Unreported Disposition
42 Misc.3d 1220(A), 986 N.Y.S.2d 864 (Table), 2014 WL 432458 (N.Y.Sup.), 2014 N.Y. Slip Op. 50106(U)

This opinion is uncorrected and will not be published in the printed Official Reports.

Allstate Insurance Company, ALLSTATE LIFE INSURANCE COMPANY, ALLSTATE BANK (F/K/A ALLSTATE FEDERAL SAVINGS BANK), AND KENNETT CAPITAL, INC., Plaintiffs,
v.
Credit Suisse Securities (USA) LLC, CREDIT SUISSE FIRST BOSTON MORTGAGE SECURITIES CORPORATION, CREDIT SUISSE FINANCIAL CORPORATION, ASSET BACKED SECURITIES CORPORATION, AND DLJ MORTGAGE CAPITAL, INC., Defendants.

650547/2011
Supreme Court, New York County
Decided on January 24, 2014

CITE TITLE AS: Allstate Ins. Co. v Credit Suisse Sec. (USA) LLC

ABSTRACT

APPEARANCES OF COUNSEL
Counsel for the plaintiff is A. William Urquhart, Esq., Quinn Emanuel Urquhart & Sullivan, LLP, 51 Madison Avenue, New York, New York. Counsel for the defendant is Richard W. Clary, Esq., Cravath, Swaine & Moore LLP, 825 Eighth Avenue, New York, New York.

OPINION OF THE COURT

Marcy S. Friedman, J.

This fraud action arises out of the Allstate plaintiffs' purchase of residential mortgage backed securities (RMBS) Certificates from the Credit Suisse defendants.' Defendants move to dismiss the Amended Complaint, pursuant to CPLR 3211 (a) (5) and (7), on the grounds that it is barred by the statute of limitations and fails to state a cause of action.

BACKGROUND / THE AMENDED COMPLAINT

Plaintiffs 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. Allstate Life is a wholly-owned subsidiary of Allstate Insurance, which is the successor-in-interest to Allstate Bank. Plaintiff Kennett Capital, Inc. is a Delaware ***2** corporation and, along with Allstate Insurance and Allstate Life, an indirect, wholly-owned subsidiary of non-party The Allstate Corporation. (Am. Compl., ¶¶ 14-17). Between December 2005 and November 2007, plaintiffs purchased $231,999,837 in RMBS Certificates from Credit Suisse First Boston Corporation, the predecessor to defendant Credit Suisse Securities (USA) LLC, in eleven offerings.

The RMBS 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., ¶ 33.)

The securities are created in a multi-step process which, according to the complaint, was entirely controlled by defendants. *(Id.,* ¶ 18.) **More particularly, a "sponsor" or "seller" *3** originates the loans or acquires the loans from third-party lenders. *(Id.,* ¶ 34.) Here, defendant DLJ Mortgage Capital, Inc. acted as the sponsor or seller (or both) for all of the securitizations at issue. It also originated and/or acquired some of the mortgage loans underlying ARMT 2005-6A, ARMT 2007-1, CSMC 2006-8, CSMC 2007-3 and CSMC 2007-5. *(Id.,* **¶¶ 19, 61, 65.) Defendant Credit Suisse Financial Corporation originated a significant portion of the loans securitized in ARMT 2007-1, CSMC 2007-3, CSMC 2007-5, and** HEMT 2006-2. *(Id.,* **¶¶ 21, 61.) The remaining loans were originated by third-party mortgage lenders that received substantial "warehouse" lines of credit from defendants to do so. These lenders included Countrywide Home Loans Inc. ("Countrywide"), Option One Mortgage Corp. ("Option One"), and Taylor, Bean and Whitaker Mortgage Corp. ("TBW"). (Id.,[1] ¶ 62.) Countrywide originated a significant percentage of loans underlying the ARMT 2007-1, CSMC 2006-8, CSMC 2007-3 and CSMC 2007-5 offerings** *(id.,* **¶ 165); Option One originated 100% of the mortgage loans underlying the ABSC 2006-HE5 offering** *(id.,* **¶ 180); and TBW originated 100% of the loans underlying the TBW 2006-4 offering.** *(Id.,* **If 189.)**

After the loans are pooled, the sponsor transfers them to the "depositor," which is typically a special-purpose

affiliate of the sponsor. *(Id.,* ¶ 35.) Here, the depositors for all of the securitizations were defendants Credit Suisse First Boston Mortgage Securities Corp. and Asset Backed Securities Corporation. *(Id.,* ¶¶ 35, 67.)

The depositor transfers the acquired loan pool to an "issuing trust." The depositor then securitizes the loan pool in the issuing trust. *(Id.,* 36.) The issuing trust passes the securities back to the depositor, which becomes the issuer of the RMBS. *(Id.,* 37.) The depositor then passes the RMBS to the underwriter, which offers and sells the securities to investors. Here, the underwriter was defendant Credit Suisse Securities (USA) LLC, formerly known as Credit Suisse First Boston Corp. *(Id.,* ¶¶ 20, 37-38, 69.)

As alleged in the complaint, the loans underlying plaintiffs' Certificates experienced high default rates. By February 2011, when the complaint was filed, nearly one-third of the loans in the collateral pools for ARMT 2007-1, HEMT 2005-5, and HEMT 2006-2 had already been written off for a loss. *(Id.,* ¶ 118.) The delinquency rates for loans remaining in the loan pools at the time of filing of the complaint were as follows: ARMT 2005-6A (41.20%); ARMT 2007-1 (43.03%); CSMC 2006-8 (18.45%); CSMC 2007-3 (29.92%); CSMC 2007-5 (24.14%); HEMT 2005-5 (19.31%); HEMT 2006-2 (17.84%); and TBW 2006-4 (47.79%). *(Id.,* ¶ 119.) The credit ratings for the Certificates also deteriorated, with all but one of them dropping to non-investment grade by at least two of the three ratings agencies which originally provided their ratings, and all of them fell to "junk-bond" status according to at least one rating agency. *(Id.,* ¶ 121.)

As discussed more fully below, the complaint alleges that defendants made false representations that the mortgage loans were originated in accordance with sound underwriting guidelines. *(Id.,* 76-85.) It further alleges that defendants misrepresented specific "risk ***4** metrics" that were material to assessing the riskiness of the mortgage loans, including metrics regarding owner-occupancy levels, loan-to-value ratios, sufficiency of the borrowers' income, credit ratings, and credit enhancements relating to the Certificates. *(Id.,* 89-116.) Based on the alleged misrepresentations and omissions, the complaint pleads causes of action for common law fraud *(id.,* ¶¶ 307-313), fraudulent inducement *(id.,* ¶¶ 314-320), and negligent misrepresentation *(id.,* ¶¶ 321-331).

DISCUSSION

Statute of Limitations

Defendants argue that the complaint is barred by the Illinois statute of limitations. The parties agree that under New York's borrowing statute, CPLR 202, the cause of action must be timely under the limitations period of both New York and the jurisdiction where the cause of action accrued. *(See Global Fin. Corp. v Triarc Corp.,* 93 NY2d 525, 528 [1999].) They further agree that in view of the Allstate plaintiffs' residence, their claims must satisfy the limitations provided by both New York and Illinois law. As all of the Certificates were purchased in and after December 2005, and the complaint was filed on February 28, 2011, plaintiffs' claims would be timely under the six-year New York statute of limitations for fraud. (CPLR 213.) The critical question is therefore whether the claims are barred by Illinois' shorter statute of limitations.

The parties dispute whether the applicable Illinois statute of limitations is the five year statute of limitations for common law fraud (Illinois Code of Civil Procedure, 735 ILCS 5/13-205) or that provided by the Illinois Securities Law of 1953 (815 ILCS 5/13 [D]). The latter statute requires an action to be commenced within three years of the date of sale of the security. Its tolling provision provides, however, that the three year period shall run from the earlier of the date on which the plaintiff had actual notice of the violation of the statute, or the date on which the plaintiff in the exercise of reasonable diligence had knowledge of facts that would lead to knowledge of the violation. The version of the Illinois Securities Law in effect at the time of the sale of the Certificates at issue also provided that an action could not in any event be brought more than five years after the sale of the securities. ***5**

The parties agree that this court must borrow Illinois' rules for tolling in applying the Illinois statute of limitations. *(See Antone v General Motors Corp.,* 64 NY2d 20, 31 [1984].) However, defendants contend, and plaintiffs dispute, that information in the public domain was sufficient to afford plaintiffs actual or constructive knowledge of their claims by February 2008, and that all of plaintiffs' claims are therefore time-barred. (Ds.' Memo. In Support at 12.)

These very issues were decided by this Court (Bransten, J.) in determining motions to dismiss substantially similar actions filed by Allstate against other fmancial institutions that offered RMBS Certificates. *(Allstate Ins. v Ace Secs. Corp.,* 2013 NY Slip Op 31844 [U], 2013 WL 1103159 [Sup Ct, NY County Mar. 14, 2013] *[Ace]; Allstate Ins. Co. v Merrill Lynch & Co.,* 2013 NY Slip Op 31845[U], 2013 WL 4046711 [Sup Ct, NY County Mar. 14, 2013] *[Merrill Lynch]; Allstate Ins. Co. v Morgan Stanley,* 2013 NY Slip Op 31130 [U], 2013 WL 2369953 [Sup Ct, NY

County Mar. 14, 2013][Morgan Stanley].) In each case, the Court declined to dismiss any of the state law claims on statute of limitations grounds, with the exception in *Ace* of claims relating to two certificates. The arguments and case law proffered by the parties on the prior motions were essentially identical to those presented here. The factual differences, relating primarily to the particular certificates purchased and the identity of the third party loan originators, are not material. The court concurs with the analysis of the three decisions on the statute of limitations issues and adopts it here.

In brief, as held by the *Ace* Court, the statute of limitations in the Illinois Securities Law applies not merely to statutory securities claims but also to common law fraud and negligent misrepresentation claims arising from the purchase of a security. *(Ace,* 2013 WL 1103159, at *5, citing *Tregenza v Lehman Bros., Inc.,* 287 Ill App3d 108 [Ill App 1st Dist 1997], *lv denied* 174 Ill 2d 595.) Thus, absent tolling, all of plaintiffs' claims arising out of RMBS purchases prior to February 28, 2008 would be time-barred under the statute's base three-year limitations period accruing from the "date of sale." Moreover, recovery relating to any RMBS purchases prior to February 28, 2006 is barred regardless of tolling, under the ultimate five-year deadline imposed by the Illinois Securities Law. (815 ILCS 5/13 [D][2].) Plaintiffs thus concede that claims under the two HEMT 2005-5, AlA Certificates are untimely under the Illinois Securities Law statute of limitations. (Ps.' Memo. In Opp. at 10, 11 n 23.)

As to tolling, the court rejects defendants' contention that the documentary evidence demonstrates as a matter of law that Allstate was put on notice of its claims by information that was publicly available prior to February 2008. In support of this contention, defendants cite statements in offering documents from 2007, which warn of weakness in the residential mortgage market, increasing delinquencies, and potential problems with the performance of loans originated by bankrupt originator New Century. (Ds.' Memo. In Support at 12.) Defendants also cite newspaper articles from 2007, which generally discuss a loosening of underwriting standards by investment banks, problems with sponsor due diligence, and pressures on appraisers to inflate appraisals. (Ds.' Reply Memo. at 3-4, n 5.) ***6**

As the *Ace* Court reasoned, 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 defendants were aware of the misrepresentations and thus acted with intent to deceive. *(Ace,* 2013 WL 1103159, at *8 [citing *Baron v Chrans,* 2008 WL 2796948 [CD Ill 2008]; *Merck & Co. v Reynolds,* 559 US 633, 648 [2010]]; *Phoenix Light SF Ltd. v Ace Secs. Corp.,* 2013 NY Slip Op 50653[U], 2013 WL 1788007, *5 [Sup Ct, NY County 2013, Kornreich, J.] [same].) The underwriter defendants in *Ace* sought to demonstrate that Allstate was on notice of its claims by virtue of information that was publicly available prior to 2008. The *Ace* Court rejected this contention, notwithstanding the defendants' citation of more extensive public information than that cited by defendants here, including information about class actions brought in 2006 and 2007 against the originator of certain of the offerings, alleging misrepresentations regarding appraisals and underwriting standards; newspaper reports in 2007 about the bankruptcies or closings of several of the originators; an announcement by Allstate's counsel that it was conducting an investigation into the conduct of numerous subprime lenders; and Standard & Poor's placement of certain offerings on a credit watch for possible downgrade in November 2007 and January 2008. The Court held that "[n]one of the allegations or facts which defendants contend should impute notice to plaintiffs directly implicate misrepresentation or scienter on the part of defendants. The collapse of the various loan originators, or even plaintiffs' counsel's accusations of wrongdoing against one of them, would not necessarily apprise plaintiffs that defendants were complicit in their wrongdoing. . . ." *(Ace,* 2013 WL 1103159, at * 9.)

In declining to hold as a matter of law that the publicly available information was sufficient to afford plaintiffs notice, the *Ace* Court also reasoned that general allegations of misconduct in the subprime industry were insufficient to show knowledge or misconduct by the defendants with respect to the particular loan pools at issue. *(Id.)*

The *Ace* decision is consistent with the decisions of numerous other Courts in RMBS cases which have denied motions to dismiss based on claims that the plaintiffs were put on notice, or their duty of inquiry was triggered, by information, including newspaper reports, available prior to 2008. As one Court noted, "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." *(Massachusetts Mut. Life Ins. Co. v Residential Funding Co., LLC,* 843 F Supp 2d 191, 208-09 [D Mass 2012] [holding that information from newspaper articles, industry publications and government reports that was publicly available before 2007 was insufficient to establish inquiry notice "because it did not directly relate to the misrepresentations and omissions alleged in the complaints," and "did not alert Plaintiff to potential fraud in any specific securitization it had purchased"]; *Matter of*

Countrywide Fin. Corp. Mtge.-Backed Secs. Litig., 2012 WL 1322884, *4 [CD Cal 2012] [holding, in case under state Blue Sky law, that "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," and that Court could not, based solely on the complaint and judicially noticeable documents, conclude that a reasonably diligent investor by August 2007 would have linked reports of increased delinquencies in loan pools with the delinquencies in the loan pools at issue]; *Capital Ventures Intl. v J.P. Morgan Mtge. Acquisition Corp.,* 2013 WL 535320, *7 [D Mass 2013] ***7** [holding that plaintiff was not put on notice of its claims by newspaper articles, government publications, and media reports, available before October 2007, which noted the widespread erosion of underwriting guidelines in the mortgage market, pressure on appraisers to generate inflated property values, and pervasive misrepresentation of owner occupancy, and which associated the erosion of underwriting guidelines and increased default rates with the primary originators whose loans backed plaintiffs' certificates]; *Phoenix Light SF Ltd.,* 2013 WL 1788007, at *5 [holding that "information reported in newspapers about the possible falsity of loan data is insufficient to put plaintiffs on notice of a defendant's intent to defraud"].)

This court concludes, similarly, that defendants fail to demonstrate as a matter of law that Allstate was put on notice of facts, prior to February 28, 2008, which in the exercise of reasonable diligence would have led to knowledge of its claims that defendants were aware of misrepresentations as to the underwriting standards and the quality of the mortgage loans underlying the offerings at issue, or as to scienter on defendants' part. The bankruptcy of New Century was of limited significance, as New Century was responsible for originating only 10% of one of the ten mortgage groups in the offerings. Plaintiffs were not required to conclude, from New Century's problems, that all of the Certificates were affected by fraud and that defendants were or might be complicit in the wrongdoing. Nor did general reports of misconduct in the subprime industry put plaintiffs on notice that defendants had engaged in misconduct or had knowledge of the misconduct of others involved in the securitization process. Defendants' further contention that the loan level analysis made by plaintiffs in 2010 could have been made based on information available prior to 2008 *(see* Oral Argument Transcript at 11) at most raises a triable issue of fact.

On the record on this motion to dismiss, the court must also credit plaintiffs' allegation that the necessary information giving rise to a duty to inquire only emerged after February 28, 2008. In this connection, plaintiffs note that the first non-investment-grade credit rating downgrade to any of the Certificates occurred in March 2008, with downgrades to other Certificates occurring later in 2008 and throughout 2009. (Am. Compl., ¶¶ 12, 303-05.) Plaintiffs allege that other necessary information regarding defendants' and the originators' specific practices only became available between late 2008 and 2011 by virtue of reports by the Office of the Comptroller of the Currency, the Financial Crisis Inquiry Commission, and the United States Senate Permanent Subcommittee on Investigations *(id.,* ¶¶ 49-52, 231-35); investigations and lawsuits by the Securities and Exchange Commission, the Massachusetts Attorney General, and private litigants with access to the loan files *(id.,* ¶¶ 8, 10, 171-75, 182-84, 201-227); the release of a "trending" report by due diligence firm Clayton (id.,'If 157); and plaintiffs' own development of complex methodologies which enabled them to conduct a loan-level analysis. *(Id.,* ¶ 302).

The *Ace, Merrill Lynch,* and *Morgan Stanley* actions were all filed between February 17, 2011 and July 11, 2011, in close proximity to or later than the date of tolling of the statute of limitations in this case. As in those cases, the issue of timeliness cannot be resolved on this motion except as to the claims arising out of the HEMT 2005-5, AlA Certificates. The motion to dismiss on statute of limitations grounds will therefore be denied except as to those purchases.

Failure to State a Claim

Defendants contend that the complaint fails to state causes of action for fraud or ***8** fraudulent inducement. To plead fraud, the plaintiff must allege the following elements: "a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff, and damages." *(Eurycleia Partners, LP v Seward & Kissel, LLP,* 12 NY3d 553, 559 [2009].) The elements of a fraudulent inducement claim are substantially the same. *(See Perrotti v Becker, Glynn, Melamed & Muffly LLP,* 82 AD3d 495 [1st Dept 2011].) A fraud claim must be pleaded with particularity, pursuant to CPLR 3016 (b). *(Eurycleia,* 12 NY3d at 559.) However, this statute "should not be so strictly interpreted as to prevent an otherwise valid cause of action in situations where it may be impossible to state in detail the circumstances constituting a fraud." *(Id.,* quoting *Pludeman v Northern Leasing Sys., Inc.,* 10 NY3d 486, 491[2008].) CPLR 3016 (b) is satisfied when the alleged facts "suffice to permit a reasonable inference' of the alleged misconduct." *(Id.,* quoting *Pludeman,* 10 NY3d at .)

This Court and Courts in other jurisdictions have repeatedly considered the sufficiency of pleadings of fraud claims in RMBS cases. This court's task in determining Credit Suisse's motion to dismiss is therefore the case-specific one of applying a well-developed body of law to the particular allegations of the complaint at issue.

Misrepresentations

As noted above, the complaint alleges that Credit Suisse falsely represented in the offering materials (principally prospectuses and prospectus supplements) that loans were originated in accordance with sound underwriting guidelines. (Am. Compl., ¶ 76.) The complaint sets forth specific allegations in this regard, including that the offering materials represented that the lenders or underwriters employed underwriting standards to evaluate the mortgage loans and the borrowers' credit standing and repayment ability *(id.,* ¶ 77); that the offering materials represented that loans "were originated or acquired generally in accordance with" described underwriting guidelines *(id.,* ¶ 78); that in acquiring the loans, defendants conducted diligence on the operations of the originators *(id.,* ¶ 81); and that "exceptions" to underwriting standards were made on a case-by-case basis only when the borrower was able to demonstrate the existence of "compensating factors." *(Id.,* ¶ 82.)

The complaint alleges in summary:"[A]t the time Defendants made these representations, they knew the Mortgage Loans were not being generated in accordance with the underwriting guidelines they described to investors. At the time of these Offerings, Defendants had, in fact, abandoned sound underwriting practices and knew the companies from which they were acquiring the Mortgage Loans had similarly abandoned sound loan-origination practices. Defendants' abandonment of sound underwriting practices was systematic and significant and pervaded Defendants' RMBS offerings during this period."

(Id., 5.) In addition, the complaint charges that defendants ignored their own due diligence and ***9** that of Clayton, a third-party firm they hired. *(Id.,* ¶¶ 240-246.) Defendants also allegedly took "affirmative measures to profit from" their packaging of loans that they knew to be defective. *(Id.,* ¶ 10.) After the securities were sold, Credit Suisse would allegedly "issue repurchase demands' to originators . . . . Credit Suisse would then *keep the money* it recovered from the originators, rather than pass the proceeds to the securitization trusts that own the loans for the benefit of investors, *while leaving the defective loans in the pools." (Id.,* ri 10, 260-264 [emphasis in Complaint].) In support of these allegations, the complaint pleads that defendants' deviations from underwriting standards are confirmed by Allstate's loan-level analysis of the specific loans at issue, the collateral pools' "dismal performance," independent forensic review of thousands of defendants' loan files by their own insurers and other entities, internal e-mails, and documents reflecting defendants' discovery of borrower misrepresentations and underwriting defects. *(Id.,* ¶ 85.)

Defendants counter that the offering materials fully disclosed the risks of the mortgage loans underlying the Certificates. They cite the following disclosures and qualifications: The offering materials "did not make defmitive representations about the underwriting standards used to originate the mortgage loans" but, rather, "reported that the mortgage loans . . . were originated *generally* in accordance with the underwriting criteria described herein.'" (Ds.' Memo. In Support at 4 [defendants' emphasis].) The offering materials disclosed that the underwriting standards for a substantial number of the mortgage loans would be *"generally less stringent"* than the standards for Fannie Mae or Freddie Mac. *(Id.* [defendants' emphasis].) They also disclosed that certain exceptions to the underwriting standards would be made, with no representations as to the frequency of such exceptions. *(Id.* at 4-5.) The offering materials acknowledged that some loans might not conform even to these less stringent standards, in which case there were specific procedures for replacing or repurchasing mortgages that were discovered to depart from the representations and warranties of the seller. *(Id. at* 5.) In addition, the offering materials disclosed that defendants did not verify the information about the loans, that "many loans" were underwritten using reduced and other limited-documentation programs, and that loans originated under such programs "may experience higher rates of default than other types of loans." *(Id.* at 5-6.)

Defendants also point to the following specific disclosures in the offering materials regarding data material to the quality of the underlying loans: With respect to owner occupancy, the offering materials explicitly stated that owner occupancy information was based solely on the borrower's representation in the loan application and was not independently verified by defendants. *(Id.* at 6.) With respect to the loan-to-value and combined loan-to-value ratios of the mortgages, the offering materials disclosed that these ratios were based on appraisers' valuations that were not necessarily current and were not independently verified by defendants. *(Id.)* The offering materials also expressly warned that there were no assurances that a property's value would remain at the appraised price and, if residential real estate values declined, the ratios might not reliably predict delinquencies, foreclosures and losses that might occur on the mortgage loans. *(Id.* at 7.) With respect to credit ratings, the offering materials warned that the performance of the mortgage loans could vary from the rating agencies' assumptions, and that the ratings might be subject to revision or withdrawal at any time by the rating agencies. *(Id.)* With respect to credit enhancements, the offering materials warned that the enhancements available to *10 certain classes of certificates were not insurance against all losses and that, once exhausted, the classes would bear the losses. *(Id.* at 8.)

According to defendants, the offering materials also generally warned that economic conditions affect loan repayment and delinquency rates, and that the secondary market for the Certificates could become illiquid. *(Id.)* The Certificates purchased in 2007 warned that the residential mortgage market had experienced difficulties that may adversely affect the performance or market value of the securities. *(Id.* at 9.)

Courts considering RMBS claims have overwhelmingly held that such disclosures or warnings do not give notice to investors of the defendant's "wholesale abandonment of underwriting standards." *(Plumbers' Union Local No. 12 Pension Fund v Nomura Asset Acceptance Corp.,* 632 F3d 762, 773 [1st Cir. 2011] [denying motion to dismiss based on disclosures in offering materials, like those at issue here, that underwriting standards were generally less stringent than those for Fannie Mae and Freddie Mac; that certain exceptions to underwriting standards were made in the event compensating factors were demonstrated for a prospective borrower; and that defendant bank originated or purchased loans that may have been originated under limited documentation programs]; *see also Matter of Morgan Stanley Mtge. Pass-Through Certificates Litig.,* 810 F Supp 2d 650, 672 [SD NY 2011] [holding that "boilerplate disclaimers and disclosures in the relevant offering documents," including disclosures that borrower information was not always obtained or verified, and that appraisals might not be independent, did not "disclose the risk of a systematic disregard for underwriting standards or an effort to maximize loan originations without regard to loan quality"]; *New Jersey Carpenters Vacation Fund v Royal Bank of Scotland Group, PLC,* 720 F Supp 2d 254, 270 [SD NY 2010], *mod on other grounds* 2013 WL 1809767 [SD NY 2013, No. 08-CV-5093] ["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"]; *Public Empls.'Ret Sys. of Mississippi v Merrill Lynch & Co. Inc.,* 714 F Supp 2d 475, 483 [SD NY 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"]; *Matter of IndyMac Mtge.--Backed Secs. Litig.,* 718 F Supp 2d 495, 509 [SD NY 2010] [holding that warnings that loans could have been issued under reduced or no documentation programs or pursuant to exceptions to underwriting guidelines "do not adequately warn of the risk the standards will be ignored"]; *see Ace,* 2013 WL 1103159, at *12 [holding that disclosure that "originators could make a substantial' number of exceptions to the underwriting guidelines," and warnings of possibly high delinquency, foreclosure and bankruptcy rates, and other risks, were insufficient to disclose the risk of "systematic disregard for underwriting standards"]; *Stichting Pensioenfonds ABP v Credit Suisse Group AG,* 2012 NY Slip Op 52433 [U], 2012 WL 6929336, *8 [Sup Ct, NY County 2012, Schweitzer, J.] [holding that disclosure that loans would be originated "generally in accordance" with described underwriting standards and that "exceptions" to such standards would be made based on "compensating factors," without any statements as to the frequency of such exceptions or factors that would be considered, were insufficient to immunize defendant from claim that underwriting standards "were in fact ignored"].)

This court holds, on this persuasive authority, that the cited disclosures in the offering *11 materials do not, as a matter of law, bar Allstate's claim that the offering materials made actionable misrepresentations that the underlying mortgage loans were made in compliance with sound underwriting standards. Put another way, the allegations of the complaint regarding defendants' repeated deviations from underwriting standards are actionable, notwithstanding that the offering materials disclosed that exceptions to the underwriting standards might be made in issuing the loans.

Defendants further argue, based on the inclusion in the offering materials of a "repurchase or substitute" provision, under which defendants agreed to repurchase or substitute nonconforming loans, that the offering materials made clear that there was a possibility that nonconforming loans would be included in the pools backing the offerings. They assert that the repurchase provision thus "changed the nature of the representations in the Offering Documents regarding the characteristics of the underlying loans, rendering Allstate's alleged misstatements non-actionable." (Ds.' Reply Memo. at 9; Ds.' Memo. In Support at 24-25.) This argument is based on *Lone Star Fund V (US.), L.P. v Barclays Bank PLC* (594 F3d 383 [5th Cir 2010]), in which the plaintiff's fraud claim was predicated entirely upon the defendant's representation in the offering materials that there were no delinquent loans underlying the certificates. *(Id.* at 388.) The Court reasoned that this representation must be read in the context of the offering materials as a whole, and that because they contained a repurchase or substitute provision, which contemplated that the mortgage pools might contain delinquent mortgages, the defendant "made no actionable misrepresentations." *(Id.* at 389.) *Lone Star* has repeatedly been distinguished as inapplicable where, as here, plaintiffs based 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,* 2012 WL 6929336, at *7; *see also Plumbers' & Pipefitters' Local No. 562 Supplemental Plan & Trust v J.P. Morgan Acceptance Corp. I,* 2012 WL 601448, *18--19 [ED NY 2012, No. 08-CV-1713]; *Employees' Retirement Sys. of the Govt. of the Virgin Islands v J.P. Morgan Chase & Co.,* 804 F Supp 2d 141, 155 [SD NY 2011].) This court agrees that the existence of the repurchase or cure provision "does not change the nature of [defendants'] representations about their process." *(Stichting,* 2012 WL 6929336, at *7.)

Defendants further argue that the pleadings lack particularity because plaintiffs have not tied their allegations of misconduct to the particular Certificates purchased, or to the groups of loans within each offering that back their purchases. *(See* Ds.' Memo. In Support at 17-19.) Again, however, the courts have repeatedly rejected similar allegations. *(Tsereteli v Residential Asset Securitization Trust 2006--A8,* 692 F Supp 2d 387, 392 [SD NY 2010] [holding that where complaint alleged that there was "widespread abandonment of underwriting guidelines at IndyMac Bank during the period of time at issue and that the percentage of defaulting' loans rose dramatically shortly after the Certificates were issued," complaint pleaded a "sufficient nexus between the alleged underwriting standard abandonment and the loans underlying the Certificates"]; *Plumbers & Pipefitters' Local No. 562,* 2012 WL 601448, at *18 [following *Tsereteli* in rejecting claim that complaint should be dismissed based on failure of complaint to identify any specific nonconforming loans underlying the certificates]; *Employees' Ret. Sys. of the Govt. of the Virgin Islands,* 804 F Supp 2d at 152 [quoting *Tsereteli* for the proposition that "[a] plaintiff need not allege that any particular loan or loans were issued in deviation from the ***12** underwriting standards, so long as the complaint alleges widespread abandonment of underwriting guidelines"']; *Morgan Stanley Mtge. Pass-Through Certificates Litig.,* 810 F Supp 2d at 672 [same]; *IndyMac Mtge.-Backed Secs. Litig.,* 718 F Supp 2d at 509-510 [same].) Recently, the Second Circuit approved this line of cases. *(New Jersey Carpenters Health Fund v Royal Bank of Scotland Group, PLC,* 709 F3d 109, 122-123 [2013], *revg New Jersey Carpenters Health Fund v Novastar Mtge., Inc.,* 2012 WL 1076143, * 5, 6 [SD NY 2012, No. 08-CV-5310].)There are cases that have dismissed complaints for failure to plead a sufficient nexus between deviations from underwriting standards and specific loans. *(See e.g. Footbridge Ltd. Trust v Countrywide Home Loans, Inc.,* 2010 WL 3790810 [SD NY 2010, No. 09-CV-4050] [fmding nexus between general allegations and specific securities insufficient in case involving fixed-rate loans secured by second liens on residential properties -- securities that were concededly known by plaintiffs to be risky]; *City of Ann Arbor Empls.' Retirement Sys. v Citigroup Mtge. Loan Trust Inc.,* 2010 WL 6617866, ** 4, 6 [ED NY 2010, No. 08-CV-1418] [after initially dismissing complaint without prejudice [703 F Supp 2d 253], holding that plaintiffs complied with "court's directive to tie the allegedly misleading statements to their particular investments," but accepting allegations as to specific loans representing only a "tiny fraction" of the mortgages underlying the securities at issue].)

However, as this Court has noted, "the weight of the authority indicates that . . . allegations of systematic underwriting failure are sufficient to state a claim and do not need to be accompanied by reference to specific loans in the securitization pools of the Certificates." *(Stichting,* 2012 WL 6929336, at *8.) The court adopts this reasoning and holds that plaintiffs' allegations regarding the poor performance of their particular Certificates, coupled with their allegations of defendants' systemic abandonment of underwriting standards, are sufficient to state a claim for misrepresentation.

The court further finds that the allegations of the complaint regarding specific misrepresentations as to loan-to-value ratios, owner occupancy, and credit ratings are sufficient to support the fraud causes of action. Misrepresentations of such data have repeatedly been held actionable. *(Ace,* 2013 WL 1103159, a [and authorities cited therein].)

As to loan-to-value ratios (i.e., the ratio of a mortgage loan's principal balance to the value of the mortgaged property), the complaint alleges that the offering materials misrepresented these ratios (Am. Compl., TT 95-97), and misrepresented that the ratios were calculated using data based on sound appraisal practices *(id.,* ¶ 98). The complaint further alleges that defendants knew that the appraisal process was manipulated *(id.,* TT 101, 273-276), and sets forth specific allegations about the appraisal practices of the originators of some of the mortgages underlying the offerings at issue *(id.,* ¶¶ 176-179 [Countrywide],181-183 [Option One], 198 [TBW]). *13

Fraud claims based on appraisals have been dismissed on the ground that an appraisal is a subjective opinion and is not actionable absent an allegation that the appraiser did not believe the appraisal at the time it was issued. *(See e.g. Tsereteli,* 692 F Supp 2d at 393; *IndyMac Mtge.-Backed Secs. Litig.,* 718 F Supp 2d at 511.) Fraud claims involving appraisals have also been dismissed where the complaint pleaded only general allegations that the appraisers were subject to pressure from the banking industry to inflate their appraisals, and not that the appraisers of the loans at issue succumbed to such pressure. *(See e.g. Plumbers' Union Local No. 12 [Nomura],* 632 F3d at 774.) However, fraud claims based on allegations similar to those here have repeatedly been upheld where the complaint pleaded allegations about the appraisal practices of the originators at issue. *(Capital Ventures [J.P. Morgan],* 2013 WL 535320, at * 4-5; *Morgan Stanley Mtge. Pass-Through Certificates Litig.,* 810 F Supp 2d at 672-673 [holding that claim was stated where complaint made detailed allegations as to systematic disregard of appraisal standards by originators at issue]; *see also Matter of Bear Stearns Mtge. Pass-Through Secs. Litig.,* 851 F Supp 2d 746, 769 [SD NY 2012]] [declining to dismiss appraisal allegations based on subjective opinion rule]; *Matter of Wachovia Equity Secs. Litig.,* 753 F Supp 2d 326, 378 n 48 [SD NY 2011] [same]; *Allstate Ins. Co. v Countrywide Fin. Corp.,* 824 F Supp 2d 1164, 1185-1186 [CD Cal 2011] [noting that appraisals are generally inactionable opinions, but upholding fraud claim based on appraisals where complaint pleaded facts calling into question the factual bases for the appraisals].) Here, similarly, the specific allegations of the complaint regarding the originators' deviations from appraisal standards, with resulting impact on the calculation of the loan-to-value ratios, are sufficient to support the fraud cause of action.

As to owner occupancy, the complaint alleges that the offering materials made specific representations that falsely overstated the percentage of the loans in the loan pools that were owner occupied (Am. Compl., ¶¶ 91-94), and that defendants knew that occupancy data was being manipulated in order to facilitate the securitization process. *(Id.)* Defendants argue that the offering materials were not misleading because they disclosed that the owner occupancy data was based on the borrowers' representations, without independent verification. (Ds.' Memo. In Support at 19.) However, as this Court previously held on similar allegations, "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." *(Merrill Lynch,* 2013 WL 4046711, at *12; *Capital Ventures [J.P. Morgan],* 2013 WL 535320, at *5.)

As to credit ratings, the complaint alleges that defendants "affirmatively manipulated the ratings process to secure ratings they knew were not an accurate reflection of the credit risk of the offerings. Defendants also fed the ratings agencies baseless and false statistics regarding the loans . . . ." (Am. Compl.,'Irlf 112, 229-236, 281.) Claims based on credit ratings have been dismissed as inactionable absent an allegation that the rating agency did not believe that the ratings it assigned were supported by the factors considered. *(Tsereteli,* 692 F Supp 2d at 394-395; *Plumbers' Union Local No. 12 [Nomura],* 632 F3d at 775-776 [holding that ratings are "inherently opinions" and that fraud claim was not maintainable "so long as the ratings were honestly made, had some basis, and did not omit critical information. That a high rating may be mistaken, a rater negligent in the model employed or the rating company interested in securing more business may be true, but it does not make the report of the rating false or misleading"]; ***14** *IndyMac Mtge.-Backed Secs. Litig.,* 718 F Supp 2d at 511-512.) Allegations based on credit ratings have been upheld, however, where the complaint focused not on the subjective belief of the ratings agency but on the knowledge of the defendants as to the support for the ratings. *(Capital Ventures [J.P. Morgan],*2013 WL 535320, at *6 [upholding claim based on ratings where plaintiff claimed "defendants knew that the underlying data was faulty and so that there was no real basis for the credit ratings," court reasoning that "defendants cannot simply repeat opinions they know are inaccurate or baseless and then disclaim liability"]; *Bear Stearns Mtge. Pass-Through Secs. Litig.,* 851 F Supp 2d at 772 ["If Bear Stearns knowingly fed incomplete or inaccurate information to the Rating Agencies . .. the ratings' unqualified reproduction in the Offering Documents would constitute an actionable misrepresentation and omission"].) Here, the allegations of the complaint are sufficient, under this persuasive latter authority, to support the fraud claim.'

Remaining Elements of Fraud Claim

Defendants contend that the allegations of the complaint are insufficient to plead scienter. (Ds.' Memo. In Support at 26-29.) The scienter element, like the other elements of a fraud claim, must be pleaded with particularity. (CPLR 3016 [b].) This requirement is satisfied where the "complaint contains some rational basis for inferring that the alleged misrepresentation was knowingly made."

(Houbigant, Inc. v Deloitte & Touche LLP, 303 AD2d 92, 93 [1st Dept 2003]; *accord Seaview Mezzanine Fund, LP v Ramson,* 77 AD3d 567, 568 [1st Dept 2010].)

This Court has rejected challenges to the pleading of the scienter element in RMBS cases brought on substantially similar complaints. *(Stichting,* 2012 WL 6929336, at * 10 [holding that scienter was adequately pleaded where complaint alleged that Credit Suisse 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," and where complaint alleged that defendants' knowledge of poor quality of the loans could be inferred from their "repricing program," which involved demanding extra compensation from third-party originators for poor quality loans]; *Ace,* 2013 WL 1103159, at * 10 [upholding scienter pleading where complaint alleged 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, and used its knowledge to negotiate cheaper prices for loans"].) Consistent with this authority, the court holds that the scienter element is sufficiently pleaded on the substantially similar allegations at issue.

Defendants also challenge the sufficiency of the pleading of the justifiable reliance ***15** element of the fraud claim, primarily on the ground that the offering materials made disclosures about the quality of the underlying loans, including the lack of verification of borrower information, and the risks in investing in RMBS Certificates in a weakening residential market. (Ds.' Memo. In Support at 29-31.)

The complaint alleges that plaintiffs did not have access to the underlying loan files in determining whether to invest in the Certificates and therefore depended on defendants to present accurate information about the underlying loans. (Am. Compl., ¶ 4.) Defendants do not dispute that plaintiffs did not have access to the loan files. As held by this Court in prior RMBS cases, plaintiffs' allegation as to this lack of access supports the justifiable reliance element of the fraud claim at the pleading stage. *(Ace,* 2013 WL 1103159, at * 14; *Stichting,* 2012 WL 6929336, at *10; *see CIFG Assur. N. Am., Inc. v Goldman, Sachs & Co.,* 106 AD3d 437, 437-438 [1st Dept 2013] [holding, in RMBS case in which plaintiff conducted its own due diligence, that there was a question of fact as to whether plaintiff reasonably relied on defendants' representations, and that plaintiff "was not required, as a matter of law, to audit or sample the underlying loan files"].)The court notes, however, that "the reasonableness of [an investor's] reliance generally implicates factual issues whose resolution would be inappropriate" on a motion to dismiss. *(Knight Secs., L.P. v Fiduciary Trust Co.,* 5 AD3d 172, 173 [1st Dept 2004] [brackets omitted].) There is an extensive body of case law, which continues to develop, on the extent to which a sophisticated investor may justifiably rely on the representations of the seller regarding the risks of the transaction or, put another way, on the circumstances in which an investor must conduct its own due diligence. *(See e.g. DDJ Mgmt., LLC v Rhone Group L.L.C.,* 15 NY3d 147 [2010]; *ACA Fin. Guar. Corp. v Goldman, Sachs & Co.,* 106 AD3d 494 [1st Dept 2013]; *HSH Nordbank AG v UBS AG,* 95 AD3d 185, 188-189 [1st Dept 2012].) While the instant case is not one in which "the allegations of the . . . complaint itself establish that [plaintiffs] could have uncovered any misrepresentation of the risk of the transaction through the exercise of reasonable due diligence within the means of a financial institution of its size and sophistication" *(compare HSH Nordbank,* 95 AD3d at 188-189), neither is it one in which the pleadings demonstrate as a matter of law that plaintiffs' reliance on defendants' representations was justifiable. Rather, a significant issue of fact exists as to the reasonableness of plaintiffs' investigation in light of the information available to them.

Defendants also assert that plaintiffs cannot establish loss causation -- i.e., that the decline in the value of the RMBS Certificates was proximately caused by defendants' alleged misrepresentations. In particular, defendants contend that plaintiffs have impermissibly ignored non-fraudulent explanations for their losses, such as whether the economic downturn was an intervening cause. (Ds.' Memo. In Support at 32-33.) This claim has been rejected by this Department. *(MBIA Ins. Corp.,* 87 AD3d at 296 [holding that "[i]t cannot be said, on this pre-answer motion to dismiss, that MBIA's losses were caused, as a matter of law, by the 2007 housing and credit crisis"].)

For the above reasons, defendants' motion to dismiss the fraud claims will be denied.

Negligent Misrepresentation

Negligent misrepresentation claims based on allegations substantially similar to those here have repeatedly been dismissed. *(E.g. MBIA Ins. Corp.,* 87 AD3d at 296-297; *Ace,* 2013 WL 1103159, at * 15-16; *Stichting,* 2012 WL

6929336, at * 13.) Here, as well, the negligent ***16** misrepresentation claim will be dismissed as a result of plaintiffs' failure to allege the existence of the necessary special or privity-like relationship.

It is accordingly hereby ORDERED that defendants' motion to dismiss is granted only to the extent of dismissing the cause of action for negligent misrepresentation and the fraud causes of action arising out of the purchases of the HEMT 2005-5, AlA Certificates.

Dated: New York, New York

January 24, 2014

MARCY S. FRIEDMAN, J.S.C.

FOOTNOTES

Footnotes

Plaintiffs and defendants will collectively be referred to as Allstate and Credit Suisse, respectively, except where the entities must be distinguished. The roles of the various defendants in the process by which the securities were created are discussed below.

The offerings were as follows:

Offering	*Purchaser*	*Purchase Price*	*Date*
HEMT 2005-5, AlA	Allstate Life	$35,460,000	38707
	Allstate Insurance	$10,000,000	38707
ARMT 2005-6A, A22	Allstate Insurance	$3,526,279	38790
HEMT 2006-2, 2A1	Allstate Insurance	$10,000,000	38809
	Allstate Life	$15,000,000	38809
CSMC 2006-8, 3A1	Allstate Life	$19,902,325	5/06/[06]
TBW 2006-4, A4	Allstate Insurance	$30,113,015	38951
ABSC 2006-HE5, Al	Allstate Life	$5,539,343	39006
	Allstate Insurance	$5,538,448	39006
CSMC 2007-3, 4A6	Allstate Bank	$13,000,000	39154
	Allstate Insurance	$14,166,666	39154
HEMT 2005-5, A1F2	Allstate Insurance	$17,641,262	39329
HEMT 2006-2, 1A1	Allstate Insurance	$24,992,167	8/28/07
ARMT 2007-1, 5A4	Kennett Capital	$19,935,897	39356
CSMC 2007-5, 1A10	Allstate Insurance	$7,184,435	39415

(Am. Compl., ¶ 11 and Am. Compl., Exh. B).

3 The process by which residential mortgages are securitized was summarized by the Appellate Division as follows: "Securitization involves packaging numerous mortgage loans into a trust, issuing debt securities in the trust and selling those notes, known as residential mortgage-backed securities, to investors. The securities are backed by the mortgages, and the borrowers'

payments of principal and interest on their mortgage loans are used to pay the investors who purchased the securities." *(MBIA Ins. Corp. v Countrywide Home Loans, Inc.,* 87 AD3d 287, 290 [1st Dept 2011].)

4 Illinois Securities Law (815 ILCS 5/13 [D]), at the time of the sale of the securities at issue, provided:"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 . . . 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."
An amendment, effective August 5, 2013, deleted from the end of D (2): "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." Plaintiff has not notified this court, since the submission of the instant motion, of any claim that the amendment is retroactive.

The reasoning of the Court in the three decisions was virtually identical. For purposes of convenience, citations are therefore only to the *Ace* decision.

While plaintiffs cite examples of representations made in offering materials for specified Certificates (Am. Compl., Ini 76-83), they represent that the offering materials for each Certificate contain substantially similar or identical statements of fact concerning the underwriting standards. *(Id.,* ¶ 84.) Defendants do not deny that the pleaded allegations are representative.

To the extent that defendants argue that the complaint is not pleaded with particularity because the factual allegations as to the deviations from underwriting standards are insufficiently specific, plaintiffs cite independent loan level analyses and internal emails regarding defendants' discovery of deviations. (Am. Compl., ΠΓ 273-275.) Such pleaded factual bases for general allegations as to deviations from underwriting standards have been characterized by the Courts as "substantial sources," and cited in upholding the complaints. *(Plumbers' Union Local No. 12 Pension Fund [Nomura] ,* 632 F3d at 773; *Capital Ventures [JP. Morgan] ,* 2013 WL 535320, at *3.)

8 Defendants seek dismissal of the claims based on allegedly false representations as to credit enhancements, on the ground that they are derivative of the claims regarding misrepresentations as to deviations from underwriting standards, owner occupancy status, and loan-to-value ratios. (Ds.' Memo. In Support at 23-24.) As those allegations have been held sufficient to withstand the motion to dismiss, the allegations as to credit enhancements are also sufficient.

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