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

PRESENT: HON. EILEEN BRANSTEN J.S.C. PART 3
Justice

Index Number : 650559/2011
ALLSTATE INSURANCE COMPANY
vs
MERRILL LYNCH & CO.
Sequence Number : 001
DISMISS ACTION

INDEX NO. 650559/2011
MOTION DATE 4/30/12
MOTION SEQ. NO. 001
MOTION CAL. NO.

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

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	1
Answering Affidavits — Exhibits	2
Replying Affidavits	3

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion

IS DECIDED

IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION

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

Dated: 3-14-13

EILEEN BRANSTEN J.S.C.

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDG. ☐ SETTLE ORDER /JUDG.

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

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ALLSTATE INSURANCE COMPANY, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK, AGENTS PENSION PLAN, and ALLSTATE RETIREMENT PLAN,

Plaintiffs,

-against-

MERRILL LYNCH & CO., MERRILL LYNCH, PIERCE, FENNER & SMITH INC., MERRILL LYNCH MORTGAGE INVESTORS, INC., and MERRILL LYNCH MORTGAGE LENDING, INC.,

Defendants.

Index No. 650559/2011
Motion Seq. No. 001
Motion Date: 4/30/12

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BRANSTEN, J.

This fraud action arises from the Allstate plaintiffs' purchase of nearly $167 million worth of residential mortgage backed securities ("RMBS") from the Merrill Lynch defendants. Defendants move to dismiss the Amended Complaint as time-barred and for failure to state a claim under CPLR 3211(a)(5) and (7).

Background / The Amended Complaint

Plaintiff's Allstate Insurance Company ("Allstate Insurance") and Allstate Life Insurance Company ("Allstate Life") are insurance companies domiciled in, and with their principal places of business in Illinois. Plaintiff Allstate Life Insurance Company of New York ("Allstate New York") is an insurance company domiciled in and with its

principal place of business in New York. Allstate Life is a wholly-owned subsidiary of Allstate Insurance, and Allstate New York is a wholly-owned subsidiary of Allstate Life. Plaintiff Allstate Bank (formerly known as Allstate Federal Savings Bank) is a federally-chartered thrift institution with its registered office in Illinois. Plaintiffs Agents Pension Plan and Allstate Retirement Plan are Employee Retirement Income Security Act ("ERISA") plans sponsored by Allstate Insurance. (Am. Compl. ¶¶ 15-20.) For the purposes of this motion, the plaintiff entities will be referred to as "Allstate" unless a distinction between them needs to be made.

Between March 2, 2006 and March 7, 2007, the various Allstate entities purchased a total of $167,408,178 in RMBS (the "Certificates") from the Merrill Lynch defendants in eighteen offerings as follows:

SURF 2006-BC2, A2B	($14,999,985 on March 2, 2006)
OWNIT 2006-2, A2B	($10,000,000 on March 2, 2006)
MLMI 2006-WMC2, A2B	($22,182,889.09 on March 23, 2006)
SURF 2006-BC3, A-2C	($27,000,000 on June 7, 2006)
MLMI 2005-A2 A2	($19,028,041 on August 17, 2006)
MLMI 2006-OPT1, A2D	($ 5,096,000 on September 12, 2006)
MLMI 2006-RM1, A2D	($ 8,235,076 on January 11, 2007)
MLMI 2006-RM5, A2B	($21,914,000 on January 18, 2007)
FFML 2007-FF2 A2B	($30,000,000 on February 23, 2007)
SURF 2005-BC3, M2	($8,952,187.50 on March 7, 2007)

(Am. Compl. ¶ 13 and Ex. B.)

The Certificates are mortgage pass-through securities which represent interests in a pool of mortgage loans. The cash flows from the borrowers who make interest and principal payments on the individual mortgages comprising the mortgage pool are "passed through" to the certificate holders. (Am. Compl. ¶ 31.)

RMBS certificates are created in a multi-step process. The first step is the acquisition by a "depositor" of an inventory of loans from a "sponsor" or "seller," which either originates the loans or acquires them from third-party mortgage originators. The primary third-party originators for the loans underlying the Certificates were First Franklin Financial Corporation ("First Franklin"), Option One Mortgage Corp. ("Option One"), Ownit Mortgage Solutions, Inc. ("Ownit"), ResMAE Mortgage Corporation ("ResMAE"), Washington Mutual Bank ("WaMu") and WMC Mortgage Corp. ("WMC"). (Am. Compl. ¶¶ 32, 159, 164, 173, 179, 184, 192.)

The depositor is typically a special-purpose affiliate of the sponsor, and exists solely to receive and pass on the rights to the pools of loans. The depositor is also often controlled directly by the same officers and directors who run the sponsor. Here, defendant Merrill Lynch Mortgage Lending, Inc. ("Merrill Lending") acted as the sponsor of the RMBS securitizations purchased by Allstate, and its affiliate Merrill Lynch Mortgage Investors, Inc. ("Merrill Investors") acted as the depositor. (Am. Compl. ¶ 33.)

Upon acquisition of the loans, the depositor transfers, or "deposits," the acquired

loan pool to an "issuing trust." The depositor then securitizes the loan pool in the issuing trust so that the rights to the cash flows from the pool can be sold to investors. RMBS securitization transactions are structured so that the risk of loss is divided among different levels of investment, or "tranches," with each having a different level of risk and reward (Am. Compl. ¶ 34.)

Once the tranches are established, the issuing trust passes the securities back to the depositor, which becomes the issuer of the RMBS. The depositor then passes the RMBS to the underwriter, which here was Merrill Lynch, Pierce, Fenner & Smith, Inc. ("MLPFS").(Am. Compl. ¶¶ 24, 35.)

The collateral pool for each securitization usually contains thousands of loans. Information about those mortgages is included in the "loan files" that the mortgage originators developed while making the loans. A loan file typically contains documents which include the borrower's application for the loan; documents relating to verification of the borrower's income, assets, and employment; references; credit reports on the borrower; an appraisal of the property that will secure the loan and provide the basis for measures of credit quality, such as loan-to-value ratios; and a statement of the occupancy status of the property. The loan file also typically contains the record of the investigation by the loan originator of the documents and information provided by the borrower, as

well as detailed notes of the underwriter setting forth the rationale for the making of each loan. (Am. Compl. ¶¶ 37-39.)

Investors, like Allstate, were not given access to the loan files. (Am. Compl. ¶ 40.) Instead, they relied on the representations made by Morgan Stanley in the registration statements, prospectuses, prospectus supplements, free writing prospectuses, term sheets, and other draft and final written materials provided to Allstate ("Offering Materials)" about the quality and nature of the loans forming the security for the RMBS (Am. Compl. ¶¶ 6, 40.) Merrill also controlled and/or facilitated all aspects of originating, servicing, acquiring, and pooling the mortgage loans, as well as subsequently creating the securities and marketing and selling the Certificates at issue. Merrill purchased a 20 percent ownership stake in originator Ownit in the fall of 2005, and purchased originator First Franklin late 2006. (Am. Compl. ¶ 58.) First Franklin and Ownit originated or acquired all or substantially all of the loans collateralizing certain of Allstate's Certificates, including all of the loans in OWNIT 2006-2 and FFML 2007-FF2. The other Certificates were backed by loans originated by various third-party originators, many of whom received substantially discounted warehouse loans from Merrill to finance the loan originations. (Am. Compl. ¶ 61.) Two affiliates of Merrill, Home Loan Services, Inc. and Wilshire Credit Corporation ("Wilshire"), serviced all of the Certificates except for OWNIT 2006-2. (Am. Compl. ¶ 63.)

The loans began experiencing high default rates. (Am. Compl. ¶ 113.) By early 2011, nearly 75% of the loans from the original pool in MLMI 2006-RM5 were already delinquent or written off for a loss. The rate was 60% for FFML 2007-FF2 and 55% for SURF 2006-BC3, with an overall default rate of over 50% for all of the Certificates. (Am. Compl. ¶¶ 114-15.) The ratings of most of the Certificates were downgraded from Triple-A to "junk," with most of the downgrades to non-investment grade occurring by mid-2008. (Am. Compl. ¶¶ 119-20.)

Allstate alleges that Merrill falsely represented in the Offering Materials that the mortgage loans were originated in accordance with sound underwriting guidelines (Am. Compl. ¶¶ 65-79), misrepresented its due diligence with respect to the quality of the loans in the loan pools (Am. Compl. ¶¶ 80-83), misrepresented key metrics relating to the loans including owner-occupancy (Am. Compl. ¶¶ 86-90), average loan-to-value ("LTV") and combined loan-to-value ("CLTV") ratios (Am. Compl. ¶¶ 91-96), borrower income (Am. Compl. ¶¶ 97-102) and credit enhancements (excess interest, over-collateralization, subordination, net swap payments) (Am. Compl. ¶¶ 103-06) and misrepresented the Certificates' credit ratings. (Am. Compl. ¶¶ 107-112.) A loan-level analysis conducted by Allstate revealed that the Offering Materials overstated the owner-occupancy rates corresponding to each Certificate by between 8.6% and 15%. (Am. Compl. ¶¶ 125-31.)

Allstate also determined that the percentage of loans with LTV ratios over 80% had been understated by up to nearly 40% in some loan pools, and the number with LTV ratios of over 100% (and thus "underwater") had been understated by up to 26%. (Am. Compl. ¶¶ 133-40.) Allstate alleges that Merrill "waived in" to the loan pools a substantial percentage of loans that its own third party due diligence providers rejected for failure to meet underwriting guidelines. (Am. Compl. ¶¶ 145-56.) Merrill also allegedly relied on loan originators who systematically abandoned sound underwriting practices, procuring inflated appraisals to help generate loans irrespective of their quality or the borrower's ability to repay them. (Am. Compl. ¶¶ 157-94.) Merrill also allegedly provided credit ratings agencies with false information to boost the RMBS ratings, and engaged in a variety of other practices to manipulate or pressure the agencies into keeping the ratings high. (Am. Compl. ¶¶ 195-204.) Allstate alleges that Merrill, by virtue of it relationships with the loan originators and credits agencies, and in view of its due diligence efforts, was aware of, and often encouraged, the improper practices described above. (Am. Compl. ¶¶ 205-40.)

On and after December 5, 2008, a series of class actions implicating seven of the Certificates held by Allstate were commenced in various jurisdictions, and consolidated on May 20, 2009. (Am. Compl. ¶¶ 273-79.) On March 31, 2010, the court in which the class action was filed ruled that the named plaintiffs in the Class Action had standing to

sue Merrill only with respect to the Offerings in which the named plaintiffs themselves had invested, and could not represent classmembers who bought in other Merrill offerings, even if the offerings emanated from a common registration statement. (Am. Compl. ¶¶ 280-81.)

The original complaint was filed on March 1, 2011. The Amended Complaint sets forth seven causes of action: common law fraud (Am. Compl. ¶¶ 287-93), fraudulent inducement (Am. Compl. ¶¶ 294-300), aiding and abetting fraud (Am. Compl. ¶¶ 301-06), negligent misrepresentation (Am. Compl. ¶¶ 307-319), violations of Section 11 of the Securities Act of 1933 (the "1933 Act") (Am. Compl. ¶¶ 320-31), violations of Section 12(a)(2) of the 1933 Act (Am. Compl. ¶¶ 332-41), and violations of Section 15 of the 1933 Act. (Am. Compl. ¶¶ 342-50.) The common law fraud, inducement and negligent misrepresentation claims are brought against all defendants except Merrill Lynch & Co., and the aiding and abetting claim is asserted against all defendants. The Section 11 and 12 claims are brought against MLPFS as underwriter, and Merrill Investors, Inc. as depositor, with respect to seven certificates only.[1] The Section 15 claim is brought against Merrill Lynch & Co.

[1] The Certificates are: FFML 2007-FF2, A2B; MLMI 2006-OPT1, A2D; MLMI 2006-RM5, A2B; SURF 2006-BC3, A-2C; SURF 2006-BC2, A2B; OWNIT 2006-2, A2B; and MLMI 2006-WMC2, A2B (Am. Compl. ¶¶ 322, 334).

Discussion

Defendants move to dismiss most of the claims as time-barred under Illinois and federal law. Additionally, defendants argue that the entire complaint must be dismissed on the merits because plaintiffs have failed to plead reasonable reliance or scienter. Defendants further contend that plaintiffs have not alleged actionable misrepresentations with respect to LTV ratios, credit ratings, credit enhancements, owner occupancy, borrower income and due diligence. With respect to the claim for negligent misrepresentation, defendants contend that the complaint fails to allege a special relationship between the parties. For the following reasons, the motion is granted to the extent of dismissing the federal securities claims and the claim for negligent misrepresentation, but is otherwise denied.

I. Statute of Limitations

Defendants do not challenge of the timeliness of the common law claims brought by Allstate New York, which would be subject to the six-year statute of limitations for fraud (CPLR 213). Furthermore, plaintiffs have conceded that the claims under the 1933 Act with respect to three of the seven Certificates sued upon are time-barred.[2] Accordingly, at issue is the timeliness of the common law claims of the Allstate plaintiffs

[2] Certificates MLMI 2006-OPT1, A2D; SURF 2006-BC3, A-2C and SURF 2006-BC2, A2B.

in Illinois, and the timeliness of the claims brought with respect to four of the Certificates[3] under the 1933 Act.

A. Illinois Statute of Limitations

In moving to dismiss the common law claims as time-barred, defendants invoke New York's borrowing statute, CPLR 202, which "requires the cause of action to be timely under the limitations period 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. Cty. 2012). The purpose of the statute is to "prevent[] nonresidents from shopping in New York for a favorable Statute of Limitations." *Global*, 93 N.Y.2d at 528. Furthermore, "[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.* at 529. The parties agree that in view of the relevant Allstate plaintiffs' Illinois residence, their claims must satisfy the limitations provided under both New York and Illinois law. Furthermore, "in '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).

[3] Certificates OWNIT 2006-2, A2B, MLMI 2006-WMC2, A2B, MLMI 2006-RM5, A2B and FFML 2007-FF2, A2B.

All of plaintiffs' claims would be timely under New York's six year limitations period for fraud, so the parties agree that the critical analysis implicates the shorter statute of limitations under the Illinois Securities Law of 1953. That statute, 815 Ill. Comp. Stat. ("ISL") 5/13, provides:

> D. No action shall be brought for relief under this Section or upon or because of any of the matters for which relief is granted by this Section after 3 years from the date of sale; provided, that if the party bringing the action neither knew nor in the exercise of reasonable diligence should have known of any alleged violation of subsection E, F, G, H, I or J of Section 12 of this Act which is the basis for the action, the 3 year period provided herein shall begin to run upon the earlier of:
>
> (1) the date upon which the party bringing the action has actual knowledge of the alleged violation of this Act; or
>
> (2) the date upon which the party bringing the action has notice of facts which in the exercise of reasonable diligence would lead to actual knowledge of the alleged violation of this Act; but in no event shall the period of limitation so extended be more than 2 years beyond the expiration of the 3 year period otherwise applicable.

The limitations provisions of this section applies not merely to statutory securities claims, but to common law fraud and negligent misrepresentations claims arising from the purchase of a security. *See Tregenza v. Lehman Bros., Inc.*, 287 Ill.App.3d 108, 109-10 (1st Dist. 1997) (general five-year limitations period ordinarily governing common law

fraud claims under 735 Ill. Comp. Stat. 5/13-205 superseded by more specific provisions of ISL 5/13[D], which imposes shorter period for both statutory securities law violations and "any of the matters for which relief is granted" under the securities law. Accordingly, absent tolling, all of plaintiffs' claims arising out of RMBS purchases prior to March 1, 2008 would be time-barred under the statue's base three-year limitations period accruing from the "date of sale." Moreover, recovery relating to any RMBS purchases prior to March 1, 2006 would be barred regardless of tolling under the ultimate five-year deadline imposed by ISL 5/13(D)(2),

As noted, the original complaint was filed on March 1, 2011. As plaintiffs plead that they purchased all of the securities between March 2, 2006 and March 7, 2007 (Am Comp. ¶ 13 and Ex. B), no claim can survive absent tolling. However, if entitled to the longest permissible tolling extension, all claims would be timely as all of the RMBS were purchased after March 1, 2006.

Defendants first argue that the plain language of ISL 5/13(D) does not permit tolling for common law claims, but only for claims for violations of subsection E, F, G, H, I or J of Section 12 of the ISL. However, insofar as common law fraud claims are deemed "matters for which relief is granted" under the statute for the purpose of imposing the statute's limitations period upon them, the statute's tolling provisions should apply to the fraud claims as well. Furthermore, subsections E, G, H and I of Section 12 clearly

describe the alleged wrongdoing complained of here, so common law fraud would also constitute a violation of those sections and trigger the availability of tolling.

Defendants next argue that the complaint is fatally flawed because it fails to affirmatively plead that the three year sale-based limitations period was tolled. However, neither the statute nor *Rein v. David A. Noyes and Co.*, 230 Ill.App.3d 12 (2d Dist. 1992), upon which defendants rely, impose such a rule. Although the *Rein* court did state that the effect of ILS 5/13(D) was "to lengthen the time in which such a suit may be filed, provided that plaintiffs properly *allege* and demonstrate the requisite grounds," *Rein*, 230 Ill.App.3d at 15 (emphasis supplied), there is no indication that the court was announcing a formal pleading requirement. Moreover, the plaintiffs in *Rein* did not even invoke the discovery rule set forth in ILS 5/13(D) or contest that their security purchases fell outside the longer five-year limitations period, so the case has little application to the issues at bar. The statute itself does not declare a pleading rule, but merely sets forth alternatives to the sale-based accrual period, *i.e.*, the earlier of three years from either actual knowledge of the violation or notice of facts that would, with reasonable diligence, lead to such knowledge.

Defendants nevertheless argue that it can be determined from the face of the complaint, and the documents referenced therein, that plaintiffs had sufficient "notice of facts" prior to March 2008 which should have led to discovery of their claims.

Specifically, defendants point to allegations in the complaint which they claim were derived from sources predating March 2008, including a May 2007 F.B.I. report which linked the rate of early delinquencies to widespread misrepresentations in the underwriting of loans (Am. Compl. ¶ 117), a November 2007 lawsuit against WaMu (Am. Compl. ¶ 190) and various articles from the New York Times, the Wall Street Journal and Reuters describing the practices of Merrill, Ownit and WaMu. (Am. Compl. ¶¶ 173-78, 206.)

However, defendants must demonstrate not merely that plaintiffs could have known that certain statements in the Offering Materials were false, but also that plaintiffs could have known that Merrill knew and thus acted with intent to deceive. *Baron v. Chrans*, 2008 WL 2796948, at *21 (C.D. Ill. July 21, 2008) ("In a securities fraud context, an injured person knows sufficient facts on the date on which the person learned, or should have learned, both that the representations were untrue and that the misrepresentations were knowingly false"); *see Merck & Co. v. Reynolds*, 130 S. Ct. 1784, 1796 (2010) ("A plaintiff cannot recover without proving that a defendant made a material misstatement *with an intent to deceive* . . . [i]t would therefore frustrate the very purpose of the discovery rule . . . if the limitations period began to run regardless of whether a plaintiff had discovered any facts suggesting scienter").

In *In re Countrywide Fin. Corp. Mortgage-Backed Securities*, 860 F. Supp. 2d 1062 (C.D. Cal. 2012) (*Countrywide I*), the Court denied a motion to dismiss under ILS 5/13(D), noting that the "reasonable diligence" requirement of the statute only required diligence in obtaining knowledge of the violation once plaintiff had obtained actual notice of the facts, but did not require diligence in obtaining the facts triggering the inquiry. The court concluded that "[i]nformation that was sent to [plaintiff] or that [plaintiff] was aware of will constitute notice, whereas information that was widely reported in the press but never seen by [plaintiff] will not suffice." *Id.* at 1076.

A number of courts have denied limitations-based motions in RMBS fraud actions despite objections similar to those raised by 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 Massachusetts 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 Intern. v. J.P. Morgan Mortgage Acquisition Corp.*, 2013 WL 535320, at *7 (D. Mass. 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); *Public Employees' Ret. Sys. of Miss. v. Merrill Lynch*, 714 F. Supp. 2d 475, 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).

The court must credit, at this juncture, plaintiffs' allegation that the necessary information giving rise to a duty to inquire only emerged in 2009-11, that Allstate did not know of the fraud when perpetrated (Am. Compl. ¶¶ 8, 107, 247), and the fraud only became known to Allstate well after March 2008 due to serious credit rating downgrades (Am. Compl. ¶ 120) and reports by the Office of the Comptroller of the Currency in late 2008 (AC ¶ 5), the Financial Crisis Inquiry Commission in 2011 (Am. Compl. ¶¶ 7, 46) and the United States Senate Permanent Subcommittee on Investigations in 2011. (Am. Compl. ¶¶ 196-200.)

Accordingly, for the foregoing reasons, defendants' motion to dismiss on this basis is denied.

B. Federal Statute of Limitations / Repose

Plaintiffs' federal securities claims under the 1933 Act are subject to the provisions of Section 13 of the Act, which provides that "[n]o action shall be maintained to enforce any liability created under section 11 or 12(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence." 15 U.S.C. § 77m. Where plaintiffs lack actual knowledge of the facts giving rise to their claim, the one-year limitation period begins to run when a plaintiff is placed on "inquiry notice." *NECA-IBEW Pension Trust Fund v. Bank of Am. Corp.*, 2013 WL 620257, at *5 (S.D.N.Y. 2013); *In re Bear Stearns Mortgage Pass-Through Certificates Litig.*, 851 F. Supp. 2d 746, 762 (S.D.N.Y. 2012). Additionally, "Section 11 and 12 claims are also subject to an absolute three-year limitations period, commonly referred to as Section 13's statute of repose." *NECA-IBEW*, 2013 WL 620257, at *6. Thus, Section 13 provides that claims under Section 11 or 12(a)(1) of the Securities Act must be brought within three years of the date on which the security was first offered to the public, and that claims under Section 12(a)(2) must be brought within three years of the sale of the security. 15 U.S.C. § 77m; *NECA-IBEW*, 2013 WL 620257, at *6.

As with the Illinois statute, defendants first argue that plaintiffs have failed to affirmatively allege tolling. This time, the objection is meritorious. Under the 1933 Act,

"[t]he burden is on Plaintiffs to affirmatively plead compliance with the statute of limitations because it is a substantive element of the cause of action." *Lighthouse Fin. Group v. Royal Bank of Scotland Group, PLC*, 2012 WL 4616958, at *12 (S.D.N.Y. 2012); *see also Wigand v. Flo-Tek, Inc.*, 609 F.2d 1028, 1033 n.5 (2d Cir. 1979) ("[C]ompliance with the statute of limitations in section 12(2) actions is a prerequisite of jurisdiction"). "In order for the Plaintiff to comply with the statute of limitations the complaint must set forth: (1) the time and circumstances of the discovery of the fraudulent statement; (2) the reasons why it was not discovered earlier (if more than one year has lapsed); and (3) the diligent efforts which plaintiff undertook in making or seeking such discovery." *Ho v. Duoyuan Global Water, Inc.*, – F. Supp. 2d –, 2012 WL 3647043, at *9 (S.D.N.Y. Aug. 24, 2012) (internal quotations and citations omitted).

Plaintiffs do not attempt this showing. Instead, the complaint merely alleges that the claims are timely "by virtue of the timely filing of the Class Action." (Am. Compl. ¶¶ 329, 340.) The allegation is inadequate because it does not identify "the precise timing or the means by which [they] gained knowledge of the relevant facts." *In re Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 2010 WL 3239430, at *6 (S.D.N.Y. 2010).

Additionally, assuming the pleading defect could be cured by repleading, the 1933 Act claims would all be barred by the three-year statute of repose. There is no dispute that more than three years elapsed between the last Certificate offering in 2007 and the

filing of the complaint in 2011. The court rejects plaintiffs' contention that the statute of repose was tolled by the pendency of the class action under the doctrine announced in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974). Although neither the United States Supreme Court nor the Second Circuit Court of Appeals has addressed the issue, and the federal courts are split on the issue in New York and elsewhere, this court finds persuasive the reasoning of the line of cases holding that the nature of a statute of repose is absolute and may not be tolled. *See Plumbers, Pipefitters & MES Local Union No. 392 Pension Fund v. Fairfax Fin. Holdings Ltd.,* 886 F. Supp. 2d 328, at *4 (S.D.N.Y. 2012); *In re Lehman Bros. Sec. & ERISA Litig.*, 800 F. Supp. 2d 477, 481-82 (S.D.N.Y. 2011); *Footbridge Ltd. Trust v. Countrywide Fin. Corp.*, 770 F. Supp. 2d 618, 626-27 (S.D.N.Y. 2011); *In re IndyMac Mortgage-Backed Sec. Litig.*, 793 F. Supp. 2d 637, 642-43 (S.D.N.Y. 2011). There is not need to repeat the analysis of those cases at length, other than to summarize the chief arguments favoring this conclusion: (1) the plain language of Section 13 permits the three-year limit to be exceeded "in no event" and thus "plainly precludes judicial circumvention of the repose period, even in class action suits, (2) the legislative history indicates that Congress intended statutes of repose to impose an absolute limitation on litigation; (3) American Pipe addressed a statute of limitations, not a statute of repose; (4) the Supreme Court in *Lampf, Pleva, Lipkind, Prupis & Petigrow v Gilbertson*, 501 U.S. 350 (1991), expressed a strong preference

Prupis & Petigrow v Gilbertson, 501 U.S. 350 (1991), expressed a strong preference against tolling statutes of repose. *Plumbers*, 886 F. Supp. 2d 328, at *4-*5.

Accordingly, it is unnecessary to address the parties' further arguments regarding whether *American Pipe* tolling applies to putative class members where the original class plaintiff was found to lack standing, and the claims under the 1933 Act are dismissed as untimely.

II. Common Law Fraud and Fraudulent Inducement Claims

Plaintiffs assert both common law fraud and fraudulent inducement claims in the Amended Complaint (Counts One and Two). To plead fraud, the plaintiff must allege "(1) a material misrepresentation of a fact, (2) knowledge of its falsity, (3) an intent to induce reliance, (4) justifiable reliance by the plaintiff, and (5) damages." *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009). The elements of a fraudulent inducement claim are substantially the same. *See Perrotti v. Becker, Glynn, Melamed & Muffly LLP*, 82 A.D.3d 495, 498 (1st Dep't 2011).

A. Reliance

Defendants argue that, as to at least six of the Certificates, plaintiffs cannot claim that they reasonably relied on the representations in the prospectus supplements because

the offerings were purchased before the supplements were issued. However, this objection is misguided because the complaint defines the "Offering Materials" as including "drafts," term sheets and other non-final documents (Am. Compl. ¶ 6), not merely prospectus supplements. Plaintiffs further alleged that they reviewed the Offering Materials before they made their purchases, and relied upon the representations therein. (Am. Compl. ¶ 6.) This is sufficient. 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 Securities LP v. Fiduciary Trust Co.*, 5 A.D.3d 172, 173 (1st Dep't 2004).

Defendants also argue that it was not reasonable for plaintiffs, as sophisticated investors in the mortgage-backed security market, to rely on "unverified information." In particular, defendants contend that the Offering Materials disclosed that occupancy statistics were merely "based upon the representations of the related mortgagors at the time of origination"; that "applicants [were] qualified based upon monthly income as stated on the mortgage loan application," or "no documentation" programs, which "d[id] not require any statement or proof of income;" and that for certain offerings, disclosures regarding underwriting standards were provided by originators with Merrill making "no representations or warranties as to the accuracy or completeness of that information."

As in other RMBS cases where such warnings have been deemed ineffective, defendants have 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. *In re Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 810 F. Supp. 2d 650, 672 (S.D.N.Y. 2011). Defendants' warnings that some borrower information was unverified did not give notice of "a wholesale abandonment of underwriting standards." *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 773 (1st Cir. 2011). *See also New Jersey Carpenters Vacation Fund v. Royal Bank of Scotland Group, PLC*, 720 F. Supp. 2d 254, 270 (S.D.N.Y. 2010) ("Disclosures that described lenient, but nonetheless existing guidelines about risky loan collateral, would not lead a reasonable investor to conclude that the mortgage originators could entirely disregard or ignore those loan guidelines"); *Pub. Employees' Ret. Sys. of Mississippi v. Merrill Lynch & Co. Inc.*, 714 F. Supp. 2d 475, 483 (S.D.N.Y. 2010) ("[T]he alleged repeated deviation from established underwriting standards is enough to render misleading the assertion in the registration statements that underwriting guidelines were generally followed"); *In re IndyMac Mortgage-Backed Sec. Litig.*, 718 F. Supp. 2d 495, 509 (S.D.N.Y. 2010) ("Disclosures regarding the risks stemming from the allegedly abandoned standards do not adequately warn of the risk the standards will be ignored").

Moreover, 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 Minerals & Metals Corp. v. Holme*, 35 A.D.3d 93, 100 (1st Dep't 2006), "such rule is not determinative . . . where [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*, 86 A.D.3d at 436. Plaintiffs allege that they lacked access to the underlying RMBS loan files and had to rely on defendants' representations about their quality. (Am. Compl. ¶ 40.) This pleading distinguishes the instant case from *HSH Nordbank AG v. UBS AG*, 95 A.D.3d 185 (1st Dep't 2012), as Plaintiffs' allegations here stem from facts not alleged by either side to be discoverable through publicly available sources or ascertainable through means available to plaintiffs – i.e., the underwriting practices used to originate the loans in the securitization and the resulting quality of those loans. *See ACA Fin. Guar. Corp. v. Goldman Sachs & Co.*, 35 Misc.3d 1217(A), at *12-*13 (Sup. Ct. N.Y. Cty. Apr. 23, 2012). Accordingly, the Court finds that Plaintiffs have adequately pleaded reliance. *See Stichting*, 38 Misc.3d 1214(A) at *10 ("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").

B. Misrepresentations

Defendants contend that the Offering Materials, read as a whole, made limited representations about the quality of the loans, stating only that the loans did, or would be made to meet the disclosed characteristics. Defendants note that the materials in fact anticipated that some loans would be nonconforming, and provided an express remedy whereby the sponsor or originator would cure, repurchase or replace the loan. Defendants rely on *Lone Star Fund V U.S., L.P. v. Barclays Bank PLC*, 594 F.3d 383 (5th Cir. 2010), which held that a purchaser of RMBS was not defrauded because "[r]ead as a whole, the prospectuses and warranties provide that the mortgages should be non-delinquent, but if some mortgages were delinquent then [defendant] would either repurchase them or substitute performing mortgages into the trusts." *Id.* at 389. *Lone Star*, however, is inapplicable here, where plaintiffs base their claims "not on the mere presence of specific mortgages which do not meet the standards described in the Offering Documents, but instead on the systematic abandonment of [defendants'] purported underwriting standards." *Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 38 Misc.3d 1214(A), at *7 (Sup. Ct. N.Y. Cty. 2012); *see also Plumbers' & Pipefitters' Local No.*

562 Supplemental Plan & Trust v. J.P. Morgan Acceptance Corp. I, 2012 WL 601448, at *18–19 (E.D.N.Y. 2012) (distinguishing *Lone Star*); *Employees' Ret. Sys. of the Gov't of the Virgin Islands v. J.P. Morgan Chase & Co.*, 804 F. Supp. 2d 141, 155 (S.D.N.Y. 2011); *City of Ann Arbor Employees' Ret. Sys. v. Citigroup Mortg. Loan Trust Inc.*, 2010 WL 6617866, at *7 (E.D.N.Y. 2010). As in *Stichting*, "[a] cure provision does not change the nature of [defendants'] representations about their process." *Stichting*, 38 Misc.3d 1214(A), at *7.

Defendants next argue that Allstate's allegations concerning appraisals, LTV ratios, credit ratings, and credit enhancements must be dismissed because statements regarding those subjects "constitute mere puffery, opinions of value or future expectations." However, misrepresentations about those precise items have been held to be actionable. *See MBIA v. Countrywide,* 87 A.D.3d 287, 294 (1st Dep't 2011)*; Morgan Stanley Mortgage Pass-Through Certificates Litig.*, 810 F. Supp. 2d at 672-73 (appraisals); *Stichting,* 38 Misc.3d 1214(A), at *9 (LTV ratios, appraisals, credit ratings). Appraisals are "akin to representations of fact" when they purport to represent an "analysis of the market conditions, sales 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 * 5 (Sup. Ct. N.Y. Cty. 2011).

Defendants further argue that plaintiffs have not demonstrated that misrepresentations were made regarding owner-occupancy levels, noting that defendants disclosed that they were based on the representations of the mortgagors. They fault plaintiffs' loan-level analysis, contending that at best it shows that some owners may have ceased to occupy their properties at some point after the loans were originated. However, accepting plaintiffs allegations as true for the purpose of this motion, if defendants knew that they and their originators had systematically abandoned the underwriting guidelines and were permitting or encouraging borrowers to falsify information, they cannot hide behind the borrowers' representations to immunize their conduct. And what the loan-level analysis may "prove" merely creates a question of fact. Similarly, defendants' disclosures that the borrowers' incomes were unverified does not shield them from liability if they were actively falsifying that data.

Plaintiffs have adequately pled that defendants misrepresented their due diligence and underwriting standards. Although defendants again point to disclaimers that certain guidelines were less stringent, or warned of possible delinquencies, their representations that they generally adhered to certain standards were misleading in the face the widespread underwriting misconduct alleged.

C. Scienter

Defendants' dispute the adequacy of plaintiffs' allegations of scienter. To satisfy that element, the pleading 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 also Seaview Mezzanine Fund, LP v. Ramson*, 77 A.D.3d 567, 568 (1st Dep't 2010). However, this "requirement should not be confused with unassailable proof of fraud." *Pludeman v. N. 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 Co. May 26, 2011); *see also 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, 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,* 38 Misc.3d 1214(A), at *10 (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").

As described above, the Amended Complaint alleges, *inter alia*, that defendants knew about and ignored deficiencies in the loan pools, deliberately manipulated the due diligence process and ratings procedures to conceal the deficiencies, participated in a variety of other questionable practices to procure a high volume of loans. Contrary to defendants' suggestion, there is no requirement that plaintiffs identify the particular individuals in each Merrill entity whose knowledge constituted scienter on its behalf. Rather, as discussed above, the inference of scienter may be drawn from the pervasive misconduct in the underwriting process.

***

The Amended Complaint adequately pleads the requisite misrepresentation, reliance and scienter elements for both plaintiffs' common law fraud and fraudulent

inducement claims. Since defendants made no argument as to intent to cause reliance or damages, the Court need not consider whether these elements have been stated. Accordingly, defendants' motion to dismiss Counts One and Two is denied.

III. Aiding and Abetting Fraud

Defendants's sole argument in support of dismissing the aiding and abetting fraud claim is that it is derivative of the underlying fraud count. Since the Court denies defendants' motion to dismiss the common law fraud claim, the Court likewise denies defendants' motion as to aiding and abetting (count four).

IV. Negligent Misrepresentation

The negligent misrepresentation cause of action presents different concerns. Such a claim requires allegations of "(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information." *Mandarin Trading Ltd. v. Wildenstein*, 16 N.Y.3d 173, 180 (2011) (internal quotation omitted); *Gomez-Jimenez v. New York Law School,* 103 A.D.3d 13, at *3 (2012). A duty to impart correct information falls only upon "persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that

reliance on the negligent misrepresentation is justified." *Kimmell v. Schaefer*, 89 N.Y.2d 257, 263 (1996). Plaintiffs argue that defendants possessed superior knowledge or special expertise because of their access to the loan files and their understanding of the underwriting procedures and its inherent defects. However, "a company's knowledge of the particulars of its own business is not the type of unique or specialized knowledge" that can create a duty. *MBIA Ins. Co. v. GMAC*, 30 Misc.3d 856, 864 (Sup. Ct. N.Y. Cty. 2010) (quotations omitted). New York courts have dismissed negligent misrepresentation claims in other RMBS cases on the ground that "[m]ere possession of the loan files and servicing files does not create the type of specialized knowledge discussed in *Kimmell*." *Id.* at 865; *see also Stichting*, 38 Misc.3d 1214(A) at *13 (dismissing negligent misrepresentation claim where plaintiff did not plead "specialized knowledge" despite assertions that Credit Suisse "had superior knowledge of its own underwriting procedures" and "it alone had the ability to investigate the underlying loans."); *MBIA Ins. Corp. v Residential Funding Co.*, 2009 WL 5178337, at *6 (Sup. Ct. Westchester Cty. 2009). Likewise here, dismissal of the negligent misrepresentation claim is warranted, given plaintiffs' failure to plead a special or privity-like relationship with defendants. Accordingly, count four of the Amended Complaint is dismissed.

Order

Accordingly, it is hereby

ORDERED, that defendants' motion to dismiss is granted as to the fourth through seventh causes of action, and it is further

ORDERED, that defendants' motion to dismiss is denied as to all other claims; 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 May 7, 2013, at 10:45 AM.

Dated: 3-14-13

ENTER:

Hon. Eileen Bransten, J.S.C.