[*1]

Basis Pac-Rim Opportunity Fund (Master) v TCW Asset Mgt. Co.
2013 NY Slip Op 51494(U)
Decided on September 10, 2013
Supreme Court, New York County
Kornreich, J.
Published by New York State Law Reporting Bureau pursuant to Judiciary Law § 431.
This opinion is uncorrected and will not be published in the printed Official Reports.

Decided on September 10, 2013

Supreme Court, New York County

Basis Pac-Rim Opportunity Fund (Master), and BASIS YIELD ALPHA FUND (MASTER), Plaintiffs,

against

TCW Asset Management Company, Defendant.

654033/2012

Lewis Baach PLLC, for plaintiffs.

Gibson Dunn & Crutcher LLP, for defendant.

Shirley Werner Kornreich, J.

Two Australian-based Cayman Islands investment funds, plaintiffs Basis Pac-Rim Opportunity Fund (Master) (Pac-Rim) and Basis Yield Alpha Fund (Master) (BYAFM),

allege that they were fraudulently induced by defendant TCW Asset Management Company (TCW) to invest over $28 million in a collateralized debt obligation (CDO) called Dutch Hill Funding II, Ltd. (Dutch Hill). TCW is a New York based investment advisory firm that is indirectly owned by Société Générale, S.A., a French bank. TCW moves to dismiss the Complaint pursuant to CPLR 3211 and 3016(b). The motion is granted in part and denied in part for the reasons that follow.

A CDO is an investment vehicle collateralized by other securities, such as here, residential mortgage backed securities (RMBS). In a CDO comprised primarily of RMBS,[FN1] the CDO investor is betting that the RMBS will generate revenue, which occurs when homeowners make payments on the underlying mortgages. As with RMBS, a CDO does not always distribute revenue to its investors equally because the investors often purchase different tranches of the CDO which determine the priority of payment. The highest tranches are paid first, but have a lower rate of return.[FN2] Revenue is only distributed to investors in the lower tranches if and when [*2]investors in the higher tranches have been paid, but the lower tranches offer a higher rate of return due to this risk. The lowest tranche of a CDO, called the equity or the subordinated notes, has the highest level of risk and is typically not assigned a credit rating.

Dutch Hill was a CDO comprised of RMBS and investments in other CDOs. It had multiple tranches, of which plaintiffs purchased the lowest rated tranche and the unrated subordinated notes.

Factual Background & Procedural History

As this decision involves a motion to dismiss, the facts recited are taken from the Complaint.

On January 16, 2007, Paul Brownsey, an employee of non-party Deutcshe Bank, sent plaintiffs an email solicitation to invest in Dutch Hill. Complaint ¶ 43. On January 26, 2007, representatives of plaintiffs and TCW attended a Deutcshe Bank conference in Portugal. ¶ 44. At that conference, TCW predicted that there would be losses on RMBS issued in 2006.[FN3] *Id.* However, TCW claimed to have developed a system for "navigating" the RMBS market that could identify which RMBS were likely to fail and which RMBS were still good investments. *Id.* This methodology was supposedly applied to the selection of Dutch Hill's

RMBS investments. ¶¶ 48-49. Plaintiffs were told that TCW had so much confidence in Dutch Hill that TCW's senior managers would personally invest in Dutch Hill's equity. ¶ 45.

On February 12, 2007, Deutsche Bank's Brownsey sent plaintiffs a "preliminary investor presentation" for Dutch Hill (the Presentation). ¶ 47. The Presentation expanded on TCW's supposed ability to continue to identify good RMBS investments. ¶¶ 47-50. Specifically, TCW represented that it "designed [Dutch Hill] to capitalize on opportunities in the *below investment grade* RMBS market" [emphasis added] by "exploiting market inefficiencies" as "the most reliable way to enhance returns." ¶¶ 48-49. The supposed "inefficiencies" were "the market being relatively young' and still developing'", "the perceived complexity of security valuation," and "'lack of skill or experience' leading investors to avoid these offerings." ¶ 49. The Presentation expressed TCW's view that "on a selective basis the subprime RMBS market remains a fundamentally sound asset class." ¶ 66. TCW also confirmed that, as originally indicated at the conference, three of its senior staff would personally invest in the equity of Dutch Hill. ¶ 50.

On March 14, 2007, TCW sent plaintiffs a "U.S. Housing Market Update" (the Market Update) along with a letter by TCW's Managing Director (who supposedly intended to purchase Dutch Hill equity), which stated that "we are confident that our investment process has mitigated the impact on [RMBS] portfolios." ¶ 52. The Market Update again remarked on problems in the RMBS market, such as originators easing mortgage underwriting standards and home price depreciation, but reemphasized that TCW has "minimized and often avoided" poor quality loans in TCW transactions. ¶ 53.

On April 30, 2007, Brownsey forwarded plaintiffs an email from TCW which stated that the three senior TCW employees who were going to invest in Dutch Hill had decided not to [*3]invest. ¶ 55. The explanation provided was that they were relying on a loan from TCW to make the investment, but TCW recently changed company policy to prohibit such loans. *Id.* Plaintiffs were assured, however, that the TCW employees' decision not to invest was based solely on the unavailability of TCW financing and "in no way reflects on their confidence in [Dutch Hill], which remains very high." *Id.*

In reliance on all of TCW's above mentioned representations — most importantly its ability to figure out which RMBS were still good, long bets — plaintiffs decided to invest in the riskiest portions of Dutch Hill. ¶ 56. On May 2, 2007, Pac-Rim purchased $11.8 million

of BBB minus rated Dutch Hill notes and BYAFM purchased over $16.3 million in unrated Dutch Hill subordinated notes (including the notes that were originally going to be purchased by TCW employees). *Id.*

The very next day, May 3, 2007, Jeffrey E. Gundlach, TCW's Chief Investment Officer (the lead executive on Dutch Hill), published a letter in which he expressed negative views on the RMBS market and indicated that "the lowest-rated investment grade bonds [such as the notes purchased by plaintiffs] would experience losses." ¶ 57. Over the next few months, as the RMBS market continued to deteriorate and eventually crash, Gundlach made further negative remarks about the RMBS market. ¶¶ 58-59. He later referred to his May 3, 2007 letter as a "public sell recommendation on subprime bonds and CDOs." ¶ 60. By the end of July 2007, after ratings agency downgrades and margin calls, plaintiffs' Dutch Hill notes had lost most of their value. ¶ 61. Plaintiffs' Dutch Hill notes, now, are virtually worthless. *Id.*

Plaintiffs commenced this action on November 21, 2012. The Complaint lists five causes of action: (1) fraudulent inducement; (2) fraudulent concealment; (3) negligent misrepresentation; (4) breach of contract — third-party beneficiary; and (5) unjust enrichment.

The fraud claims, as alleged, can be summarized as follows. First, TCW — which supposedly was an independent collateral manager tasked with picking Dutch Hill's RMBS investments based on some proprietary method of separating the wheat from the chaff — was neither independent nor that insightful. Rather, TCW, whose business of managing CDOs worth approximately $28 billion was in peril due to the impending collapse of the housing market, needed to find a way to convince investors to keep making long RMBS bets in an environment where the appetite for such bets was justifiably waning. Thus, TCW fabricated an ability for finding "good" RMBS and touted such ability to investors, such as plaintiffs, to assure them that, with TCW's expertise, there was still good money to be made on RMBS even as the market continued to destabilize. This was a lie.

Moreover, TCW, according to plaintiffs, worked closely with major financial institutions, such as Deutcshe Bank, who TCW relied on to structure RMBS deals. To maintain this relationship and ensure that Deutcshe Bank continued to send TCW highly lucrative deals, TCW betrayed its obligation of independence to CDO investors by allowing Deutcshe Bank to offload toxic RMBS from its balance sheet and dump them into CDOs

managed by TCW. In this case, plaintiffs identified a notorious CDO called Gemstone 7, that they claimed Deutsche Bank knew to be toxic (its underlying RMBS were called "crap" by Deutsche Bank's employee Greg Lippman) and could not sell to anyone. Despite TCW's assurances that it would only allow Dutch Hill to acquire RMBS investments it knew to be good, TCW caused Dutch Hill to acquire Gemstone 7. Plaintiffs allege that TCW engaged in similar improper methods of building Dutch Hill's portfolio.

As for plaintiffs' contract claim, plaintiffs allege that they can maintain a claim for breach [*4]of TCW's obligations under the Investment Advisory Agreement (the IAA), which TCW entered into with Dutch Hill. TCW's alleged failure to adhere to its contractual obligations, such as performing specific credit analysis (e.g. vetting cash flow stability), plaintiffs argue, is a breach that plaintiffs have standing to maintain as third-party beneficiaries of the IAA.

Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, L.L.C. v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1992); *see also Cron v Harago Fabrics*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of NY*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

Fraudulent Inducement & Fraudulent Concealment

To begin, this is a case where all parties recognized the problems in the housing market prior to plaintiffs' investment. However, unlike other investors who may have disagreed with the general consensus about the housing market and still made large, long RMBS investments as late as May 2007, plaintiffs, sophisticated investors, relied upon TCW's representations championing a unique investment strategy. Here, TCW marketed and plaintiffs invested in a purported ability to target specific RMBS that were immune from the general toxicity of the housing market. Though most investors were wary of all RMBS given the known problems in the market, plaintiffs bought into TCW's alleged ability to identify non-toxic RMBS. If this really was the basis for plaintiffs' investment, TCW cannot rely on the common defense that "plaintiffs are sophisticated" and that "they should have known better" because "problems in the housing market were well known at the time of their investment." This argument is useless because the very point of investing with TCW was to alleviate these concerns. Hence, the issue in this case is not whether it was objectively reasonable for a sophisticated investor to make long RMBS bets in May 2007. Rather, the question is whether a sophisticated investor such as TCW could have reasonably believed in TCW's purported unique abilities. As discussed below, this question of fact is not suitably resolved on a motion to dismiss.

To properly plead a claim of fraud, the complaint must contain allegations of a material misrepresentation, scienter, reliance, and injury. *Small v Lorillard Tobacco Co.*, 94 NY2d 43, 57 (1999); *Perrotti v Becker, Glynn, Melamed & Muffly LLP*, 82 AD3d 495, 498 (1st Dept 2011) (to maintain a claim of fraudulent inducement, a complaint must allege "a false representation, [*5]made for the purpose of inducing another to act on it, and that the party to whom the representation was made justifiably relied on it and was damaged."), citing *Lama Holding Co. v Smith Barney Inc.*, 88 NY2d 413 (1996). Additionally, pursuant to CPLR 3016 (b), the circumstances constituting the fraud must be stated in detail. *Id.*

In a securities fraud case, there are two ways to establish a material misrepresentation. The first, as in all fraud cases, is to identify a specific false statement. The second is to establish that " defendants' representations, taken together and in context, would have [misled] a reasonable investor' about the nature of the investment." *Acacia Nat'l. Life Ins. Co. v Kay Jewelers, Inc.*, 203 AD2d 40, 44 (1st Dept 1994), quoting *I. Meyer Pincus & Assoc., P.C. v Oppenheimer & Co.*, 936 F2d 759 (2d Cir 1991); *Delia SA/NV v Bear, Stearns & Co.*, 2013

WL 856499, at *4 (SDNY Feb. 27, 2013) (Rakoff, J.), quoting *Oakey v Hyperion 1999 Term Trust*, 98 F3d 2, 5 (2d Cir 1996) ("the central issue' in determining whether material misrepresentations have been sufficiently pleaded is not whether the particular statements, taken separately, were literally true, but whether defendants' representations, taken together and in context, would have mis[led] a reasonable investor about the nature of the [securities]."'); *State v The Bank of New York Mellon Corp.*, Index No. 114735/2009, Dkt. 74, at *25 (Sup Ct, NY County Aug. 5, 2013) (Friedman, J.) (applying this standard under New York law), citing *Phoenix Light SF Ltd. v Ace Securities Corp.*, 39 Misc 3d 1218(A), at *4 (Sup Ct, NY County Apr. 24, 2013) (Kornreich, J.) (same); *see also MBIA Ins. Corp. v Countrywide Home Loans, Inc.*, 87 AD3d 287, 294-96 (1st Dept 2011) (plaintiff must prove that representations were material to its decision to enter into transaction).

As discussed in part I, TCW represented that it was capable of identifying which subprime RMBS were still good investments. The Complaint alleges that this specific representation of TCW's skill set was false. On this motion to dismiss, the court must assume that TCW lied about knowing which RMBS were not toxic.[FN4] Lying about the fundamental way in which a CDO was structured is a material misrepresentation.

TCW's reason for doing so may have merely been to continue to earn fees for as long as possible until the market crashed or may have been part of an alleged conspiracy with Deutcshe Bank to transfer their bad RMBS to Dutch Hill. Regardless, TCW's motive is relevant to scienter. TCW argues that its motive to earn fees on Dutch Hill is insufficient to infer scienter because (1) a motive to earn fees is generally insufficient to make such inference; and (2) the structure of TCW's fees aligned TCW's incentives with plaintiffs' investment in Dutch Hill.

TCW's first argument is correct. As this court has held, the motive to earn fees alone is, without more, insufficient for the court to infer scienter under CPLR 3016(b). *SSR II, LLC v John Hancock Life Ins. Co.*, 37 Misc 3d 1204(A), at *5-7 (Sup Ct, NY County 2012), citing *Tech. Support Servs., Inc. v Int'l. Bus. Machs. Corp.*, 18 Misc 3d 1106[A], at *30 (Sup Ct, Westchester County 2007) (the "desire for higher compensation . . . is found in virtually all [*6]commercial transactions, making it an ill-suited motive from which to draw an inference of intent to defraud"); *Zutty v Rye Select Broad Market Prime Fund, L.P.*, 2011 WL 5962804, at *11 (Sup Ct, NY County 2011) (allegation that "defendants had a motive to defraud

plaintiffs — a pecuniary interest in causing unearned fees, commissions and bonuses' . . . was legally insufficient to establish scienter."); *Prickett v NY Life Ins. Co.*, 896 FSupp2d 236, 246 (SDNY 2012) ("a general profit motive, such as the motive to earn fees, is not a sufficient motive to commit fraud."); *see also In re Merrill Lynch & Co., Inc. Research Reports Securities Litigation*, 289 FSupp2d 416, 428 (SDNY 2003) ("If this Court were to accept the plaintiffs' allegations of scienter as adequate, it would essentially read the scienter element out of existence. All firms in the securities industry want to increase profits and all individuals are assumed to desire to increase their compensation. Allegations such as these are inadequate to plead motive to commit a fraud on the market or the public under the securities laws and the Reform Act and will not be endorsed by this Court").

However, TCW's second argument, which is based on the fact that the majority of TCW's fees would only be paid if plaintiff made money on Dutch Hill (because the fees were subordinated to the CDO's lowest tranches), is uncompelling in the context of the events of May 2007. If, as plaintiffs allege, TCW knew that Dutch Hill was going to fail and the market for new long RMBS investors was about to disappear, TCW had every incentive to get whatever fees it could on an RMBS CDO before the crash. Though TCW surely would have preferred the whole fee if Dutch Hill succeeded, TCW (or any rational firm) would sooner get something rather than nothing. Therefore, TCW stood to gain either a small fee upfront or nothing at all. The court can infer scienter from the Complaint because it states a plausible theory of why TCW would lie about its RMBS selection process — namely, that without such lies, no one would have been willing to invest in TCW managed RMBS CDOs because the market for generic long RMBS bets was virtually non-existent. As this is merely a motion to dismiss, TCW will have ample opportunity in discovery to establish that its selection process was as advertized and devoid of any nefarious intent.

That being said, the Complaint alleges an additional basis for the court to infer scienter: an alleged conspiracy with Deutcshe Bank, similar to the fraud allegedly committed by other financial institutions, such as Goldman Sachs. *See Dodona I, LLC v Goldman, Sachs & Co.*, 847 FSupp2d 624, 632-33 (SDNY 2012) (discussing why allegations that Goldman engaged in "risk reduction strategy," whereby Goldman sought to purge its balance sheet of assets that had exposure to subprime mortgage market by unloading such assets onto its clients, sufficed to properly plead causes of action for federal securities fraud and common law fraud). In *Dodona*, the court held that plaintiff's "theory of securities law violations rests not upon a

single decisive action which manifestly demonstrates Goldman's alleged wrongdoing, but on a series of interrelated events which, viewed as a whole, represent the big picture of fraudulent conduct." *Id.* at 640. In a similar case involving one of the plaintiffs in this action (BYAFM), this court held that "BYAFM paints a picture that is substantially similar to *Dodona* . . . that the scheme that Goldman allegedly engaged in is fraudulent on its face . . . [and], as in *Dodona*, this Court finds that plaintiff has not only adequately pled its fraud causes of action based on the representations and omissions alleged in the complaint, but also for the big picture of fraudulent conduct' that is alleged as well." *Basis Yield Alpha Fund (Master) v Goldman Sachs Group, [*7]Inc.*, 37 Misc 3d 1212(A), at *8 (Sup Ct, NY County 2012).[FN5]

As in *Dodona* and *Basis Yield*, the Complaint alludes to a "big picture of fraudulent conduct." If TCW added Gemstone 7 to Dutch Hill's portfolio knowing that it was a losing investment and did so specifically to benefit Deutcshe Bank at the expense of Dutch Hill's investors, TCW would have acted in a fraudulent manner. Moreover, if Dutch Hill was generally constructed to aid Deutcshe Bank or other financial institutions in their own "risk reduction strategy,"[FN6] TCW's conduct would extend well beyond lying about having keen insight into the RMBS market.

However, the Complaint is not clear about whether plaintiffs intend to pursue this broad fraud theory or if they wish to restrict their case to the specific issue of TCW's CDO structuring methodology. Indeed, if plaintiffs wish to pursue the broad approach, they will predictably seek substantial discovery from Deutcshe Bank. While Deutcshe Bank's involvement in the process leading up to plaintiffs' investment in Dutch Hill is described in the Complaint, plaintiffs did not name Deutcshe Bank as a defendant. Plaintiffs must decide now, not at the end of discovery (which would significantly delay the case), whether they seek to assert claims against Deutcshe Bank. For this reason, as ordered below, the deadline for plaintiffs to file an amended complaint is 30 days from the entry of this order so that there can be clarity about the scope of this case. The court will not allow discovery in this case to be used as an investigative tool for future potential lawsuits.

Finally, TCW argues that plaintiffs cannot claim reasonable reliance because Dutch Hill's offering materials contained fraud disclaimers stating that investors should conduct their own due diligence. *See UST Private Equity Invs. Fund v Salomon Smith Barney*, 288 AD2d 87, 88

(1st Dept 2001) ("a sophisticated plaintiff cannot establish that it entered into an arm's length transaction in justifiable reliance on alleged misrepresentations if that plaintiff failed to make use of the means of verification that were available to it"). However, as plaintiffs correctly argue, these types of general disclaimers do not sanitize specific instances of fraud. *See Silver Oak Capital L.L.C. v UBS AG*, 82 AD3d 666, 667 (1st Dept 2011). Instead, "[a] claim for fraud is [only] barred by the existence of a specific disclaimer and failure to exercise reasonable diligence." *Steinhardt Group Inc. v Citicorp*, 272 AD2d 255, 256 (1st Dept 2000), accord *Danann Realty Corp. v Harris*, 5 NY2d 317 (1959).

Here, as discussed earlier, the alleged fraud was TCW's lies about how it constructed Dutch Hill. Additionally, the offering materials did not mention any collusion with Deutcshe [*8] Bank. Plaintiffs could not have deduced TCW's alleged fraud with "means of verification that were available to [them]," which, in this case, would seem impossible without an audit of TCW's operations or its communications with Deutcshe Bank.

Nevertheless, there is a real question of whether highly sophisticated investment funds, such as plaintiffs, could have reasonably relied on TCW's representations about its RMBS selection process.[FN7] To be sure, TCW may have been even more sophisticated than plaintiffs. Yet, big players in the structured finance trading game cannot reasonably expect to win a fraud case merely on the ground that the defendant is marginally more sophisticated than the plaintiff. Indeed, no two investors are equally sophisticated. But, there is some threshold of sophistication beyond which claims of naiveté about the way Wall Street works will not succeed. Further, there is a difference between relative sophistication and varying access to information. Specifically, plaintiffs, who themselves had involvement in many other RMBS securitizations, surely had access to information about RMBS and the loans that comprised them that may or may not have overlapped with Dutch Hill's investments. Then too, even if plaintiffs did not have access to such information, expert discovery is needed to determine whether plaintiff, investment funds, can credibly contend that they acted reasonably in relying upon TCW's advertized abilities or if sophisticated investors would view TCW's claims as mere inactionable puffery. *See Mandarin Trading Ltd. v Wildenstein*, 16 NY3d 173, 179 (2011). However, the Deutcshe Bank conspiracy allegations, if they are pursued, may form the basis for a fraud claim — regardless of plaintiffs' sophistication — but only if such allegations are pled with the requisite specificity.

For these reasons, the motion to dismiss plaintiffs' fraud claims is denied.

Negligent Misrepresentation

"A claim for negligent misrepresentation requires the plaintiff to demonstrate (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." *J.A.O. Acquisition Corp. v Stavitsky*, 8 NY3d 144, 148 (2007). Where, as here, the parties entered into an arms' length RMBS transaction, no special relationship exists. *See Allstate Ins. Co. v Morgan Stanley*, Index No. 651840/2011, Dkt. 48, at *32-33 (Sup Ct, NY County, Mar. 14, 2013); *see also MBIA*, 87 AD3d at 297.

*[*9]Breach of Contract — Third-Party Beneficiary*

"A party asserting rights as a third-party beneficiary must establish (1) the existence of a valid and binding contract between other parties, (2) that the contract was intended for his benefit and (3) that the benefit to him is sufficiently immediate, rather than incidental, to indicate the assumption by the contracting parties of a duty to compensate him if the benefit is lost.'" *State of California Pub. Employees' Ret. Sys. v Shearman & Sterling*, 95 NY2d 427, 434-35 (2000), quoting *Burns Jackson Miller Summit & Spitzer v Lindner*, 59 NY2d 314, 336 (1983). New York has adopted the standard set forth in the § 302 of the Restatement (Second) of Contracts to determine if a party was an intended beneficiary: "One is an intended beneficiary if one's right to performance is appropriate to effectuate the intention of the parties' to the contract **and** either the performance will satisfy a money debt obligation of the promisee to the beneficiary or the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance." *See Edge Mgmt. Consulting, Inc. v Blank*, 25 AD3d 364, 368 (1st Dept 2006) (emphasis in original). Additionally, "[t]he parties' intent to benefit the third party must be apparent from the face of the contract." *LaSalle Nat'l Bank v Ernst & Young LLP*, 285 AD2d 101, 108 (1st Dept 2001); *see also U.S. Bank Nat'l Ass'n. v GreenPoint Mortg. Funding, Inc.*, 105 AD3d 639, 640 (1st Dept 2013) (dismissing third-party beneficiary claim because of "the absence of any clear language on the face of the [contracts]"). "Absent clear contractual language evincing such intent, New York courts have demonstrated a reluctance to interpret circumstances to construe such an intent." *LaSalle*, 285 AD2d at 108-09, citing *Fourth Ocean Putnam Corp. v Interstate Wrecking Co.*, 66 NY2d 38,

45 (1985).

Plaintiffs cite to a federal case holding that a CDO investor stated a third-party beneficiary claim to enforce a "collateral management agreement" similar to the IAA. *See Space Coast Credit Union v Barclays Capital, Inc.*, 2012 WL 946832, at *3 (SDNY 2012). Though the exact terms of the IAA may differ from the contract in that case, the clear purpose of both contracts was to establish that the CDO's independent collateral manager (here, TCW) would select the CDO's assets pursuant to certain criteria for the benefit of the CDO's investors. Though the IAA lacks explicit language identifying Dutch Hill's investors as intended beneficiaries,[FN8] plaintiffs contend that, on its face, the very point of the IAA was to establish TCW's independence so that investors would be willing to invest in Dutch Hill. This argument has intuitive appeal.

Nonetheless, the specific terms of the IAA create issues that may make a claim under the IAA duplicative and strategically complicated. First, section 4(a) of the IAA states: "nothing herein shall be deemed to protect [TCW] against any liability under the Transaction Documents to which you would otherwise be subject by reason of willful misconduct, bad faith or gross negligence in the performance of your duties hereunder." Hence, plaintiffs, if they have standing, can only sue TCW under the IAA for conduct that basically amounts to TCW's alleged fraud. *See AMBAC Assurance Corp. v EMC Mortg. LLC*, 39 Misc 3d 1240 (A), at *4-6 (Sup Ct, NY County 2013) (Ramos, J.) (third-party beneficiary "has no greater rights or remedies than the direct parties to [a contract]"). To the extent that there is a difference between the elements necessary to establish a fraud claim and a claim under the IAA, the difference appears quite narrow. Indeed, the wisdom of invoking the IAA may not have fully been thought through by [*10]plaintiffs since it contains a jury waiver (IAA, Sec. 22).

Also, as plaintiffs observe, the date of the IAA (May 2, 2007) is the same date plaintiffs made their investment in Dutch Hill. Yet, Dutch Hill's collateral was allegedly selected by TCW before that date. This raises a question of whether the IAA is the actual or only contract governing TCW's role as collateral manager because, presumably, there would have been some written agreement in place before TCW worked for Dutch Hill. In fact, the IAA begins by stating "We herewith confirm our agreement with you as follows". The IAA itself appears to indicate that an earlier agreement was in place.

For these reasons, plaintiffs' third-party beneficiary claim is dismissed without prejudice with leave to replead. If it has not already done so, TCW must promptly give plaintiffs a copy of all agreements governing TCW's involvement with Dutch Hill so that plaintiffs can determine if they can maintain a breach of contract claim. As discussed in part II.A, the deadline to file an amended complaint is 30 days from the entry of this order.

Unjust Enrichment

Plaintiffs cannot maintain an unjust enrichment claim because their investment in Dutch Hill is governed by written contracts. *Goldman v Metropolitan Life Ins. Co.*, 5 NY3d 561 (2005), accord *Clark-Fitzpatrick, Inc. v Long Island R.R. Co.*, 70 NY2d 382, 388 (1987) ("existence of a valid and enforceable written contract governing a particular subject matter ordinarily precludes recovery in quasi contract for events arising out of the same subject matter"). Further, if plaintiffs establish that such contracts are unenforceable due to fraud, this unjust enrichment claim would merely be duplicative of plaintiffs' fraud claim. This cause of action, therefore, is dismissed. Accordingly, it is

ORDERED that the motion by defendant TCW Asset Management Company to dismiss the Complaint is granted in part as follows: (1) the third (negligent misrepresentation) and fifth (unjust enrichment) causes of action are dismissed with prejudice; (2) the fourth cause of action (breach of contract — third-party beneficiary) is dismissed without prejudice with leave to replead; and (3) the motion is otherwise denied; and it is further

ORDERED that the deadline for plaintiffs Basis Pac-Rim Opportunity Fund (Master) and Basis Yield Alpha Fund (Master) to file an amended complaint to add new claims or defendants is 30 days after the entry of this order on the NYSCEF system; and it is further

ORDERED that the parties are to appear in Part 54, Supreme Court, New York County, 60 Centre Street, Room 228, New York, NY, for a status conference on October 22, 2013 at 10:30 in the forenoon.

Dated: September 10, 2013ENTER:

_____

J.S.C.

Footnotes

Footnote 1: There are numerous ways in which a CDO can make investments in RMBS, such as directly investing in particular RMBS, investing in tranches of other CDOs that are invested in RMBS, or by entering into credit default swaps (CDSs). In this case, the Dutch Hill's Offering Circular allows for RMBS investments to be made in myriad ways. The court will not discuss them in detail because the only relevant fact about the nature of Dutch Hill is that it was a CDO designed to allow investors to make a net-long investment on RMBS in accordance with TCW's investment selection criteria. That Dutch Hill may have taken certain short positions (whether through direct shorting or CDSs) is not particularly relevant since such trades did not change Dutch Hill's overall net long RMBS position.

Footnote 2: For instance, Dutch Hill's Class A-1 Notes had a return of Three-Month LIBOR plus 0.4% while the Class D-3 Notes had a return of Three-Month LIBOR plus 8.5%.

Footnote 3: By January 2007, it was no secret that there was trouble in the housing market and that sophisticated financial institutions had begun taking steps in anticipation of major losses on RMBS and RMBS related investments.

Footnote 4:

The court uses terms such as "toxic" or "bad" to describe RMBS without getting into a longer discussion about why particular RMBS were bad investments (e.g. bad underwriting). The reason that Dutch Hill's RMBS lost money is not particularly important on this motion because TCW's alleged fraud has nothing to do with mortgage fraud or compromising the performance of previously existing securitizations. Rather, the alleged fraud was TCW's purported special selection methodology. Thus, while TCW's knowledge about why Dutch Hill's RMBS investments may be relevant in discovery, such detail is beyond the scope of this motion.

Footnote 5: Plaintiffs contend that there are further similarities between this case and *Basis Yield*, such as TCW's lies about its opinion that Dutch Hill was a good investment. *See Abu Dhabi Commercial Bank v Morgan Stanley & Co. Inc.*, 651 FSupp2d 155, 176 (SDNY 2009), quoting *In re IBM Corp. Sec. Litg.*, 163 F3d 102, 109 (2d Cir 1998) ("an opinion may still be actionable if the speaker does not genuinely and reasonably believe it or if it is without a basis in fact."). TCW disputes whether its opinions are actionable. The court declines to reach this issue because, as discussed earlier, the Complaint otherwise identifies actionable misrepresentations of fact.

Footnote 6: To be clear, there is nothing wrong with a collateral manager purchasing a security from a bank's prop trading desk (unless the IAA prohibits this) if the collateral manager's opinion about the security is genuinely different than the opinion of the bank's trader. However, *if* the collateral manager believes that the security is a bad investment but

purchases the security in a *quid pro quo* scheme with the bank, such conduct is fraudulent.

Footnote 7: Regardless of TCW's ability to select "good" RMBS in 2007, a sophisticated investor betting that the lowest rated tranches and the equity of a CDO would generate revenue was making a particularly aggressive bet on the positive performance of the housing market and mortgage default rates. The parties dispute the significance of the rating of the senior CDO tranches to the likelihood that the lowest and unrated tranches would realize returns. However, it is questionable whether plaintiffs were, despite the allegations (assumed to be true on this motion) in the Complaint, really relying on TCW or if plaintiffs were mere contrarians looking to capitalize on underpriced long RMBS bets that they felt would be profitable when housing prices — as it was believed at the time — would again continue to perpetually rise. Discovery will need to flesh out whether TCW's representations were the reason plaintiffs invested in Dutch Hill or if plaintiffs merely seek to revise history to couch themselves as hapless Wall Street victims rather than bad gamblers.

Footnote 8: The only exception being section 15 of the IAA, which obligates TCW to maintain Dutch Hill's books and records for inspection by the investors.

Return to Decision List