by MetLife (the "Principal Securitizations"). *Id.* ¶ 31. With respect to one offering, IXIS 2006-HE3, Defendant Morgan Stanley ABS Capital I Inc. ("MSAC") acted as depositor and underwriter. *Id.* ¶ 27. On the remaining six offerings, Morgan Stanley acted solely as underwriter (the "Non Principal Securitizations").

The collateral pool for each securitization usually included thousands of loans. "Loan files" were developed by the originators while making the loans, which included information about the credit quality and characteristics of the loans deposited in the trusts. Investors, like MetLife, were not given access to the loan files. *Id.* ¶¶ 41, 60. Instead, MetLife relied upon the representations by Morgan Stanley in registration statements, prospectuses, draft prospectus supplements, prospectus supplements, and term sheets (the "Offering Materials") about the purportedly conservative mortgage underwriting standards applied by the originators, the appraisals of the properties, and other factors regarding the quality and nature of the loans forming the security for the RMBS. *Id.* ¶¶ 2, 145, 270-272. The gravamen of MetLife's claims is that Morgan Stanley defrauded MetLife by selling it ostensibly low-risk, investment grade RMBS that Morgan Stanley knew were risky investments, and concealing the true risk by its actions in underwriting the mortgages, packaging them into securities obtaining investment grade credit ratings by providing the credit agencies with false and misleading information, and selling the securities to MetLife as low-risk, while knowing they were toxic.

Specifically, MetLife asserts that the Offering Materials represented that the loans complied with the originators' underwriting guidelines, which were primarily intended to assess the borrowers' ability to repay, and that any exceptions thereto would be made only when compensating factors were demonstrated. *Id.* ¶ 145. They further represented that each loan was based on a property appraisal that conformed with the standards established by the Uniform Standards of Professional Appraisal Practice ("USPAP"), and that loan to value and combined loan to value ("LTV/CLTV") ratios of the loans were calculated using such conformed appraised values, and were accurate. *Id.* ¶¶ 145, 102, 104. Additionally, they represented that the underlying loans adhered to stated borrower debt to income ("DTI") limits, and that the credit ratings for the Certificates accurately reflected the likelihood that the holder would receive cash flows from the underlying loans. *Id.* ¶¶ 145, 242-243.

MetLife alleges that the various originators of the loans underlying the RMBS at issue routinely violated and practically abandoned their stated underwriting guidelines by approving DTI and CLTV ratios above the maximum permitted guidelines, ignoring borrower credit scores below the guidelines, ignoring unreasonable and unsubstantiated stated borrower income, allowing loans exceptions without compensating factors, approving loans with LTV ratios above 100%, and by manipulating the appraisal process in order to inflate the value of the mortgaged properties in order to originate and then sell as many mortgages as possible. *Id.* ¶¶ 147-148, 150, 154, 156-166, 173, 177-180, 188-189, 193, 195-196, 198, 204, 214, 224. The originators included MSMC (*id.* ¶¶ 146-154), Saxon Mortgage, Inc. (*id.* ¶¶ 155-161), Countrywide Home Loans (*id.* ¶¶ 162-173), First Horizon Home Loan Corp. (*id.* ¶¶ 174-182), CitiMortgage, Inc. (*id.* ¶¶ 183-190), American Home Mortgage Corp. (*id.* ¶¶ 191-201), Accredited Home Lenders, Inc. (*id.* ¶¶ 202-210), First NLC Financial Services LLC (*id.* ¶¶ 211-220), and New Century (*id.* ¶¶ 221-238). All of these loan originators are, or have been, the subject of governmental investigations and private lawsuits alleging misconduct arising out of pervasive illegal and improper mortgage lending practices and other violations of law, and many were shut down by regulators, filed for bankruptcy, and closed down operations (*id.* ¶ 5).

MetLife asserts that the Offering Materials contained false statements and omissions of material facts regarding the quality of the loans and the underwriting of them, including misrepresentations as to the originators' underwriting guidelines, that the property appraisals conformed to USPAP, that the LTV/CLTV ratios used conforming appraisal values and were accurate, that loans met DTI limits, the true risks of the RMBS, and that the credit ratings actually indicated the likelihood of receipt of payment by Certificateholders. *Id.* ¶¶ 145, 147, 156-157, 163-164, 175-176, 184, 192, 203, 212-213, 222-223, 240, and Exs. B through F annexed to Amended Complaint). MetLife further asserts that Morgan Stanley misrepresented the due diligence it conducted into the loan originators and the mortgage loans and ignored the results from such due diligence that the loans were defective. *Id.* ¶¶ 9, 69-103, 240. It contends that Morgan Stanley manipulated the credit rating agencies so that the ratings failed to accurately reflect the originators' underwriting guidelines and practices and the specific qualities of the underlying loans. *Id.* ¶¶ 242-251, 257-258, 260-264, 266, 268. Moreover, MetLife maintains that Morgan Stanley misrepresented the true risks of the RMBS, understating the severity thereof. *Id.* ¶¶ 239-241.

Plaintiffs allege that Morgan Stanley knew of the defects in the loans and the originators' underwriting practices, because they had retained an independent third-party due diligence provider, Clayton Holdings, Inc. ("Clayton") which had uncovered the problems. *Id.* ¶¶ 6-8, 62, 65-66, 72-76, 81-88. For example, Clayton as part of the due diligence did a calculation of debt-to-income ("DTI") ratios, Morgan Stanley's own policy was that borrowers with DTI ratios above 55% could not be expected to repay and should be rejected, but that Morgan Stanley routinely violated this policy with regard to the underlying loans. *Id.* ¶¶ 62, 98-101, 169. Morgan Stanley nevertheless continued to purchase and securitize the defective loans to continue its securitization operations and generate enormous fees, and to protect the warehouse lines of credit it provided to originators. *Id.* ¶¶ 106-110. Defendants allegedly negotiated lower prices for loans that it knew were not compliant with the originators' guidelines, and included them in pools for its principal securitizations of investment grade RMBS that it later sold to MetLife and other investors. *Id.* ¶¶ 9, 74. They would further bolster their bottom line, capitalizing on their knowledge of the poor quality of the loans by betting that those loans would fail by betting against a series of collateralized debt obligations backed by the RMBS that Morgan Stanley had underwritten and sold to MetLife. *Id.* ¶¶ 11, 124-130.

Moreover, the amended complaint alleges that Morgan Stanley would shred documents submitted by borrowers on full documentation loans which demonstrated that the borrowers' income was insufficient, and have the originator sell the loans to Morgan Stanley as cheaper "stated income" loans using an unverified borrowers' income that made the loans appear reasonable. *Id.* ¶¶ 9 n.2, 250. Morgan Stanley also participated in a practice in which unqualified borrowers were provided with cash– that is, the originator gave them cash to close or made some initial loan payments in order to keep the securitization machine going or keep the initial default rate artificially low, or it would negotiate side agreements with sellers of the loans regarding problem loans, such as foregoing a second appraisal required under an underwriting guideline, and have the originator agree to provide the "missing" appraisal at a later date. *Id.* ¶¶ 122-123.

MetLife also alleged that Morgan Stanley not only knowingly provided false information to credit rating agencies to get the highest rating, or withheld adverse information (*id.* ¶ 268), but also exploited its powerful influence over those agencies to obtain inflated investment grade ratings. *Id.* ¶¶ 12, 242-268. For example, the Morgan Stanley Defendants would routinely threaten to take their business to another rating agency, they would blacklist agency analysts who refused to give favorable credit ratings, and pushing Standard & Poor's and Moody's to use outdated rating methods that they knew resulted in inflated ratings. *Id.* ¶¶ 251, 255-256, 260, 262, 264, 266.

The loans backing the RMBS at issue consequently experienced a very high default rate. *Id.* ¶¶ 14, 276. By May 2012, on average, almost 28% of the principal balance of the mortgage loans underlying the Certificates was over 60 days delinquent, in foreclosure, bankruptcy or repossession. *Id.* ¶ 14. The serious delinquency rate for CMALT 2007-A4 was 19.98 % (*id.* ¶¶ 14, 190); for CWALT 2005-47CB was 24.24% (*id.* ¶¶ 14, 173); for CWALT 2005-86CB was 24.11% (*id.* ¶¶ 14, 173); for CWALT 2006-20CB was 39.98% (*id.*); for CWALT 2007-17CB was 21.62% (*id.*); for FHAMS 2007-FA3 was 25.20% (*id.* ¶¶ 14, 182); for IXIS 2006-HE3 was 32.28% (*id.* ¶¶ 14, 210, 220, 238); for MSM 2006-11 was 28.31% (*id.* ¶ 14); and for SAST 2007-3 was 33.55% (*id.*).

Almost every Certificate MetLife purchased carried an initial investment grade rating of AAA/Aaa, with an annual loss rate of close to zero, which have now all been downgraded to "junk." *Id.* ¶¶ 42, 282-283.

The original complaint in this action was filed on April 25, 2012. The amended complaint, later filed on June 29, 2012, sets forth three causes of action, each asserted against all the Defendants, for fraud (*id.* ¶¶ 285-293); fraudulent inducement (*id.* ¶¶ 294-301); and aiding and abetting fraud (*id.* ¶¶ 303-308).

Morgan Stanley Defendants move to dismiss on the grounds that the claims of three of the five Plaintiffs are time-barred under New York's borrowing statute and under the laws of those Plaintiffs' home states. They further urge that MetLife fails to state a claim for fraud because, as a sophisticated investor, it cannot allege justifiable reliance; MetLife purchased from five of the RMBS several months to a year after the prospectus supplements were issued, and, therefore, could not have relied upon representations made therein; MetLife fails to allege a material misrepresentation with regard to the RMBS for which Morgan Stanley served only as underwriter and was not responsible for the prospectus supplement misrepresentations; and MetLife fails to allege scienter and loss causation.

II. Discussion

The motion to dismiss is granted only to the extent that the claims by Plaintiff MLCT are dismissed as untimely, but is otherwise denied.

A. *Statute of Limitations*

Morgan Stanley asserts that the claims by Plaintiffs MLCT, MLSC, and MLIUSA are untimely by operation of the borrowing statute, CPLR 202. That provision requires that when a nonresident brings a claim accruing outside New York, the claim must be "timely under the limitation periods of both New York and the jurisdiction where the cause of action accrued." *Global Fin. Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 528 (1999); *see Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A), at *2 (Sup. Ct. N.Y. Cnty. 2012). The purpose of the statute is to "prevent[] nonresidents from shopping in New York for a favorable Statute of Limitations." *Global Fin. Corp.*, 93 N.Y.2d at 528. There is no dispute that Plaintiff MLCT is a Connecticut corporation, MLSC is a South Carolina corporation, and MLIUSA is a Delaware corporation, and, thus, they are not residents of New York. (Am. Compl. ¶¶ 18, 19, 21.) The Court of Appeals in *Global Financial Corporation* held that a claim accrues "at the time and in the place of the injury" for purposes of CPLR 202. 93 N.Y.2d at 529. It further ruled that "[w]hen an alleged injury is purely economic, the place of injury usually is where the Plaintiff resides and sustains the economic impact of the loss." *Id.* (citations omitted); *see also Portfolio Recovery Assoc., LLC v. King*, 14 N.Y.3d 410, 416 (2010).

Plaintiffs contend that this statute does not apply because the claims accrued in New York since MLCT, MLSC, and MLIUSA are all subsidiaries of MLIC, which is a New York resident, and the purchases of the RMBS occurred through MetLife's custodian bank in New York, and were held in accounts maintained in New York. They urge that, in securities cases, courts may consider other factors such as where the Plaintiff conducted its investment activities, paid for the securities, maintained the account which reflected the loss, and where the securities were handled, citing to *Epstein v. Haas Securties Corp.,* 731 F. Supp 1166, 1178 (S.D.N.Y. 1990) and *Lang v. Paine, Webber, Jackson & Curtis, Inc.,* 582 F. Supp 1421, 1425-1426 (S.D.N.Y. 1984). In *Lang,*, the plaintiff was a citizen of Canada residing in Ottawa, but the court found that he maintained a separate financial base in Massachusetts, which was where he suffered economic injury. In a strategic attempt to move assets to, and keep assets in, the U.S. as protection against currency fluctuations, the Plaintiff maintained an account in Massachusetts, and all trades through that account were directed by his broker who was based in Massachusetts. Under those exceptional circumstances, the court determined that Plaintiff had established his financial base in Massachusetts, and that his economic injury occurred there, not where he resided in Canada.

Plaintiffs MLCT, MLSC, and MLIUSA, however, have not demonstrated the sort of unusual circumstance that would warrant application of this "extremely rare" exception to the general rule that a Plaintiff suffers economic injury, that is, becomes poorer, in its state of residence. *See Epstein v. Haas Sec. Corp.*, 731 F. Supp. at 1178 (citations omitted); *accord In re Countrywide Fin. Corp. Mortgage-Backed Sec. Litig.*, 834 F. Supp. 2d 949, 959-960 (C.D. Cal. 2012) (fraud claims accrued where Plaintiff has its principal place of business); *Gordon & Co. v. Ross*, 63 F. Supp. 2d 405, 408-409 (S.D.N.Y. 1999) (securities fraud claims accrue where Plaintiff resides not where investment activity occurred, following *Global Financial Corp.)*; *Gorlin v. Bond Richman & Co.*, 706 F. Supp. 236, 239-240 (S.D.N.Y. 1989) (claims by Connecticut residents who suffered losses in New York brokerage account from unauthorized trading accrued in Connecticut)). The court also notes that the *Lang* and *Epstein* cases both pre-date *Global Financial Corp.*, which reiterated the general applicability of the residence standard. To extend the financial base exception to a foreign corporation conducting financial business through a parent corporation, without actual unusual circumstances, would allow this exception to overtake the rule, and eviscerate the borrowing statute. Accordingly, this court concludes that MLCT's, MLSC's, and MLIUSA's claims arose in the states of their residency – respectively, Connecticut, South Carolina, and either Delaware or California.

"[I]n 'borrowing' a Statute of Limitations of another State, a New York court will also 'borrow' the other State's rules as to tolling." *Antone v. General Motors Corp.*, 64 N.Y.2d 20, 31 (1984) (internal quotations and citations omitted)).

All of the Plaintiffs' claims would be timely under the six-year New York statute of limitations for fraud, CPLR 213, so the critical analysis for Plaintiffs MLCT, MLSC, and MLIUSA involves the application of the shorter statute of limitations of Connecticut, South Carolina, Delaware, and California.

1. MLCT's Claims

In Connecticut, claims based on fraud are governed by a three-year statute of limitations. *See* Conn. Gen. Stat. § 52-577; *see also Krondes v. Norwalk Sav. Soc'y.*, 728 A.2d 1103, 1109-1110 (Conn. App. Ct. 1999) (fraud claims governed by Conn. Gen. Stat. § 52-577). The "date of the act or omission complained of" is the date when the wrongful conduct of the Defendant occurs, not the date of Plaintiff's discovery. *Certain Underwriters at Lloyd's, London v. Cooperman*, 957 A.2d 836, 850 (Conn. 2008) (internal quotation and citation omitted). It is a statute of repose which does not toll until the Plaintiff discovers the injury. *Id.* Accordingly, all of Plaintiff MLCT's claims arising out of RMBS purchases prior to April 25, 2009 would be time-barred under Connecticut's three-year limitations period accruing from the wrongful conduct which occurred on the date of sale of the Certificates. Thus, Plaintiff MLCT's claims for fraud accrued before April 25, 2009, since the purchases at issue, for Certificates CWALT 2005-86CB, CWALT 2006-20CB, CWALT 2007-17CB, IXIS 2006-HE3, and SAST 2007-3, occurred from April 25, 2006 through August 1, 2007. Therefore, they are time-barred.

2. MLSC's Claims

With regard to Plaintiff MLSC, in South Carolina, the statute of limitations for fraud is three years from when the Plaintiff has inquiry notice, that is, it knew or by the exercise of reasonable diligence should have known that it had a claim. S.C. Code § 15-3-530(7); *see Moore v. Benson*, 700 S.E.2d 273, 277 (S.C. Ct. App. 2010) (fraud claim limitations period is three years, and runs from when person could or should have known through exercise of reasonable diligence that claim might exist)). Morgan Stanley argues that MLSC could or should have discovered that it had a fraud claim when, as alleged in the amended complaint, there was a public radio broadcast of an interview of Mike Francis, a former executive director on Morgan Stanley's residential mortgage desk.

The difficulty with this argument is that it is not alleged in the complaint, when this interview occurred, when MLSC became aware of it, and when it became aware that it meant that Morgan Stanley had misrepresented the risk involved with the RMBS it sold MLSC. Morgan Stanley further points to the fact that, by mid-2007, MetLife had reduced its sub-prime RMBS exposure by 25%, purportedly because of recognition of deterioration in mortgage underwriting standards (citing Exhibits 17 and 18 to Affirmation of James P. Rouhandeh). This proof, however, is insufficient to show as a matter of law that Plaintiff MLSC could have known not only that certain statements in the Offering Materials were false, but also that Morgan Stanley knew they were false and acted with intent to defraud. *See Merck & Co., Inc. v. Reynolds*, 130 S.Ct. 1784, 1796 (2010) (plaintiff cannot recover on securities law violation claim without demonstrating that defendant made misrepresentation with intent to deceive, and limitations period begins to run where Plaintiff discovers facts suggesting scienter).

A number of courts have denied limitations-based motions in RMBS fraud actions despite objections similar to those raised by the Morgan Stanley Defendants here. For example, in *In re Countrywide Fin. Corp. Mortgage-Backed Securities*, 2012 WL 1322884 (C.D. Cal. Apr 16, 2012) (*Countrywide II*), the court held:

> Defendants have cited a number of articles from 2007 that either make or hint at this same connection. As in *Allstate* it is possible, perhaps probable, that Defendants will ultimately demonstrate that a reasonable investor was on inquiry notice by August 31, 2007. However, 2007 was a turbulent time during which the causes, consequences, and interrelated natures of the housing downturn and subprime crisis were still being worked out. The Court cannot, based solely on the [complaint] and judicially noticeable documents, conclude that by August 31, 2007 a reasonably diligent investor should have linked increased defaults and delinquencies in the loan pools underlying the Certificates with both a failure to follow the underwriting and appraisal guidelines specified in the Offering Documents and the possibility that the tranches purchased by [Plaintiff] would suffer losses. That is the link that a reasonable investor would have needed to make in order to know that something material was amiss with the Offering Documents for the particular tranches that are at issue in this case. Accordingly, the Court DENIES Defendants' motions to dismiss based on the statute of limitations"

Countrywide II, 2012 WL 1322884 at *4; *see also Mass. Mut. Life Ins. Co. v Residential Funding Co., LLC*, 843 F. Supp. 2d 191, 208-09 (D. Mass. 2012) ("At this point in the litigation, Defendants have not met the relatively high burden to demonstrate that Plaintiff was on inquiry notice in 2007 . . . [i]ndeed, courts have been reluctant to conclude that purchasers of mortgage-backed securities were on inquiry notice of similar claims as late as mid–2008, let alone as early as 2007"); *Capital Ventures Int'l v. J.P. Morgan Mortg. Acquisition Corp.*, 2013 WL 535320 at *7 (D. Mass. Feb. 13, 2013) (finding that Defendants failed to carry "heavy burden" of demonstrating that Plaintiff was on notice of its claims by October 2007, despite defendants' citation to newspaper articles, government publications, and media reports noting the widespread erosion of underwriting guidelines in the mortgage market, the pressure on appraisers to generate inflated property values, pervasive misrepresentation of owner occupancy and associating the erosion of underwriting guidelines and increased default rates with the primary originators whose loans backed plaintiffs' certificates); *Pub. Employees' Ret. Sys. of Mississippi v. Merrill Lynch & Co., Inc.*, 714 F. Supp. 2d 475, 479-480 (S.D.N.Y. 2010) (although defendants "proffered substantial evidence that prior to December 2007, let alone prior to March 27, 2008, questions about the bona fides of mortgage-backed securities were the subject of news reports, government investigations, public hearings, and civil complaints," dismissal was premature absent evidence that plaintiffs would have been put on notice that Merrill or its particular Certificates were implicated). Indeed, this court recently held that information reported in newspapers, or otherwise broadcast, about the possible falsity of loan information is insufficient to put Plaintiffs on notice of Morgan Stanley's intent to defraud. *See Allstate Ins. Co. v Morgan Stanley*, 2013 WL 2369953, 2013 NY Slip Op 31130(U) at *9-10 (Sup. Ct. N.Y. Cnty. 2013).

None of the facts or allegations which Defendants contend should impute notice to Plaintiff MLSC directly implicate the Morgan Stanley Defendants' misrepresentations or scienter. The collapse of the various loan originators, ratings downgrades (even those with regard to these specific Certificates), general allegations of misconduct in the subprime mortgage industry or monthly delinquency reports, would not necessarily apprise Plaintiffs that Morgan Stanley was complicit in their wrongdoing. The link becomes even more attenuated insofar as most of the originators were only responsible for a percentage of the loans placed in various combinations of the RMBS.

The court must credit, at this point, Plaintiffs' allegations that the necessary information giving rise to a duty to inquire only emerged after April 2009-2011, that Plaintiffs did not know of Morgan Stanley's fraud when perpetrated, that they did not know and could not have known that the originators were not following their stated underwriting guidelines, that the appraisals were not independent and resulted in false appraisal values, that they were accepting false information concerning borrowers' stated income and other characteristics, that Morgan Stanley had identified numerous problems with the originators' loans, and that Morgan Stanley was improperly manipulating the credit rating agencies (Am. Compl. ¶ 275; *see also* ¶¶ 41, 55), and the fraud only became known to Plaintiffs when the "Financial Crisis Inquiry Commission" and "United States Senate Permanent Subcommittee on Investigations" reports were first released in 2011. *Id.* ¶¶ 269-280.

The only allegation relating to Morgan Stanley's scienter is the national public radio broadcast, and, again, there is no allegation when that actually occurred (although according to the parties in *Allstate Insurance Co. v Morgan Stanley*, 2013 WL 2369953, it allegedly occurred in May 2008), and more importantly, when Plaintiffs became aware of it. In addition, the statement was general and did not provide specifics of any purported fraud by Morgan Stanley with regard to the Certificates Plaintiff MLSC purchased. Moreover, even where facts are "widely-reported," their knowledge cannot be imputed to a Plaintiff absent actual notice. Defendants would need to make an additional demonstration that these facts would have led to knowledge of fraud with respect to Plaintiffs' MLSC's investment in the Certificates at issue here. At this early pleading stage, such a determination may not be made based on the alleged content of that broadcast or the more general press coverage regarding problems and misconduct in the subprime mortgage industry. *See In re Countrywide Fin. Corp. Mortgage-Backed Sec. Litig.*, 2012 WL 1322884, at *4 (C.D. Cal. Apr 16, 2012); *Massachusetts Mut. Life Ins. Co. v. Residential Funding Co., LLC*, 843 F. Supp. 2d at 208-209; *Capital Ventures Int'l v. J.P.*

Morgan Mortg. Acquisition Corp., 2013 WL 535320, at *7; *Allstate Ins. Co. v. Morgan Stanley*, 2013 WL 2369953, at *9.

Therefore, for the foregoing reasons, Defendants' motion to dismiss Plaintiff MLSC's claims in the Amended Complaint as time-barred is denied without prejudice.

3. MLIUSA

With regard to Plaintiff MLIUSA, a Delaware corporation with its principal place of business in California, the motion to dismiss as time-barred is also denied without prejudice. The Court of Appeals in *Global Financial Corp. v Triarc Corp.*, 93 N.Y.2d 525, 530 (1999), ruled that a claim accrues and a corporate Plaintiff suffers injury in its place of incorporation or its principal place of business, but did not decide which would take precedence where they differed. The First Department in *Kat House Productions, LLC v. Paul, Hastings, Janofsky & Walker, LLP,* 71 A.D.3d 580, 580-581 (1st Dep't 2010), ruled that a legal malpractice claim by a company accrued in California, the company's principal place of business, without analyzing the place of incorporation. In *Oxbow Calcining USA Inc. v. American Industrial Partners,* 96 A.D.3d 646, 651 (1st Dep't 2012), that court stated that, for purposes of the borrowing statute, the place of injury for a purely economic loss is where the Plaintiff resides, and "[i]n the case of a corporate Plaintiff, that may be the state of incorporation or its principal place of business." *Id.* at 651 (citing *Global Fin. Corp. v. Triarc Corp.*, 93 N.Y.2d 525, 529-530 (1999).) The court then denied the motion to dismiss the claim as untimely on the ground that it was premature because of conflicting allegations regarding the principal place of business of the Plaintiffs. *Oxbow Calcining USA Inc.*, 96 A.D.3d at 651.

Here, there is no assertion that MLIUSA suffered injury in Delaware, where it is incorporated. In addition, there is no factual dispute as to Plaintiff MLIUSA's principal place of business – California, which is where MLIUSA is alleged to have suffered its economic injury and where its losses were most acutely felt. *See Global Fin. Corp.*, 93 N.Y.2d at 530; *In re Countrywide Fin. Corp. Mortgage-Backed Sec. Litig.*, 834 F. Supp. 2d at 959-960 (C.D. Cal. 2012). Thus, this court concludes that, under these circumstances, Plaintiff MLIUSA's claim accrued for borrowing statute purposes in California.

The California statute of limitations, like South Carolina, is three years which does not run until discovery by the Plaintiff of the facts constituting the fraud. (Cal. Civ. Proc. Code § 338(d).) While under California law, a Plaintiff does not have to have notice of the Defendant's specific intention to deceive before the fraud claim accrues, there must be a showing that the Plaintiff learned or is put on notice that a representation is false. *See Hamilton Materials, Inc. v. Dow Chem. Corp.*, 494 F.3d 1203, 1206-1207 (9th Cir. 2007). Thus, the statute begins to run when the Plaintiff "has information which would put a reasonable person on inquiry." *Kline v. Turner*, 87 Cal. App. 4th 1369, 1374 (Cal. Ct. App. 2001). It is a question for the trier of fact as to what facts or circumstances would compel inquiry by the injured party and render it chargeable with knowledge, particularly, as here, where the facts alleged are susceptible to opposing inferences. *See Fox v. Ethicon Endo-Surgery, Inc.*, 110 P.3d 914, 922 (2005). As already discussed above, at this early pleading stage, this court may not determine that Plaintiffs were on inquiry notice of Morgan Stanley's alleged fraud with respect to Plaintiffs' purchase of the Certificates at issue in this case. Accordingly, the branch of the motion to dismiss Plaintiff MLIUSA's claims as untimely is denied without prejudice.

B. *Common Law Fraud and Fraudulent Inducement Claims*

Plaintiffs allege both common-law fraud and fraudulent inducement claims in the amended complaint (first and second causes of action). To state a claim for fraud, a Plaintiff must plead "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 N.Y.3d 553, 559 (2009). The elements of a fraudulent inducement claim are substantially similar. *See Perrotti v. Becker, Glynn, Melamed & Muffly LLP*, 82 A.D.3d 495, 498 (1st Dep't 2011).

1. Justifiable Reliance

Defendants first contend that MetLife could not have reasonably relied upon the alleged misrepresentations because as a sophisticated investor MetLife had a duty to independently verify the information presented in the offering materials, and to plead the due diligence it performed. They contend that MetLife does not allege that it requested any additional data about the underlying loans, the securitization structure, or the credit ratings, and that its vague allegations of analyses of information provided directly or indirectly by Morgan Stanley is insufficient. *See* Am. Compl. ¶¶ 41, 274-275. They assert that the information available to MetLife and to the public at large at the time the Certificates were issued about the underwriting practices of originators such as Countrywide and New Century, should have alerted MetLife to the alleged misrepresentations. Morgan Stanley further points to MetLife's purchase of five of the nine securities offerings more than three months after the offering materials were issued, but yet its failure to allege that it relied on any additional information that came to light afterward regarding rising delinquency and default rates.

The pleading requirements for reliance are minimal on a motion to dismiss, and it is generally premature to decide the question at the pleading stage. *Knight Sec. LP v. Fiduciary Trust Co.*, 5 A.D.3d 172, 173 (1st Dep't 2004). While it is true that "New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions," *Global Mins. & Metals Corp. v. Holme*, 35 A.D.3d 93, 100 (1st Dep't 2006), "such rule is not determinative . . . [where the plaintiff] . . . has sufficiently alleged that [Defendant] possessed peculiar knowledge of the facts underlying the fraud, and the circumstances present would preclude any investigation by [plaintiff] conducted with due diligence." *China Dev. Indus. Bank v. Morgan Stanley & Co., Inc.*, 86 A.D.3d 435, 436 (1st Dep't 2011) (citation omitted).

MetLife alleges that they lacked access, and could not have received such access upon request, to the underlying RMBS loan files and had to rely upon Morgan Stanley's representations about their quality. (Am. Compl. ¶ 60.) This pleading distinguishes this case from *HSH Nordbank AG v. UBS AG.* 95 A.D.3d 185 (1st Dep't 2012), as MetLife's allegations stem from facts not alleged by either side to be discoverable through public sources or ascertainable through means available to MetLife – i.e., the underwriting practices used to originate the loans underlying the Certificates and the resulting quality of those loans, Defendants' practice of waiving into their securitization loans that they knew were defectively originated, and the credit ratings and the intentional manipulation of those ratings with respect to these Certificates. *See* Am. Compl. ¶¶ 269, 274-275, 278; *see also Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A), at *10

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(Sup. Ct. N.Y. Cnty. 2012) (plaintiff "has also alleged that it 'had no reasonable means or ability to conduct its own due diligence regarding the quality of the mortgage pools' because it did not have access to the underlying loan files, appraisals, or supporting documentation . . .; [t]hese allegations are sufficient to plead justifiable reliance"). As MetLife has alleged, Morgan Stanley had special knowledge as to the quality of the underlying loans to which MetLife lacked access, and thus, even though MetLife is a sophisticated investor it may reasonably rely upon such unique knowledge. *See MBIA Ins. Co. v. Morgan Stanley*, 2011 WL 2118336, at *9 (Sup. Ct. Westchester Cnty. May 26, 2011).

Morgan Stanley also argues that with regard to one offering, CWALT 2007-17CB, MetLife purchased $120 million in certificates (on June 27, 2007) before the alleged misrepresentations were made (June 28, 2007), and, therefore, could not have relied thereon. However, this objection is misguided because MetLife has defined the "Offering Materials" in its complaint as including draft prospectuses, term sheets, and other non-final documents, not simply prospectus supplements (Am. Compl. ¶ 2); Defendants also provided term sheets and free writing prospectuses with regard to the purchase; and MetLife alleges that where they "purchased an RMBS before the final prospectus supplement was issued," they understood that the "final terms would be identical to the terms they initially received and Defendants were obligated to inform Plaintiffs if those terms changed." *Id.* ¶ 273; *see also* ¶ 272. This pleading is sufficient.

2. Misrepresentation

MetLife's amended complaint asserts misrepresentations by Morgan Stanley regarding its underwriting guidelines, and the underwriting guidelines of the loan originators; its purported due diligence; the LTV and DTI ratios; the true risks of the Certificates, the accuracy of the credit ratings and Defendants' role with respect thereto; and that the property appraisals conformed to USPAP. *Id.* ¶ 145. Morgan Stanley contends that MetLife fails to sufficiently allege misrepresentations as to the non-principal securitizations, where Morgan Stanley acted only as underwriter, arguing that it cannot be liable for statements in the Offering Materials because MetLife fails to plead that Morgan Stanley had sufficient control over the statements. MetLife alleges, however, that, as the underwriter, Morgan Stanley authorized or caused false statements to be made in the Offering Materials by "gathering, verifying and presenting to potential investors accurate and complete information about the credit quality and characteristics of the loans" (Am. Compl. ¶ 41), preparing term sheets and free writing prospectuses that misrepresented the credit quality of the Certificates, and distributing the Offering Materials to investors like

MetLife, even with Morgan Stanley's name on the front page of such materials. *Id.* ¶¶ 38-39.

Common-law fraud claims may be asserted against parties who make, authorize, or cause a representation to be made. *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164, 1186 (C.D. Cal. 2011) (discussing New York common law and comparing to federal securities claims). The amended complaint here sufficiently alleges that Morgan Stanley made or caused misrepresentations to be made to MetLife regarding the credit quality of the loans and the risks of the Certificates. Morgan Stanley may be held liable for drafting and distributing statements they knew to be false, regardless of who they credit as the source of the information, such as the originators of the loans, or for acting as an insider with respect to the alleged fraudulent scheme. *See Williams v. Sidley Austin Brown & Wood, LLP*, 38 A.D.3d 219, 220 (1st Dep't 2007); *China Dev. Indus. Bank v. Morgan Stanley & Co.*, 86 A.D.3d 435, 436 (1st Dep't 2011); *King County, Washington v. IKB Deutsche Industriebank AG*, 751 F. Supp. 2d 652, 658 (S.D.N.Y. 2010) (under New York common law, allegations that Defendant worked with rating agencies to design, structure, market investment vehicle, and caused rating agencies to issue false ratings, were sufficient to hold liable for fraud as insider for misleading ratings).

For the same reason, Morgan Stanley can be held liable for promoting the Certificates based upon the high ratings from the credit rating agencies if, as alleged, they knew the ratings were based on false information provided to the agencies, and they engaged in pressuring and manipulating the agencies into using outdated ratings models. *See* Am. Compl. ¶¶ 244-268; *see also Allstate Ins. Co. v. Morgan Stanley*, 2013 WL 2369953, at *14 (Sup. Ct. N.Y. Cnty. Mar. 14, 2013). Morgan Stanley's reliance on *Janus Capital Group, Inc. v. First Derivative Traders,* 131 S. Ct. 2296, 2302-2303 (2011) is misplaced. In *Janus Capital Group, Inc.*, the Supreme Court analyzed whether, for purposes of a Rule 10b-5 claim, the maker of a statement must be the person or entity with ultimate authority over the statement. It determined that a Rule 10b-5 claim, which has narrow dimensions as a private right of action, is significantly limited in its reach. *Id.* at 2302. *Janus Capital Group, Inc.*, however, has been limited to federal securities law claims, and should not be applied to this common-law fraud claim. *In re Optimal U.S. Litig.*, 837 F. Supp. 2d 244, 262-263 (S.D.N.Y. 2011) (*Janus* is not applicable to New York common law-fraud claim); *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d at 1186 (in contrast to federal laws, "New York has embraced a broader scheme of liability for those who make, authorize, or cause a misrepresentation to be made").

Next, Morgan Stanley contends that there were no misrepresentations as to the true risks of the securities and as to the underwriting guidelines (Am. Compl. ¶ 145) because there were abundant, blunt disclosures in the prospectus supplements for each RMBS, including, *inter alia*:

> [Y]ou should carefully consider the following risks . . . that make an investment in the certificates speculative or risky (MSM 2006-11 at S-17);
>
> Owing to a 'less stringent approach to underwriting,' the underlying mortgages were more likely to experience 'higher rates of delinquencies, defaults, and foreclosures (IXIS 2006-HE3 at S-11-12);
>
> 'Recently, the subprime mortgage loan market has experienced increasing levels of delinquencies and defaults . . . you should consider the heightened risk associated with purchasing the offered certificates' (SAST 2007-3 at S-30; *see also* CWALT 2007-17CB at S-30);
>
> 'There is growing evidence that home prices in many areas in the United States have declined . . . Defaults on residential mortgage loans have been increasing,' which 'could increase defaults . . . [and] reduce the amount that could be realized on foreclosure' (CMALT 2007-A4 at 12)

(Defendants' Memorandum in Support at 18.) They also point to disclosures that "[a] significant number of Mortgage Loans . . . may represent underwriting exceptions" (MSM 2006-11 at S-82).

As in other RMBS cases where such warnings have been deemed ineffective, Morgan Stanley has merely identified "boilerplate disclaimers and disclosures in the relevant offering documents . . . that . . . [did] not disclose the risk of a systematic disregard for underwriting standards or an effort to maximize loan originations without regard to loan quality," or alert Plaintiffs to the other allegedly wrongful practices engaged in by Morgan Stanley. *In re Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 810 F. Supp. 2d 650, 672 (S.D.N.Y. 2011); *see Allstate Ins. Co. v. Morgan Stanley*, 2013 WL 2369953, at *13-14. These disclosures about the risks stemming from a less stringent approach to underwriting where the underwriting standards are abandoned does not adequately warn of the risk that such standards will be entirely ignored. *See In re IndyMac Mortgage-Backed Sec. Litig.*, 718 F. Supp. 2d 495, 509 (S.D.N.Y. 2010); *Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A),at *7. Therefore, notwithstanding the disclaimers, MetLife's allegations that the Offering Materials were misleading are sufficient to withstand this motion to dismiss.

This court also concludes that MetLife's allegations of fraud in connection with DTI's, the appraisal process, and LTV ratios may stand. The complaint alleges that the appraisers retained were manipulated by the originators, resulting in inflated appraisal values, which were then used to determine LTV ratios, causing them to be understated, and the mortgaged properties were often worth less than the loan. (Am. Compl. ¶¶ 102, 199, 209, 224, 234-237.) They further allege that Morgan Stanley was aware of these facts, but would intentionally delay or not conduct second appraisals allowing the loans to be securitized on the original flawed information. *Id.* ¶ 102. These types of misrepresentations have been held actionable notwithstanding the Defendants' contention that appraisals are statements of opinion. *See MBIA Ins. Co. v. Countrywide Home Loans,* *Inc.*, 87 A.D.3d 287, 294 (1st Dep't 2011); *In re Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 810 F. Supp. 2d at 672-673 (appraisals); *Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A), at *9 (Sup. Ct. N.Y. Cnty. Nov. 30, 2012) (LTV ratios, credit ratings, appraisals). Appraisals are "akin to representations of fact" when they purport to represent an "analysis of the market conditions, sale histories and fair market values of the relevant collateral." *Stewardship Credit Arbitrage Fund LLC v. Charles Zucker Culture Pearl Corp.*, 31 Misc.3d 1223(A), at *6 (Sup. Ct. N.Y. Cnty. 2011). With regard to DTI ratios, disclosing that exceptions to DTI ratios could be made, does not absolve Morgan Stanley of liability for systematically disregarding stated DTI limits. (Am. Compl. ¶¶ 98-101, 145.)

Finally, Morgan Stanley urges that MetLife fails to identify any misstatements regarding Morgan Stanley's due diligence. The Offering Materials provided, *inter alia*, that "[p]rior to acquiring any residential mortgage loans, [Defendant] conducts a review of the related mortgage loan seller' and "[t]he underwriting guideline review entails a review of the mortgage loan origination processes and systems." *Id.* ¶ 79. MetLife alleges that Morgan Stanley "ignored the pervasive defects that its internal and external [third-party] due diligence processes identified," ignored the findings of Clayton, its third-party due diligence provider, and used the information to obtain reduced loan prices for the defective loans and then securitize them in the the RMBS it sold to MetLife. *Id.* ¶¶ 80, 81-101.

Although Defendants did conduct the promised due diligence reviews, the statements are misleading because they imply that Morgan Stanley would act in accordance with the review rather than ignore it. The representation that the due diligence reviews would "var[y] based on the credit quality of the mortgage loans," and that they "may review" underwriting guidelines (*id.* ¶ 79), again cannot excuse a complete abandonment of underwriting practices and of the purpose of due diligence reviews.

3. Scienter

Morgan Stanley then challenges MetLife's allegations regarding scienter. To plead the element of scienter, the complaint need only "contain[] some rational basis for inferring that the alleged misrepresentation was knowingly made." *Houbigant, Inc. v. Deloitte & Touche LLP*, 303 A.D.2d 92, 98 (1st Dep't 2003); *see Seaview Mezzanine Fund, LP v. Ramson*, 77 A.D.3d 567, 568 (1st Dep't 2010). While it must be pled with particularity, this requirement "should not be confused with unassailable proof of fraud." *Pludeman v. Northern Leasing Sys., Inc.*, 10 N.Y.3d 486, 492 (2008).

In a case involving RMBS, "the allegations of the mortgage loans material and pervasive non-compliance with the Seller's underwriting Guide and the mortgage loan representations are sufficient non-compliance from which Defendant's scienter can be inferred." *MBIA Ins. Co. v. Morgan Stanley*, 2011 WL 2118336, at *4-5 (Sup. Ct.

Westchester Cnty. May 26, 2011); *see China Dev. Indus. Bank v. Morgan Stanley & Co. Inc.*, 86 A.D.3d 435, 436 (1st Dep't 2011) ("[t]he element of scienter can be reasonably inferred from the facts alleged . . . including e-mails [sic], which support a motive by Morgan, at the time of the subject transaction, to quickly dispose of troubled collateral (i.e., predominantly residential mortgage-backed securities) which it owned at the time"); *Stichting Pensioenfonds ABP v. Credit Suisse Group AG,* 38 Misc.3d 1214(A), at *11 (Sup. Ct. N.Y. Cnty. Nov. 30, 2012) (scienter requirement satisfied where complaint alleged that Defendants "were involved in every step of the complex process that eventually resulted in the Certificates, including making the mortgage loans, selecting the loans for securitization, commissioning diligence reviews of the loans, servicing the loans, monitoring loan performance, bundling the loans into RMBS, and selling the RMBS Certificates to investors . . . [d]efendants' knowledge of the poor quality of the loans can be inferred from its interactions with its due diligence vendor . . . and through its use of the 'repricing' program, which involved demanding extra compensation from third party originators for poor quality loans . . . [t]aken together, [Plaintiff's] allegations make it rational to infer that [Defendants] knew that many of the representations in its Offering Documents were false").

The amended complaint alleges, inter alia, that Morgan Stanley knew about and ignored deficiencies in the underlying loans, deliberately manipulated the due diligence process to conceal deficiencies in the loans, even shredding documents showing insufficient borrower income, used its knowledge to negotiate cheaper prices for these deficient loans before securitizing them into the RMBS, and deliberately manipulated the credit ratings process to conceal the deficiencies in the loan pools. Nevertheless, Morgan Stanley contends that their disclosed retention of risky residual tranches in the same RMBS it sold to MetLife exposed it to greater financial risk than MetLife, and assert that this fact renders the allegation that it knew that the loans it was securitizing were going to fail irrational. A similar argument was rejected in both *Federal Housing Finance Agency v. Morgan Stanley,* 2012 WL 5868300, at *2 (S.D.N.Y. Nov 19, 2012), and in this Court's decision in *Allstate Ins. Co. v. Morgan Stanley,* 2013 WL 2369953, at *11, where the Defendants had argued that the complaint's scienter allegations were incredible because Morgan Stanley had retained an interest in the RMBS and thus had no motive to permit securitization of deficient loans. Both this court and the federal district court concluded that this turns on factual disputes that are not appropriate for resolution on a motion to dismiss. *Fed. Hous. Fin. Agency v Morgan Stanley,* 2012 WL 5868300, at *2 (S.D.N.Y. Nov. 19, 2012); *Allstate Ins. Co. v Morgan Stanley*, 2013 WL 2369953, at *11; *see also Dandong v Pinnacle Performance Ltd.*, 2011 WL 5170293, at *12 (S.D.N.Y. Oct 31, 2011), *aff'd in part, remanded in part on other grounds Lam Yeen Leng v. Pinnacle*

Performance Ltd., 474 Fed. App'x 810 (2d Cir. 2012) (inferring scienter from betting against or shorting).

This Court again declines to evaluate Morgan Stanley's other motive-related arguments regarding the rationality of the complaint allegations about Morgan Stanley's warehouse lending arrangements. Moreover, the Court does not find *In re Wachovia Equity Securities Litigation*, 753 F. Supp. 2d 326 (S.D.N.Y. 2011), persuasive, because the court there was addressing a claim under the Private Securities Litigation Reform Act under a heightened standard that required that "[t]he resulting inference of scienter 'must be more than merely plausible or reasonable– it must be cogent and at least as compelling as any opposing inference of nonfraudulent intent.'" *Id.* at 348 (quoting *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 US 308, 314 (2007)); *see Stichting Pensioenfonds ABP v. Credit Suisse Group AG,* 38 Misc.3d 1214(A), at *9 (New York law employs "a more lenient test than the Second Circuit's 'strong inference of fraud' test, and requires only that the complaint include 'facts from which it is possible to infer Defendant's knowledge of the falsity of its statements'") (citations omitted)). Therefore, MetLife's allegations are sufficient to assert scienter by Morgan Stanley and survive this motion to dismiss.

4. Loss Causation and Damages

Morgan Stanley contends that MetLife has not and cannot allege that its loss was proximately cause by Morgan Stanley's acts rather than intervening market wide events such as the U.S. housing market collapse. As this court already held in *Allstate Insurance Company v. Morgan Stanley*, 2013 WL 2369953, at *11-12, this kind of argument has been repeatedly rejected as premature, and loss causation under these circumstances is for the trier of fact. "It cannot be said, on this pre-answer motion to dismiss, that [Plaintiffs'] losses were caused, as a matter of law, by the 2007 housing and credit crisis," rather, it is up to the fact-finder to determine which losses were due to extrinsic forces and which were proximately caused by Defendant's misrepresentation. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 295 (1st Dep't 2011) (internal citations and quotations omitted); *MBIA Ins. Co. v Morgan Stanley*, 2011 WL 2118336, at *5 (Sup. Ct. Westchester Cnty. May 26, 2011) ("whether MBIA's losses were caused by Morgan Stanley's representations or the economic downturn is a question of fact for trial").

Where a Plaintiff pleads that the misrepresentations caused its losses, and the Defendant claims some other cause such as a market decline then "causation is a matter of proof at trial and not to be decided on a . . . motion to dismiss." *Stichting Pensioenfonds ABP v. Credit Suisse Group AG,* 38 Misc.3d 1214(A), at *12 (internal quotations and citation omitted). MetLife has sufficiently pled a "chain of causation leading from the alleged abandonment of underwriting standards, to higher rates of default and delinquency in the underlying mortgages, to the Certificates' ratings downgrades, finally to the Certificates' decline in market value" and once that is done, "[t]he validity of this chain of causation, and the apportionment of [Plaintiff's] loss between this cause and the general credit crisis, are not sustainable issues for a motion to dismiss." *Id.* at *12-13.

Morgan Stanley's assertion that MetLife has not suffered damages fails to provide a basis for dismissal. MetLife pleads facts from which damages may properly be inferred, and that is all that is required at this stage. *See Black v. Chittenden*, 69 N.Y.2d 665, 668 (1986). At a minimum, MetLife alleges that it paid more for the Certificates than they were worth, based on Morgan Stanley's misrepresentations regarding the quality of the Certificates and the underlying mortgage loans, so they may recover the premium by which they overpaid. *See Allstate Ins. Co. v. Morgan Stanley*, 2013 WL 2369953, at *15; *Allstate Ins. Co. v Countrywide Fin. Corp.*, 824 F. Supp. 2d at 1188. MetLife may also seek the decline in the market value. *See Stichting Pensioenfonds ABP v. Credit Suisse Group AG,* 38 Misc.3d 1214(A), at *12.

Morgan Stanley advances no independent arguments in favor of dismissing either the fraudulent inducement or the aiding and abetting causes of action (the second and third causes of action). Accordingly, Morgan Stanley's motion to dismiss is denied as to all three causes of action, except that Plaintiff MLCT's claims are dismissed as untimely.

Order

Accordingly, it is hereby

ORDERED that Defendants' motion to dismiss is granted only to the extent of dismissing the claims of Plaintiff MetLife Insurance Company of Connecticut as untimely and is otherwise denied; and it is further

ORDERED that Defendants are directed to serve an answer to the complaint within 20 days of receipt of a copy of this order with notice of entry; and it is further

ORDERED that counsel are directed to appear for a preliminary conference in Room 442, 60 Centre Street, on August 13, 2013, at 10 a.m.

Dated: June 8, 2013

ENTER:

Eileen Bransten

Hon. Eileen Bransten, J.S.C.