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Hong Leong Fin. Ltd. (Singapore) v Morgan Stanley
2014 NY Slip Op 51396(U)
Decided on September 12, 2014
Supreme Court, New York County
Bransten, J.
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Decided on September 12, 2014

Supreme Court, New York County

Hong Leong Finance Limited (Singapore), Plaintiff,

against

Morgan Stanley, PINNACLE PERFORMANCE LIMITED, MORGAN STANLEY ASIA (SINGAPORE) PTE, MORGAN STANLEY & CO. INTERNATIONAL PLC, MORGAN STANLEY CAPITAL SERVICES LLC, and MORGAN STANLEY & CO. LLC, Defendants.

653894/2014

The attorneys on the matter are:

Bruce D. Angiolillo and Jonathan K. Youngwood of Simpson Thacher & Bartlett LLP for

defendants.

David S. Stellings, Jason L. Lichtman, and Douglas I. Cuthbertson of Lieff Cabraser Heimann & Bernstein, LLP for plaintiffs.

Eileen Bransten, J.

Defendants Morgan Stanley, Pinnacle Performance Limited ("Pinnacle"), Morgan Stanley Asia (Singapore) Pte. ("MS Singapore"), Morgan Stanley & Co. International plc ("MS International"), and Morgan Stanley Capital Services LLC ("MS Capital") (collectively, "Defendants") bring the instant motion to dismiss Plaintiff Hong Leong Finance Limited (Singapore)'s complaint, pursuant to CPLR 327, CPLR 3211(a)(1) and [*2](7), as well as CPLR 3016(b). For the reasons that follow, Defendants' motion is granted in part and denied in part.

I. Background [FN1]

Plaintiff Hong Leong Finance Limited (Singapore) ("HLF") is a Singapore financial company regulated by the Monetary Authority of Singapore ("MAS"), Singapore's de facto central bank and regulating entity (Compl. ¶¶ 6, 25.) The instant litigation stems from HLF's purchase of credit-linked notes ("CLNs"), issued by defendant Pinnacle and created and sold by Defendants (the "Pinnacle Notes"). HLF claims that Defendants fraudulently induced it to enter into a distributorship agreement and sell the notes, which were designed to — and did — fail. Plaintiff further contends that Defendants profited from the arrangement by taking a short position with respect to the pool of assets underlying the notes that they had created.

A. *Credit-Linked Notes and Collateralized Debt Obligations Defined*

CLNs are a type of financial instrument in which the value of the instrument is linked to the performance of debt that has been issued by certain otherwise unrelated entities,

such as corporations or sovereign nations. These entities are referred to as disclosed reference entities. CLNs are linked to reference entities through the use of a credit default swap. Through the credit default swap, the credit risk that the reference entities will default on their debt is shifted from the holder of that debt, the counterparty, the purchasers of the CLNs, the investors, in return for a higher yield than could be obtained through typical bonds. A credit default swap "is an agreement in which the 'protection buyer' pays the 'protection seller' a premium to insure a 'credit event,' such as a default. If a credit event occurs, the protection seller must pay the protection buyer a specified sum." *Loreley Fin. (Jersey) No. 4 Ltd. v. UBS Ltd.*, 40 Misc 3d 323, 325 (Sup. Ct. NY Cnty. 2013). The investors receive the yield from both the investment of their principal into the underlying assets, as well as credit protection payments from the counterparty. (Compl. ¶¶ 88-91.) Essentially, CLNs are a bet on the creditworthiness of the reference entities.

As its name implies, a collateralized debt obligation ("CDO") is a security collateralized by various debt obligations, which may consist of actual cash the CDO buys and holds (a "cash CDO"), or a collection of credit default swaps that merely reference such assets (a "synthetic CDO"). A cash CDO is backed by assets, such as bonds or loans, and the payoff is derived from the cash flows of the assets in the pool. *Id.* ¶ 95. A synthetic CDO is not backed by cash flow of assets; instead, the CDO is linked to reference entities by credit derivatives, such as credit default swaps. *Id.* ¶ 96. Thus, in a [*3]synthetic CDO, the investment bank issuing the CDO does not actually buy the assets; instead, investors invest in a fictional portfolio of assets that the bank has not purchased. *Id.* Like CLNs, synthetic CDOs transfer the credit risk with regard to certain reference entities from the sponsoring bank, such as Morgan Stanley, to investors. CDOs, however, are structured in ways that allow different investors to bear different risks through the creation of tranches, with riskier tranches yielding greater returns. *Id.* ¶¶ 96, 100-103. Since CDOs are based on credit default swaps, there are opposing counterparties — one, the sponsoring bank paying for credit protection, is "short" on the risks, that is, it benefits if the reference entities fail, and the other, the CDO issuing trust is "long" on the risk and benefits if the reference entities do not fail. *Id.* ¶ 98. The CDO-issuing trust sells notes to investors to fund its counterparty obligations, thus transferring the "long" risk to investors. *Id.* ¶ 99. Like CLNs, CDOs are "bets on the creditworthiness of the collateral pool of assets in any given tranche." *Dandong v Pinnacle Performance Ltd.*, 2011 WL 5170293,

at *2 (S.D.NY Oct. 31, 2011).B.*The Distributor Agreement*

On October 6, 2006, HLF entered into a Master Distributor Appointment Agreement (the "Distributor Agreement") with defendants Pinnacle (as issuer), MS Singapore (as arranger), and MS International (as market agent) to sell the Pinnacle Notes to HLF customers as investors. *See* Declaration of Andrew D. W. Cattell ("Cattell Declr.") Ex. 3 (Distributor Agreement). The Distributor Agreement expressly provides that HLF would rely on the Base Prospectus, dated August 7, 2006, and the Pricing Statement pursuant to which the Pinnacle Notes were created, issued, and sold to investors. (Compl. ¶¶ 110, 128.) The Distributor Agreement also contains an indemnification provision in paragraph 14.1, providing, in part, that MS Singapore and Pinnacle would compensate HLF for losses:

arising directly or indirectly out of any claim which are brought against [HLF] (whether or not such claim is successful or compromised or settled but subject as provided below), and any right of action which are exercised, arising in relation to any breach of the representations, warranties or undertakings contained in or made or deemed to be made by itself under this Agreement.

(Distributor Agreement ¶ 14.1 at 17.) The Agreement further provided that it was to be construed in accordance with Singapore law and contained a nonexclusive jurisdiction clause indicating that Singapore was a jurisdiction where disputes may be litigated. *Id.* ¶ 24.

Pursuant to the Distributor Agreement, HLF sold $72.4 million worth of Pinnacle Notes to its customers, Singapore residents, in Singapore in 2006 to 2007. *Id.* ¶ 8.

HLF alleges that Morgan Stanley, through MS International, deliberately invested HLF's customers' principal not in high-grade collateral, which was liquid and conservative, but in risky custom (called bespoke) single-tranche synthetic CDOs created by MS Capital, which were so fundamentally unsound that their failure was very likely. *Id.* ¶¶ 143-147. Morgan Stanley, through MS Capital, selected CDOs linked to pools of assets that purportedly were highly risky, including Icelandic banks, and reference entities tied to the

U.S. housing market. *Id.* ¶¶ 152-163. HLF alleges that Morgan Stanley, through MS Capital, created the Pinnacle Notes with such a high concentration of risk exposure that they basically engineered the single tranche CDOs to be more likely to generate portfolio losses and fail. HLF contends that the tranches of debt were highly susceptible to significant impairment in the event of even a modest default or loss in the portfolios underlying the CDOs. *Id.* ¶¶ 170-171. Thus, HLF asserts that Morgan Stanley through MS Capital designed these CDOs to fail.

C.*Federal Actions*

On October 25, 2010, Pinnacle Note investors, including HLF customers, brought a federal class action suit in the Southern District of New York, captioned *Dandong v. Pinnacle Performance Ltd.*, Civ. 10-8086, which made nearly the same allegations as the instant action. *See* Declaration of David S. Stellings ("Stellings Declr.") Ex. 1 (*Dandong v. Pinnacle Performance Ltd.* Complaint). The defendants in that action moved to dismiss, based on forum non conveniens, international comity, lack of jurisdiction over a necessary party, and failure to state a claim. The federal court denied the motion based on forum non conveniens, concluding that most of the alleged fraudulent activity occurred in New York and London, not Singapore. *Dandong v. Pinnacle Performance Ltd.*, 2011 WL 5170293, at *6 (S.D.NY Oct. 31, 2011). The *Dandong* court also denied the motion as to the fraud, fraudulent inducement, and breach of the duty of good faith claims, deeming them sufficiently pled. *Id.* at *11-*14, *16. However, the court dismissed the negligent misrepresentation, breach of fiduciary duty, and the aiding and abetting claims associated therewith, and the unjust enrichment claims. *Id.* at *15-*16.

Following the filing of an amended complaint, Morgan Stanley again sought dismissal on forum non conveniens grounds and as to the fraud, fraudulent inducement and breach of the covenant of good faith claims. Again, Morgan Stanley's motion was denied.

On August 6, 2012, HLF commenced its own action in federal court, alleging that Morgan Stanley was liable to it as a result of the fraudulent activity alleged in the *Dandong* action. *See* Stellings Declr. Ex. 2 (*HLF v. Morgan Stanley* SDNY Complaint, Civ. 12-6010). On October 23, 2013, the federal court dismissed the HLF action, based on lack of federal subject matter jurisdiction and declined to exercise supplemental [*4]jurisdiction

over plaintiffs' remaining state law claims. *Hong Leong Finance Ltd. (Singapore) v. Pinnacle Performance Ltd.*, 2013 WL 5746126 (S.D.NY Oct. 23, 2013).

D.*The Instant Action*

Shortly thereafter, HLF filed the instant complaint in this Court. In this action, HLF brings six claims: (1) fraud against all defendants: (2) fraudulent inducement against defendants Morgan Stanley, Pinnacle, MS International, and MS Singapore; (3) negligent misrepresentation against all defendants; (4) breach of contract against Morgan Stanley, Pinnacle, MS International, and MS Singapore; (5) breach of the duty of good faith and fair dealing against Morgan Stanley, Pinnacle, MS International, and MS Singapore; and, (6) equitable subrogation against all defendants.

II.*Discussion*

Defendants seek dismissal of HLF's complaint on several grounds — forum non conveniens, documentary evidence, failure to state a claim, and for failure to plead the fraud and fraudulent inducement claims with sufficient particularity. These arguments are addressed below.

A.*Forum Non Conveniens*

Defendants first contend that the instant complaint should be dismissed with prejudice on forum non conveniens grounds, since the acts alleged purportedly lack a New York connection. Instead, Defendants assert that the action should be brought in Singapore.

Under the doctrine of forum non conveniens, a court may dismiss an action where it finds that "in the interest of substantial justice the action should be heard in another forum." CPLR 327(a); *see Nat'l Bank & Trust Co. of N. Am. v. Banco De Vizcaya*, 72 NY2d 1005, 1007 (1988). The movant bears a "heavy burden of establishing that New York is an inconvenient forum and that a substantial nexus between New York and the action is lacking." *Elmaliach v. Bank of China Ltd.*, 110 AD3d 192, 208 (1st Dep't 2013)

(quotation and citation omitted); *see Creditanstalt Inv. Bank AG v. Chadbourne & Parke LLP*, 14 AD3d 414, 415 (1st Dep't 2005); *Anagnostou v. Stifel*, 204 AD2d 61, 61 (1st Dep't 1994).

New York courts consider certain private and public interest factors, as well as the availability of an adequate alternative forum, when evaluating New York's nexus to a particular action, and deciding whether to dismiss an action on the ground of forum non conveniens. *Islamic Republic of Iran v. Pahlavi*, 62 NY2d 474, 479 (1984). Although not every factor is necessarily articulated in every case, collectively the courts consider and balance the following factors: situs of the underlying transaction; residency of the parties; [*5]the potential hardship to the defendant; the location of the documents; the location of a majority of the witnesses; the applicability of foreign law; the existence of an adequate alternative forum; and, the burden on the New York courts. *See id.* at 479. A motion to dismiss on forum non conveniens grounds is subject to the trial court's discretion, and no one factor is controlling. *Id.*; *Phat Tan Nguyen v. Banque Indosuez*, 19 AD3d 292, 294 (1st Dep't 2005). "Generally, unless the balance is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed." *OrthoTec, LLC v. Healthpoint Capital, LLC*, 84 AD3d 702, 702-703 (1st Dep't 2011) (internal citations omitted). This is so "even where the plaintiff is not a resident of New York." *Elmaliach v. Bank of China Ltd.*, 110 AD3d 192, 208 (1st Dep't 2013).

First, the essence of this complaint is two-fold — it involves HLF's fraud claims, which are nearly identical to the fraud claims against these same defendants in the *Dandong* action and its breach of contract claims involving the indemnification provision of the Distributor Agreement. With regard to the fraud claims, most of the actions that HLF alleges were fraudulent occurred in New York or in London, not in Singapore. The breach of contract claims involve the indemnification provision of the Distributor Agreement in which HLF seeks to recover for costs it incurred "arising in relation to any breach of the representations, warranties or undertakings, contained in or made or deemed to be made by [MS Singapore and Pinnacle] under this Agreement." (Distributor Agreement § 14.1). HLF asserts that those representations and warranties included those contained in the offering documents drafted in New York by Morgan Stanley through MS Capital.

With regard to a nearly identical forum non conveniens motion, at least with respect to the fraud claims, the *Dandong* court denied these same defendants dismissal of the Pinnacle Note investors' claims. *Dandong v Pinnacle Performance Ltd.*, 2011 WL 5170293 (S.D.NY Oct. 31, 2011). In determining the motion, the court reviewed the factors to be considered and concluded that the "[c]omplaint is quite clear that the vast majority of actions that Plaintiffs allege were fraudulent occurred in New York and London." *Id.* at *5. This determination was based on the fact that MS Capital created the single tranche CDOs, which matched each series of the Pinnacle Notes, in New York. In addition, MS Capital selected the CDOs' underlying assets, and, according to the complaint, drafted the offering materials, both in New York. Moreover, MS International selected the assets underlying the CLNs in London, not in Singapore. Thus, plaintiffs alleged that the New York defendants actively participated in the fraud. Further, the plaintiffs had alleged that the misstatements and omissions at issue were made by Morgan Stanley in the offering documents, and that the arrangement of the synthetic CDOs, conduct in furtherance of the fraud, occurred in New York and London. The court stated that since most of the activity alleged to be fraudulent occurred in New York and London — not in Singapore — the availability of witnesses and evidence, and expense and convenience all favored New York, plaintiffs' choice of forum. *Id.* at *5-*6.

The *Dandong* court also deemed the Singapore forum inadequate, because the Singapore courts could not subpoena ex-employees of Morgan Stanley and MS Capital, whose testimony, according to the plaintiffs, would be critical to exposing the alleged fraud. *Id.* at *6. The court determined that "Singaporean law is at the very least equal to New York law with respect to procedural rights and not materially different in substance" and that the application of Singapore law would not present "too great a difficulty." *Id.* at *7.

Here, HLF has incorporated all of the allegations from the *Dandong* action, and, thus, similarly, has demonstrated to this court that the alleged fraud was devised in New York, through the actions of Morgan Stanley and MS Capital, and that the situs of the transaction, as well as the availability of the evidence and witnesses, favors HLF's choice of New York.

While HLF as well as Pinnacle (Cayman Islands), MS International (London) and MS Singapore are not New York residents, both Morgan Stanley and MS Capital reside in New York. Morgan Stanley, alleged to be in control of the other defendants, and MS Capital, the CDO issuing trust, are at the heart of HLF's allegations. This clearly weighs against forum non conveniens dismissal. *OrthoTec, LLC v. Healthpoint Capital, LLC*, 84 AD3d 702, 703 (1st Dep't 2011). In addition, there is insignificant potential hardship to defendants since the critical defendants and potential witnesses, both as to the fraud claims and as to the breach of the representations and warranties which underlie the breach of contract claim, are located here in New York.

Defendants' argument that the Distributor Agreement was executed and allegedly negotiated in Singapore, that it has a nonexclusive Singapore forum selection clause, and that HLF's employees, customers, and MAS officials are located there, fails to warrant dismissal. HLF's employees and customers are not essential witnesses to Defendants' alleged fraudulent activity. In addition, the relevance of where the agreement actually was signed, and where HLF paid out settlements to its Pinnacle Notes customers, is not explained by Defendants. This court cannot say that this action is devoid of New York connections. *Cf. Adamowicz v. Besnainou*, 58 AD3d 546, 547 (1st Dep't 2009) (where plaintiff a U.S. resident, only one defendant present in New York, all others in France or Europe, no U.S. witnesses, contract written in French and performed and breached in France, action lacked New York connections).

While Defendants urge that this action will require the application of Singapore law, they fail to indicate any particular difficulty likely to arise from applying that law. Defendants fail to show how that law is materially different from New York law, and, in fact, the affidavit from Sydney Michael Hwang, Defendants' expert on Singaporean law, indicates that Singapore is a common-law country with very similar substantive law to New York. *See* Affidavit of Sydney Michael Hwang ¶¶ 16-68; *Dandong v Pinnacle Performance Ltd.*, 2011 WL 5170293 at *7 (S.D.NY Oct. 31, 2011) ("Defendants have gone out of their way to suggest that Singaporean law is at the very least equal to New [*6]York law with respect to procedural rights and not materially different in substance."). Contrary to Defendants' contention, litigating this action in New York will not involve this court in evaluating decisions by regulators in Singapore. HLF is not challenging the

regulators' decision. Defendants fail to demonstrate that the balance of forum non conveniens factors are strongly in their favor, and, therefore, HLF's choice of forum will not be disturbed.

B.*Failure to State a Claim and Documentary Evidence*

1.*Negligent Misrepresentation*

HLF's third claim for negligent misrepresentation is dismissed for failure to state claim. "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) (citations omitted). In the commercial context, liability is only imposed on persons with specialized or unique knowledge, or who are in a position of trust and confidence with the plaintiff such that reliance on the defendant's misrepresentation is reasonable. *Fresh Direct v. Blue Martini Software*, 7 AD3d 487, 489 (2d Dep't 2004) (citing *Kimmell v. Schaefer*, 89 NY2d 257, 263 (1996)).

HLF's claim fails because the parties to the Distributor Agreement were sophisticated commercial entities, which entered into an arms-length transaction, and, therefore, there was no special relationship. *See Greentech Research LLC v. Wissman*, 104 AD3d 540, 540-541 (1st Dep't 2013) (no special relationship where arm's length business relationship between sophisticated financial entities, and no unique knowledge or expertise alleged); *see MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 AD3d 287, 297 (1st Dep't 2011) (no special relationship where sophisticated commercial entities entered into arm's length business transaction). In addition, HLF specifically represented in that agreement that it had not relied upon Pinnacle, MS International, MS Singapore or any of their affiliates in assessing the risks of the agreement. *See* Distributor Agreement ¶ 5.3(ii). Accordingly, this claim is dismissed.

2.*Fraud and Fraudulent Inducement*

Defendants' motion to dismiss the first cause of action for fraud against all defendants and the second claim for fraudulent inducement against defendants Morgan Stanley, Pinnacle, MS International, and MS Singapore is denied.

Defendants challenge HLF's fraud claims on several grounds. First, they urge that HLF has failed to plead fraudulent intent, and that HLF's pleading that the notes were [*7]designed to fail is insufficient. Next, they argue that the complaint fails to plead the misstatements with the requisite particularity. Further, they contend that HLF fails to plead justifiable reliance.

To assert a claim for fraud, plaintiff must allege: (1) defendant's misrepresentation of a material fact; (2) knowledge of its falsity; (3) fraudulent intent; (4) reasonable reliance; and, (5) damages. *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009); *Loreley Fin. (Jersey) No. 3 Ltd. v. Citigroup Global Markets Inc.*, 19 AD3d 136, 139 (1st Dep't 2014). A claim for fraudulent inducement must contain the same elements. *See Urstadt Biddle Props., Inc. v. Excelsior Realty Corp.*, 65 AD3d 1135, 1136-1137 (2d Dep't 2009). Pursuant to CPLR 3016(b), the circumstances constituting the fraud must be "set forth in sufficient detail to clearly inform a defendant with respect to the incidents complained of." *Lanzi v. Brooks*, 43 NY2d 778, 780 (1977).

HLF's fraud pleading satisfies these requirements. First, with regard to fraudulent intent, as Judge Sand found in analyzing the nearly identical complaint in the *Dandong* action, this element is adequately alleged, as the plaintiff alleged particularized facts supporting a strong inference of scienter. *See Dandong*, 2011 WL 5170293, at *11-*12 (S.D.NY Oct. 31, 2011). As in *Dandong*, HLF alleges that the principal invested in the Pinnacle Notes was invested in custom-made synthetic CDOs that were highly risky and allegedly rigged to fail, rather than the relatively safe credit-linked notes, which were based on safe, highly-rated disclosed reference entities, with which that Morgan Stanley induced HLF. (Compl. ¶¶ 133-137.)

Morgan Stanley allegedly seeded the CDO portfolios with undisclosed reference entities that presented a high likelihood of default. *Id.* ¶¶ 151-170. These synthetic CDOs were custom-made — that is, just one day before a particular series of Pinnacle Notes was issued, Morgan Stanley issued an underlying synthetic CDO that exactly matched the funds

the series raised. *Id.* ¶ 190. The newly-made synthetic CDO then was chosen by MS International as the underlying asset for the Pinnacle Notes. *Id.* ¶¶ 143-144. HLF alleges that Morgan Stanley was completely aware that the CDOs were highly risky, since it had created the CDOs itself. Again, as in *Dandong*, HLF alleges that Morgan Stanley was self-dealing — it was, through MS International, selecting the synthetic CDOs it had itself created, making HLF's customers, the investors, "long" on the risk, and, through MS Capital, as the swap counterparty which provided the credit protection payments to Pinnacle, was betting against, or "shorting" the CDOs. *Id.* ¶¶ 51, 143-146; *see Dandong*, 2011 WL 5170293, at *11. Morgan Stanley was negotiating only with itself rather than any independent counterparty, and, by taking the "short" side, structured the transactions so that it had a significant interest in the failure, not the success, of the CDOs. (Compl. ¶ 151.) These allegations of the "engineered frailty of the CDOs and Morgan Stanley's positions on both sides of the deal adequately alleges motive." *Dandong*, 2011 WL 5170293, at *12 (citation omitted), satisfying the requirement that HLF plead a strong inference of scienter.

Defendants likewise seek dismissal, arguing that there were no misstatements or omissions in the offering materials. The complaint, however, specifically alleges that Defendants failed to disclose in the offering materials that the CDOs were created by Morgan Stanley and that it possessed an adverse interest as the "short" counterparty to the credit default swap, which would profit from investors' losses. (Compl. ¶¶ 192-193.) Further, the complaint alleges that Defendants misrepresented that the underlying assets to the Pinnacle Notes would be "acceptable" to MS Capital, specifically that the CDO being selected would already exist and be selected based on its merit. In fact, HLF contends that the CDOs were created just for the notes and were selected based on their lack of merit. *Id.* ¶ 195. HLF likewise asserts that the disclosures in the offering materials were misleading because their brief explanations of potential risks and potential and actual conflicts of interest failed to reveal that the CDOs were created with highly risky undisclosed reference as underlying assets, and that Defendants possessed interests and counterparty positions which were opposed to the investors. *Id.* ¶ 196.

In support of dismissal, Defendants point to language in the Prospectus, warning that the CDOs were subject to a "high degree of complex risks" and that their value could

decline to "zero." *See* Defs.' Moving Br. at 17; Cattell Declr. Ex. 9 at 11 (Prospectus). Defendants further cite to language in the Pricing Statement, directing readers that it "must be read together with . . . the Base Prospectus" which contained the general warning described above. (Def. Memo at 17; Prospectus at 11). Finally, they note a provision in the Prospectus, stating that:

> Underlying Assets will not be available at the time investors decide to purchase the Notes of such Series and accordingly investors must be prepared to purchase the Notes on the terms only that the Underlying Assets for such Series may comprise any of the Eligible Investments.

(Prospectus at 12-13.)

While Defendants contend that these warnings vitiate any showing of reasonable reliance, the Court disagrees. These general warnings fail to track the particular misrepresentations and omissions alleged by HLF to warrant dismissal of its fraud claims. *Loreley Fin. (Jersey) No. 3 Ltd. v. Citigroup Global Markets Inc.*, 119 AD3d 136, 144 (1st Dep't 2014). As the *Dandong* court concluded, the cautionary language and generalized warnings in the Prospectus do not embrace the alleged fraud. *Dandong*, 2011 WL 5170293, at *12-*13. For each series of Pinnacle Notes, HLF alleges that MS International selected extremely risky CDOs specifically created by MS Capital as underlying assets, and this was contrary to industry practice "that investors' principal be invested in low-risk collateral." *Id.* Then, HLF alleged that MS Capital bet against those same CDOs as the "short" counterparty. The standard language warning that Morgan Stanley "may be adverse to the interests of the Noteholders," and that "conflicts of interest [*8]may arise" did not put investors, and, here, HLF, as the distributor, on notice of the allegedly "inevitable risk that Morgan Stanley would invest their principal in an instrument that was engineered to fail." *Id.*

HLF also has pleaded sufficient facts to support its belief that MS International had no intention of selecting anything other than the synthetic CDOs MS Capital had

specifically created for the notes, that MS Capital had intensified the normal risk of principal loss in these CDOs, and increased the percentage of companies in the CDO reference entities subject to a housing downturn, all of which make the cautionary language that the CDOs "may decline" a misstatement. These disclosures do not encompass the secret risk that Morgan Stanley had deliberately selected the riskiest assets. Thus, the disclosures and disclaimers fall significantly short of tracking the particular misrepresentations and omissions alleged by HLF.

As to reliance, whether it is or is not reasonable is generally a fact specific determination inappropriate for determination on a motion to dismiss. *Knight Sec. v. Fiduciary Trust Co.*, 5 AD3d 172, 173 (1st Dep't 2004). As discussed above, the disclosures and disclaimers in the offering materials do not specifically warn or put HLF and investors on notice of the alleged fraud, and thus, do not preclude a claim of justifiable reliance. As the *Dandong* court found on this issue, "even a sophisticated investor armed with a bevy of accountants, financial advisors, and lawyers could not have known that Morgan Stanley would select inherently risky underlying assets and short them. Plaintiffs have pled reasonable reliance." *Dandong*, 2011 WL 5170293, at *14. The fact that HLF may be considered a sophisticated, commercial party does not insulate the Defendants from liability for fraud. *See, e.g., Loreley Fin. (Jersey) No. 3 Ltd. v. Citigroup Global Markets Inc.*, 119 AD3d 136, 148 (1st Dep't 2014). Thus, the fraud claims are sufficiently pled and state a claim.

3.*Breach of Contract and Breach of Duty of Good Faith*

The fourth and fifth claims for breach of contract and breach of the implied duty of good faith also are sufficient to withstand dismissal.

To state a claim for breach of contract, plaintiff must allege that: (1) the parties entered into a contract; (2) plaintiff performed its obligation; (3) defendant breached; and, (4) plaintiff suffered damages caused by that breach. *Harris v. Seward Park Hous. Corp.*, 79 AD3d 425, 426 (1st Dep't 2010). Here, in the fourth claim, HLF alleges that it entered into the Distributor Agreement with defendants Pinnacle and MS Singapore, and that it performed its obligations thereunder by selling the Pinnacle Notes to its customers and then seeking indemnification under paragraph 14.1 for the amounts it incurred to settle

claims of those customers for losses related to the Pinnacle Notes. HLF then alleges that Defendants failed to indemnify it, and HLF suffered damages caused by Defendants breach. (Compl. ¶¶ 253-262.) In the fifth claim for breach of the duty of good faith, HLF [*9]alleges that it was unreasonable and in bad faith for Defendants to refuse to participate in the MAS claims process and to withhold their consent to the settlement. *Id*. ¶¶ 263-270.

Defendants' argument that HLF fails to allege a breach is unavailing. First, HLF specifically alleges that defendants breached paragraph 14.1, regarding indemnification for losses, liabilities, and costs incurred by HLF. Defendants urge that this indemnification provision applies only to a specific breach of the representations, warranties and undertakings of Pinnacle and MS Singapore under that agreement. Paragraph 14.1, however, covers losses and liabilities "arising in relation to any breach of the representations, warranties or undertakings contained in or made or deemed to be made by [Pinnacle and MS Singapore] under this Agreement." (Distributor Agreement ¶ 14.1 at 17.) In paragraph 5.3(ii) of the agreement, the parties expressly contemplated that HLF would rely on the Base Prospectus, and, in paragraph 7.5, HLF was obligated to instruct its customers to rely on the Base Prospectus. (Compl. ¶¶ 128, 130; *see* Distributor Agreement ¶¶ 5.3(ii) & 7.5.) Thus, the complaint alleges that defendants breached the representations and warranties in the Base Prospectus, and that those were "contained in or made or deemed to be made" under the Distributor Agreement. New York law "requires that all writings that form part of a single transaction and are designed to effectuate the same purpose be read together, even though they were executed on different dates and were not all between the same parties." *Gordon v. Vincent Youmans, Inc.*, 358 F.2d 261, 263 (2d Cir. 1975) (citing *Nau v. Vulcan Rail & Constr. Co.*, 286 NY 188, 197 (1941) (contracts executed around same time, related to same subject matter, were contemporaneous writings that must be read together); *accord Teletech Europe B.V. v. Essar Servs. Mauritius*, 83 AD3d 511, 512 (1st Dep't 2011) (contemporaneous agreements which are part of same transaction should be read together); *Williamson v. Moltech Corp.*, 261 AD2d 538, 539 (2d Dep't 1999) (construe related provisions of intertwining agreements together); *BWA Corp. v. Alltrans Express U.S.A.*, 112 AD2d 850, 852 (1st Dep't 1985) (several instruments part of same transaction must be read together). Here, the Distributor Agreement and the Base Prospectus must be read together as these agreements are part of the same transaction. Therefore, HLF has sufficiently alleged a breach of paragraph 14.1 of

the Distributor Agreement.

Defendants also contend that the indemnification provision does not unequivocally cover HLF's own negligence, and, therefore, HLF's negligent conduct, which, according to Defendants, was documented by the MAS and resulted in HLF's settlement payments to its customers, may not provide the basis for its breach of contract claim. "[I]ndemnity provisions will not be construed to indemnify a party against his own negligence unless such intention is expressed in unequivocal terms." *Margolin v. New York Life Ins. Co.*, 32 NY2d 149, 153 (1973) (citation omitted). An indemnity clause does not have to refer expressly to the indemnitee's negligence, so long as "the intention to indemnify can be clearly implied from the language and purposes of the entire agreement, and the surrounding facts and circumstances." *Id.*; *see Bradley v. Earl B. Feiden, Inc.*, 8 NY3d [*10]265, 274-275 (2007) (where intention is clear, indemnity will be enforced even if it indemnifies for one's own negligence); *Sherry v. Wal-Mart Stores East, L.P.*, 67 AD3d 992, 994-995 (2d Dep't 2009). Broadly-worded clauses, providing indemnification for "all claims, suits, loss, cost and liability," fairly include liability for active negligence of the indemnity. *See Levine v Shell Oil Co.*, 28 NY2d 205, 212 (1971).

Here, paragraph 14.1 is such a broad clause. In it, Pinnacle and MS Singapore agreed to indemnify HLF "against all losses, liabilities, costs, charges and expenses arising directly or indirectly out of any claim." (Distributor Agreement ¶ 14.1.) If such all inclusive language did not apply to situations in which HLF was negligent, the clause would be rendered meaningless. *Bradley v. Earl B. Feiden, Inc.*, 8 NY3d at 275; *see also Matter of New York City Asbestos Litig.*, 41 AD3d 299, 301 (1st Dep't 2007). Thus, even if the MAS report found that HLF was negligent, Pinnacle and MS Singapore may still be liable under this indemnification provision.

Defendants further contend that HLF's breach claim should be dismissed because it settled its customers' claims without obtaining Defendants' written consent. Paragraph 14.1 provides that neither Pinnacle nor MS Singapore "shall be liable in respect of [sic] any settlement of any such action effected without its prior written consent." (Distributor Agreement ¶ 14.1). In its claim for breach of the implied duty of good faith, HLF alleges that it repeatedly asked Defendants to compensate it for the expenses it incurred and

Defendants unreasonably refused to participate in the claims process, or to provide any reasonable rationale for its refusal. (Compl. ¶¶ 258, 266-268.) Where a "contract contemplates the exercise of discretion, this pledge includes a promise not to act arbitrarily or irrationally in exercising that discretion." *Dalton v. Educ. Testing Serv.*, 87 NY2d 384, 389 (1995) (citation omitted). The complaint here alleges that Defendants acted unreasonably and in bad faith, by withholding their consent to the settlement. Contrary to Defendants' contention, this implied covenant claim is consistent with the contract itself.

Defendants also contend that HLF cannot plead that it adequately performed its duties under the Distributor Agreement, including complying with all laws and regulations applicable to it, based on a report issued by the Singapore regulator, MAS. *See* Cattell Declr. Ex. 2. While this may provide a defense to HLF's breach claim, at this early pleading stage, the Court concludes that the contract claims are sufficiently pled and that the documentary evidence does not definitively dispose of the claim. The Court notes that HLF's failures to meet certain requirements of the Singapore Financial Advisors Act, as found in the MAS report, allegedly stem in part from Defendants' misrepresentations and fraudulent scheme. Therefore, the fourth and fifth claims are sufficient.

4.*Equitable Subrogation*

The sixth claim for equitable subrogation is dismissed. The doctrine of equitable subrogation is "applicable to cases where a party is compelled to pay the debt of a third person to protect his own rights, or to save his own property." *Gerseta Corp. v. Equitable Trust Co. of NY*, 241 NY 418, 426 (1926) (quotation and citation omitted); *see also Broadway Houston Mack Dev., LLC v Kohl*, 71 AD3d 937, 937 (2d Dep't 2010). Thus, where one person uses his property to discharge an obligation owed by another, or a lien upon the property of another, the latter person would be unjustly enriched by the retention of the benefit conferred, so the first person is entitled to be surrogated to the position of the obligee or lien-holder. *Matter of Benedictine Hosp. v. Glessing*, 90 AD3d 1383, 1386 (3d Dep't 2011). Equitable subrogation only can be invoked where the payment made was not voluntary — it was either a contractual obligation or the person needed to make it in order to protect its own legal or economic interests. *Gerseta Corp.*, 241 NY at

426; *Broadway Houston Mack Dev., LLC v Kohl*, 71 AD3d at 937. In demonstrating the latter ground, "the party seeking subrogation must show that the act is not merely helpful but necessary to the protection of its interests." *Broadway Houston Mack Dev., LLC*, 71 AD3d at 937 (citation omitted). The purpose of the doctrine is to shift the debt or obligation onto the party who more properly should be accountable to prevent unjust enrichment and an unfair result. *Hytko v. Hennessy*, 62 AD3d 1081, 1085 (3d Dep't 2009).

Here, HLF paid its Pinnacle Notes customers as a result of the proceedings before the MAS, which found that HLF violated provisions of Singapore's Financial Advisors Act. Not only were the payments a voluntary settlement, HLF only partially satisfied its customers' alleged damage claims regarding the Pinnacle Notes, paying only claims of wrongdoing leveled against HLF in the MAS proceedings. Equitable subrogation requires that the debt be paid in full. *See McGrath v. Carnegie Trust Co.*, 221 NY 92, 95 (1917]); *Cathay Pacific Airways, Ltd. v. Fly & See Travel, Inc.*, 3 F. Supp. 2d 443, 453-454 (S.D.NY 1998) (applying New York law). It is not intended to be used by a party who merely pays his or her own debt. *Benedictine Hosp.*, 90 AD3d at 1386; *Hamlet at Willow Creek Dev. Co., LLC v. Northeast Land Dev. Corp.*, 64 AD3d 85, 107-108 (2d Dep't 2009). Contrary to HLF's argument, *Winkelmann v Excelsior Ins. Co.*, 85 NY2d 577 (1995), does not state that claims for partial equitable subrogation are permitted. Rather, the Court held that where an insurer pays the policy limits to its insured, it may be subrogated to the rights of the insured even though the insured's losses were not fully covered by the proceeds of the policy (i.e., the losses were above the policy limit). *Winkelmann v. Excelsior Ins. Co.*, 85 NY2d at 582-584. Further, this claim is a quasi-contract claim, and the written Distributor Agreement, with its indemnification provisions, governs this subject matter and precludes recovery in quasi-contract. *See Hamlet at Willow Creek Dev. Co., LLC*, 64 AD3d at 102.

III.*Conclusion*

Accordingly, it is

ORDERED that defendants' motion to dismiss is granted to the extent that the third

and sixth claims of the complaint are dismissed, and is otherwise denied, and it is further

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

ORDERED that counsel are directed to appear for a preliminary conference in Room 442, 60 Centre Street, on October 14, 2014, at 10 a.m.

Dated: New York, New York

September 12, 2014

ENTER:

*/s/*Hon. Eileen Bransten, J.S.C.

Footnotes

Footnote 1: The facts as described in this section are drawn from the complaint unless otherwise noted.

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