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Phoenix Light SF Ltd. v Goldman Sachs Group, Inc.
2014 NY Slip Op 50917(U)
Decided on June 13, 2014
Supreme Court, New York County
Ramos, J.
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Phoenix Light SF Limited, BLUE HERON FUNDING II LTD., BLUE HERON FUNDING V LTD., BLUE HERON FUNDING VI LTD., BLUE HERON FUNDING VII LTD., BLUE HERON FUNDING IX LTD., SILVER ELMS CDO II LIMITED and KLEROS PREFERRED FUNDING V PLC, Plaintiffs,

against

The Goldman Sachs Group, Inc., GOLDMAN SACHS & CO., GOLDMAN SACHS MORTGAGE COMPANY and GS MORTGAGE SECURITIES CORP., Defendants.

652356/13

For plaintiffs: Sameul Rudman, Esq. of Robbins Geller Rudman & Dowd LLP

For defendants: Richard Klapper, Esq. of Sullivan & Cromwell LLP

Charles E. Ramos, J.

In motion sequence 005, defendants the Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs Mortgage Company, and GS Mortgage Securities Corp. move, pursuant to CPLR 3211 (a) (1), (3), (5), and (7), to dismiss the complaint.

Background

The following factual allegations are set forth in the complaint, and for the purposes of this motion are accepted as true.

This action arises out of the purchase of more than $450 million worth of residential mortgage-backed securities (RMBS). The RMBS at issue here are generally referred to as certificates, which are essentially bonds backed by a large number of residential real estate loans. Holders of certificates receive monthly distributions derived from payments made on the real estate loans (complaint, ¶ 1).

The Plaintiffs

During the relevant time period, nonparties WestLB AG, Greyhawk Funding LLC, and Blue Heron Funding III Ltd. purchased certificates, and, subsequently, assigned them to plaintiff Phoenix Light SF Limited (Phoenix). Plaintiff Silver Elms CDO II Limited (Silver Elms) was also an assignee of certificates that were initially purchased by nonparties WestLB AG and Paradigm Funding LLC. Plaintiff Kleros Preferred Funding V PLC (Kleros) was both an initial purchaser, as well as an assignee of certificates purchased by WestLB AG. Finally, plaintiffs Blue Heron Funding II Ltd., Blue Heron Funding VI Ltd., Blue Heron Funding VII Ltd., and Blue Heron Funding IX, Ltd. were purchasers of certificates. Plaintiffs Phoenix, Silver Elms, and Kleros allege that the assignment of the certificates included an assignment of all rights, title, interest, causes of action, and claims in and related to the certificates (complaint, ¶¶ 4-13).

RMBS Market & Securitization

The RMBS market has existed for decades. In order to create RMBS, there must be a

securitization process. This process starts off with mortgage originators making home loans, secured by mortgages, to borrowers. The mortgage originator is then able to sell such mortgages to sponsors in a secondary market. The sponsors organize and initiate the securitization aspect of the process by acquiring large numbers of mortgages in the secondary market, aggregating them, and then selling them to an issuing trust. Depositors buy these pools of mortgages, settle the trusts, and then deposit the mortgages into those trusts in exchange for certificates to be offered to investors. The certificates are then transferred to underwriters who resell them to investors such as plaintiffs (complaint, ¶¶ 27-38).

Goldman Sachs Offerings

The claims in this action involve 45 separate certificate purchases made in 23 different offerings (the Certificates), all of which were structured, marketed, and sold by the defendants during the period of 2005 through 2007 (complaint, ¶ 1).

To market and sell the Certificates, defendants used U.S. Securities and Exchange Commission forms, such as registration statements, prospectuses, prospectus supplements, as well as other documents, such as pitch books, term sheets, loan tapes, offering memoranda, draft prospectus supplements, "red," "pink" and "free writing" prospectuses, and electronic summaries of these materials.

Defendants also disseminated key information in these documents to third parties, such as rating agencies and broker-dealer and analytics firms, for the purpose of marketing and selling the Certificates to plaintiffs (the documents and information disseminated by defendants will be referred to as the Offering Documents) (complaint, ¶ 2).

Plaintiffs allege that the Offering Documents were materially false and misleading. First, plaintiffs allege that the Offering Documents' representations concerning the loan originators' underwriting guidelines were false and misleading. Plaintiffs allege that the loan originators were not originating loans in accordance with the stated guidelines and were not evaluating the borrowers' ability to repay the loans or assessing the actual value of the property serving as collateral (see complaint, ¶¶ 52-55; 66-68; 79-81; 92-95; 106-110; 121-123; 134-138; 149-153; 164-169; 180-183; 194-198; 209-213; 224-228; 239-242; 253-256; 267-269; 280-282; 293-295; 306-308; 319-321; 328-334; 345-347; 358-360; 368-511). Plaintiffs allege that defendants knew that the Certificates' underlying loans were not originated pursuant to underwriting guidelines and

*that the loans were not likely to be repaid and failed to disclose this information (see id., ¶¶ [*2]557-576).*

According to the complaint, a number of originators, including New Century Mortgage Corporation, Countrywide, and Fremont, faced public and private lawsuits and investigations, which determined that they abandoned their underwriting guidelines, and extended loans to borrowers regardless of the ability to repay them (complaint, ¶¶ 368-511).

Second, plaintiffs allege that defendants made material misrepresentations about the loan-to-value ratios (LTV Ratios) regarding the Certificates' underlying loans. It is alleged that defendants misrepresented the actual percentages of the Certificates' underlying loans that had LTV Ratios in excess of 80% and 100%. Defendants allegedly used false and inflated appraisals and valuations for the loan properties in order to generate artificial LTV Ratios in the Offering Documents (see complaint, ¶¶ 56-57; 69-70; 82-83; 96-97; 111-112; 124-125; 139—140; 154-155; 170-171; 184-185; 199-200; 214-215; 229-230; 243-244; 257-258; 270-271; 283-284; 296-297; 309-310; 335-336; 347-349; 361-362; 389; 517-525).

Third, the Offering Documents allegedly misrepresented the underlying loans' owner occupancy rates (OOR). It is alleged that defendants overstated the OOR percentages associated with the Certificates in order to create the false impression that underlying loans and the Certificates were of higher credit quality than they actually were (see complaint, ¶¶ 58-59; 71-72; 84-85; 98-99; 113-114; 126-127; 141-142; 156-157; 172-173; 186-187; 201-202; 216-217; 231-232; 245-246; 259-260; 272-273; 285-286; 298-299; 311-312; 337-338; 350-351; 363-364; 526-530).

Fourth, it is alleged that defendants misrepresented the credit rating for the Certificates. In the Offering Documents, the defendants represented that the Certificates received safe, "investment grade" ratings. Plaintiffs assert that the Certificates were far from a safe, "investment grade" rating, because they were actually risky, speculative "junk" bonds backed by low credit loans. Plaintiffs allege that all of the Certificates purchased have been downgraded to reflect their true credit ratings. Specifically, it is alleged that all 45 Certificates purchased are speculative "junk" status or below, and 20 of the 45 have a "D" credit rating, meaning they are in default (see complaint, ¶¶ 60-62; 73-75; 86-88; 100-102; 115-117; 128-130; 143-145; 158-160; 174-176; 188-190; 203-205; 218-220; 233-235; 247-249; 261-263; 274-276; 287-289; 300-302; 313-315; 322-324; 339-341; 352-354; 365-367; 531-538).

Lastly, plaintiffs allege that defendants, despite their representations in the Offering Documents, failed to ensure the proper transfer of the promissory notes and mortgages to the trusts at closing. In turn, the trusts are not able to foreclose on the loans, because they cannot prove they own the mortgages due to the fact that title to the mortgages was never properly transferred at the closing of the offerings (see complaint, ¶¶ 539-556).

*The complaint alleges that defendants knew of the misrepresentations and omissions contained within the Offering Documents through their own due diligence efforts and the efforts of their due diligence provider Clayton Holdings, Inc. (Clayton) (see complaint, ¶¶ 557-576). It is also alleged that defendants shorted the very RMBS they were selling to investors, essentially betting that the Certificates they were selling would default at significant rates (see complaint, ¶¶ 577-595).Plaintiffs assert that, in reliance on the representations made in the Offering Documents, they invested a significant amount of capital into the Certificates. It is alleged that plaintiffs did [*3]not learn of defendants' misrepresentations and omissions prior to purchasing the Certificates, because such information was peculiarly within defendants' knowledge and control and defendants did not share access to such information (complaint, ¶ 646).*

The complaint sets forth five causes of action: (1) common- law fraud, (2) fraudulent inducement, (3) aiding and abetting fraud, (4) negligent misrepresentation, and (5) rescission based upon mutual mistake. Defendants now seek to dismiss the complaint on the grounds that certain plaintiffs lack standing, all claims are time-barred, and the complaint fails to state a claim.

Analysis

Standing of Assignee Plaintiffs

Defendants' motion to dismiss for lack of standing as to plaintiffs Phoenix, Silver Elms, and Kleros is denied. At oral argument on January 9, 2014, plaintiffs' counsel presented a copy of one of the assignment agreements, which appeared to show that it was the assignor's intent to transfer causes of action arising out of the transactions involving the Certificates to the assignees. Although plaintiffs' counsel presented only one of the 29 alleged assignment agreements, at this stage, the agreement, along with the allegations of the complaint, are enough to defeat defendants' motion to dismiss with respect to standing.

Statute of Limitations

Defendants argue that the claims alleged must be dismissed as they are untimely under the applicable German three-year statute of limitations. "When a nonresident sues on a cause of action accruing outside New York, CPLR 202 [New York's Borrowing Statute] requires the cause of action to be timely under the limitation periods of both New York and the jurisdiction where the cause of action accrued" (Global Fin. Corp. v Triarc Corp., 93 NY2d 525, 528 [1999]).

Here, it is undisputed that the plaintiffs are nonresidents and that they are suing on causes of action which accrued outside of New York. Thus, New York's Borrowing Statute applies. It is also undisputed that, under New York law, a six-year statute of limitations applies and that plaintiffs' claims are timely under the six-year statute of limitations. However, the parties dispute the jurisdiction where the causes of action actually accrued, and when plaintiffs had notice, starting the time of accrual.

"When an alleged injury is purely economic, the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss" (Global Fin. Corp. v Triarc Corp., 93 NY2d at 529 [citations omitted]). When the claims involve a securities fraud arising outside of New York, the claim is subject to the statute of limitation of the jurisdiction where the investors reside (Matter of Smith Barney, Harris Upham & Co. v Luckie, 85 NY2d 193, 207 [1995]). If the injured party is a corporation, then the place of residence for the purposes of CPLR 202 is traditionally the state of incorporation or the corporation's principal place of business (American Lumbermens Mut. Cas. Co. of Ill. v Cochrane, 129 NYS2d 489 [Sup Ct, NY County], affirmed 284 AD 884 [1st Dept 1954], affirmed 309 NY 1017 [1956]). Thus, plaintiffs' claims are governed by the statute of limitations of the jurisdiction in which they are incorporated.

*Plaintiffs concede that the assigned claims arising out of the Certificate purchased by WestLB AG, a German company, and Greyhawk Funding LLC and Paradigm Funding LLC, Delaware companies, are subject to the undisputed three-year statutes of limitations of Germany [*4]and Delaware.*

However, plaintiffs argue that the claims made by plaintiffs, who were original purchasers of the Certificates, are governed by the six-year statute of limitations of Ireland and the Cayman Islands, and not Germany, as defendants contend, because Ireland and the Cayman Islands are

where those plaintiffs are incorporated (see Olts affirmation, exhibit 1-2).

This Court agrees, and, because defendants do not argue that the claims were not brought within the six-year statutory period, there is no need to address notice as to the claims made by the original purchaser plaintiffs.

*Further, defendants' argument that the Court should apply the "financial base" exception, making all plaintiffs subject to the three-year statute of limitations of Germany, is rejected. The "financial base" is a limited exception applied only in extremely rare cases where the defendant offers unusual circumstances evincing that the economic injury occurred in a place other than where the plaintiff resides (Baena v Woori Bank, 2006 WL 2935752, *6, 2006 US Dist LEXIS 74549, *19 [SD NY, Oct. 11, 2006, No. 05-CV-7018 (PKC)]). Defendants have failed to offer such evidence warranting an application of this rare exception.*

The issue of notice remains for the assignee plaintiffs, who the parties agree are governed by a three-year statute of limitations. Under German law, **[FN1]** *the limitation period commences at the end of the first calendar year by which time both the claim arose and plaintiff obtains knowledge of the circumstances giving rise to the claim or would have obtained such knowledge absent any gross negligence (see request for judicial notice of the foreign laws of Germany, exhibit 1, ¶ 9).*

Plaintiffs argue that they did not have notice of their claims until the September 2010 release of the Financial Crisis Inquiry Commission's report on the RMBS crisis. Defendants, on the other hand, argue that plaintiffs had notice of information necessary to alert them to the matters alleged in the complaint in 2007.

Specifically, defendants argue that, by 2007, the German media had reported that German banks and investors had been misled into making RMBS securities purchases. In support of their assertion, defendants submit an article, published in September 2007, from Manager Magazine Online, which discusses using U.S. courts as an outlet to file lawsuits against lenders and rating agencies involved in the "mortgage crisis" (Stokes affirmation, exhibit J). The article states that German banks and investors "were apparently misled into making their purchases through the intentionally false and deceptive valuations by the offerers of bundled mortgage packages and valuation calculations by the rating agencies, all headquartered in the United States" (id.).

"[T]he statute of limitations does not begin to run until plaintiff is on notice of every element of the claim, which, in the case of fraud, includes scienter" (Phoenix Light SF Ltd. v ACE Sec.

*Corp., 39 Misc 3d 1218[A], *5, 2013 NY Slip Op 50653[U], *12 [Sup Ct, NY County 2013]). Further, "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 [defendant] knew and thus acted with intent to deceive" (Allstate Ins. Co. v Ace Sec. Corp., 2013 WL 1103159, *8, 2013 NY Misc LEXIS 3531, *18, 2013 NY Slip Op 31844[U], *15 [Sup Ct, NY County 2013] [internal citation omitted], affd ___ AD3d ___, 2014 NY App Div LEXIS [*5]3538, 2014 NY Slip Op 3599 [1st Dept 2014]).*

This article and other media reports cited by defendants may have put plaintiffs on notice that there was false information contained in the Offering Documents, but standing alone, they are insufficient to state as a matter of law that the plaintiffs were on notice of an intent to defraud by the defendants. Defendants present no other evidence showing that plaintiffs were put on notice before 2010. Therefore, this motion to dismiss the claims as time-barred is denied.

Motion to Dismiss for Failure to State a Claim

On a motion to dismiss pursuant to CPLR 3211 (a) (7), generally the court accepts the facts alleged in the complaint as true, affords the plaintiff the benefit of every possible favorable inference, and determines only whether the facts alleged fit into a cognizable legal theory (Morgenthow & Latham v Bank of NY Co., 305 AD2d 74, 78 [1st Dept 2003]). However, "[a]llegations consisting of bare legal conclusions ... are not presumed to be true [or] accorded every favorable inference" (Biondi v Beekman Hill House Apt. Corp., 257 AD2d 76, 81 [1st Dept 1999], affd 94 NY2d 659 [2000]).

1. Fraud Claims

Defendants argue that plaintiffs' claims for common-law fraud, fraudulent inducement, and aiding and abetting fraud must be dismissed for failure to state a claim. Specifically, defendants argue that plaintiffs have failed to sufficiently plead justifiable reliance, scienter, and material misrepresentations.

To state a claim of fraud under New York law, the complaint 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 NY3d 553, 559 [2009]). These allegations must be pled in particular detail (id.;

CPLR § 3016 [b]).

Defendants first argue that the complaint does not allege justifiable reliance by the plaintiffs. Under New York law, there is an affirmative duty imposed on sophisticated investors, such as plaintiffs, "to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transactions" (Global Mins. & Metals Corp. v Holme, 35 AD3d 93, 100 [1st Dept 2006]). It has been held that "[a]s a matter of law, 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" (HSH Nordbank AG v UBS AG, 95 AD3d 185, 194-195 [1st Dept 2012]).

*Nonetheless, a fraud claim may proceed where a plaintiff has "sufficiently alleged that [defendant] possessed peculiar knowledge of the facts underlying the fraud, and the circumstances present would preclude any investigation by [plaintiff] conducted with due diligence" (China Dev. Indus. Bank v Morgan Stanley & Co. Inc., 86 AD3d 435, 436 [1st Dept 2011]). Thus, " if the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations'" (Centro Empresarial Cempresa S.A. v América Móvil, S.A.B. de C.V., 17 NY3d 269, 278-279 [2011], quoting DDJ Mgt., LLC v Rhone Group L.L.C., 15 NY3d 147, 154 [*6][2010]).*

Here, plaintiffs need to sufficiently allege that defendants were the ones who possessed peculiar knowledge about the misrepresentations and omissions, and that plaintiffs could not have uncovered the misrepresentations and omissions even with reasonable due diligence, in order to satisfy the pleading requirements for this element of fraud.While the complaint sufficiently pleads that defendants were the ones with knowledge, it fails to meet the second prong, as the allegations of the complaint, itself, actually establish that plaintiffs could have uncovered defendants' alleged misrepresentations and omissions if they had exercised due diligence by asking for the loan files, which plaintiffs admit was information available at the time they bought the Certificates.

Paragraph 648 of the complaint alleges that,

"there was no information available to plaintiffs at the time they bought the certificates - other than the loan files, which defendants did not share - that would have allowed plaintiffs or the assigning

entities to conduct an investigation that would have revealed that defendants were making representations and omitting material information in the Offering Documents."

The true nature of the risk being assumed could, admittedly, have been ascertained from reviewing these loan files and plaintiffs never asked for them (see HSH Nordbank AG v UBS AG, 95 AD3d at 195).

Instead, as alleged, plaintiffs and their external asset and investor managers reviewed only the data presented by defendants in the Offering Documents (complaint, ¶¶ 613-645), despite having the ability to ask to review the loan files. The complaint alleges that defendants "did not share" the loan files (complaint, ¶¶ 646; 648), but there are no allegations that plaintiffs sought this pertinent information and that defendants denied access to it. It does not matter if the failure to seek this information was because of blind faith in the process of origination and/or securitization, or if it was attributable to the desire to quickly get on board of what the investors thought was a profitable bandwagon, the obligation of a sophisticated investor to inquire cannot be merely excused.

"Where a party has the means to discover the true nature of the transaction by the exercise of ordinary intelligence, and fails to make use of those means, he cannot claim justifiable reliance on defendant's misrepresentations" (Stuart Silver Assoc. v Baco Dev. Corp., 245 AD2d 96, 98-99 [1st Dept 1997] [citation omitted]). Based on the allegations set forth in the complaint, plaintiffs have failed to allege justifiable reliance, and, in turn, all of the fraud claims are dismissed, because to state a claim for fraudulent inducement, as well as aiding and abetting fraud, plaintiff must allege the basic elements of fraud (see Centro Empresarial Cempresa S.A. v América Móvil, S.A.B. de C.V., 17 NY3d at 278-279).

2. Negligent Misrepresentation

*A claim for negligent misrepresentation must allege "(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] [citations omitted]). "[A] special relationship does not arise out of an ordinary arm's length business transaction between two [*7]parties" (MBIA Ins. Corp. v Countrywide Home Loans, Inc., 87 AD3d 287, 296 [1st Dept 2011] [citations omitted]).*

The allegations in the complaint are insufficient to establish a special relationship between

these parties that would impose such a duty on defendants. Plaintiffs argue that a special or privity-like relationship existed between the parties, because the complaint alleges that defendants had exclusive control over the loan files, which gave them a unique ability to evaluate the collateral and knowledge of the poor quality of the securities.

However, this argument fails, because, as discussed above, the complaint merely alleges that the defendants did not share the loan files, not that they had exclusive control over them or refused a request of plaintiffs for access to them. This cause of action is also dismissed.

3. Rescission

Plaintiffs argue that their rescission claim based on mutual mistake is actionable, because both the defendant underwriters and plaintiffs believed that the depositors had transferred title of the mortgage loans to the trusts, a vital step in the securitization process, and they had not done so at the time of the sale and purchase of the Certificates. Thus, plaintiffs argue that there was no meeting of the minds.

"Generally, a contract entered into under a mutual mistake of fact is voidable and subject to rescission. The mutual mistake must exist at the time the contract is entered into and must be substantial" (Matter of Gould v Board of Educ. of Sewanhaka Cent. High School Dist., 81 NY2d 446, 453 [1993]).

Here, plaintiffs allege that the defendants' offerings represented that "[p]ursuant to the trust agreement, the Depositor will sell, without recourse, to the trust, all right, title, and interest in and to each mortgage loan" (complaint, ¶ 544).

This representation in the Offering Documents was a future obligation. Thus, the parties could not have been mistaken about the status of the transfers at the time the contract was entered into based on this representation of something that was to occur in the future. Plaintiffs' allegation that the underwriter defendants believed the mortgages and notes were assigned to the trust directly is conclusory and is in conflict with the allegations contained in paragraph 544 of the complaint. The cause of action for rescission is dismissed.

Accordingly, it is

ORDERED that defendants' motion to dismiss is granted for failure to state a cause of action,

and the complaint is dismissed with costs and disbursements as taxed by the Clerk of

the Court, and the Clerk is directed to enter judgment accordingly.

Dated: June 13, 2014

ENTER:

J.S.C.

Footnotes

Footnote 1:*Defendants make no reference to Delaware law and only seek to apply German law.*

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