FILED: NEW YORK COUNTY CLERK 12/15/2010 INDEX NO. 600837/2010
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SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: BERNARD J. FRIED, Justice — E-FILE — PART 60

HON. BERNARD J. FRIED

MBIA Insurance Co.,

Plaintiff,

- v -

GMAC Mortgage LLC,

Defendant.

INDEX NO. 600837/2010

MOTION DATE ______

MOTION SEQ. NO. 001

MOTION CAL. NO. ______

The following papers, numbered 1 to _____ were read on this motion to/for ______________

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

Cross-Motion: ☐ Yes ☐ No

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

This motion was decided in accordance with the December 7, 2010 order and memorandum decision. However, the December 7, 2010 memorandum decision inadvertently had the wrong index number for this action. The accompanying memorandum decision has the corrected index number for this action. This is the only change that has been made to the memorandum decision.

Accordingly, it is hereby

ORDERED that this motion is decided in accordance with the accompanying memorandum decision.

Dated: 12/14/2010

J.S.C.

HON. BERNARD J. FRIED

Check one: ☐ FINAL DISPOSITION ☒ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 60

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MBIA Insurance Co.,

Plaintiff,

Index No. 600837/10 E

-against-

GMAC Mortgage LLC,

Defendant.

---X

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FRIED, J.:

Defendant GMAC Mortgage, LLC ("GMAC") moves, pursuant to CPLR §3211(a)(7), to dismiss Counts I (Fraud) and II (Negligent Misrepresentation) of the complaint arguing, *inter alia,* that these counts are insufficient because MBIA Insurance Corporation ("MBIA") is a sophisticated monoline insurer, thereby obligating MBIA to perform due diligence with the mortgage information. GMAC also moves to dismiss Count VI (Breach of Contract--Good Faith and Fair Dealing) of the complaint arguing that the breach of the covenant of good faith and fair dealing is duplicative of the breach of contract claims in Counts III to V.

As alleged in the complaint, defendant GMAC originates and sells residential mortgage loans through residential mortgage backed securities ("RMBS") transactions. In these transactions, GMAC transfers mortgage loans to pools, which, in turn, are then sold to investors. Investors receive distributions based primarily on the aggregate principal and interest cash flows from the mortgage loans included in the securitizations. MBIA and GMAC have worked together on at least eight securitization deals since 1999. Beginning in 2004, MBIA entered into three financial guaranty insurance agreements (the "Insurance Agreements") with GMAC to cover RMBS transactions made in 2004, 2006, and 2007, which had 95,615 loans in the pool, and which had a total aggregate balance of $4.399 billion. (Complaint ¶43). The 2004 and 2006 transactions specifically covered pools of mostly second-lien home equity lines of credit ("HELOC"), whereas the 2007 transaction

covered closed end mortgages (Complaint ¶40). Under the Insurance Agreements, GMAC was permitted to populate the mortgage pools for a three month period immediately after closing. (Complaint ¶41).

Prior to entering these Insurance Agreements, MBIA purportedly required GMAC to provide them with evidence of a satisfactory credit rating of the RMBs including the rating from Moody's; loan tapes detailing attributes of the individual borrowers and loans; schedules that set forth the statistics about the loan pool; registered initial and final Prospectus Supplements summarizing GMAC Mortgage's Underwriting Guidelines and origination criteria; and shadow ratings for each loan pool. (Complaint ¶47). GMAC complied with these demands by sending MBIA the requested information and also provided MBIA with prospectus supplements that would be filed with the Securities and Exchange Commission ("SEC"), which included specific representations describing GMAC's underwriting standards. (Complaint ¶49). These guidelines specifically set forth that in order to obtain a loan from GMAC, there must be full documentation of the borrower's financial information including: tax returns, pay stubs, a W-2, and a credit report. (Complaint ¶50).

MBIA alleges that GMAC made various warranties and representations in the Insurance Agreements, of which two are relevant to this motion. First, GMAC represented that all of the representations and warranties in each of the Transaction documents were "true and correct in all material aspects," which included proper documentation and accurate loan

information. (Agreement, 2.01(j)). Second, GMAC represented and warranted that they would comply with the Underwriting Standards that GMAC reported to the SEC, and that the borrowers' debt to income (DTI) ratio would not be in excess of 45%. In the event of default, which would occur during a breach of any representation or warranty occurs, the GMAC also agreed to pay and indemnify MBIA for any losses and liabilities arising out of the breach of warranty and representation. (Agreement 2.01(m)).

According to the complaint, in January 2009, MBIA became concerned about the high number of delinquencies that occurred with these loans and requested that GMAC provide them with access to the mortgage loan documents. MBIA alleges that GMAC did not allow MBIA access to all of the loan documents, but only permitted MBIA to review loan files for 4,104 delinquent loans. Upon reviewing the files for these delinquent loans, MBIA determined that GMAC routinely did not follow its own underwriting standards by approving loans and HELOCs to unqualified applicants. (Complaint ¶78). Because GMAC purportedly breached its warranties and representations, MBIA demanded that GMAC repurchase these loans and provide adequate substitutes pursuant to the Repurchase Obligation. GMAC has allegedly repurchased only 28 of the 3,669 non-compliant loans and as a result, MBIA claims that it has borne most of the risk from these transactions, paying out approximately $132 million in claims.

MBIA alleges in Count I ("Fraud") that GMAC fraudulently induced MBIA into these Insurance Agreements by intentionally misrepresenting the true nature of the borrowers'

Fair Isaac Corporation ("FICO") scores, DTI, and combined loan to value ("CLTV") ratio. Furthermore, MBIA alleges that GMAC fraudulently obtained higher shadow ratings and that MBIA had access only to the false information, thereby justifying their reliance on GMAC's representations. Instead, MBIA asserts that GMAC provided them with false information on the loan tapes and consistently approved loans that did not comply with GMAC's Underwriting Standards. (Complaint ¶108). Likewise, MBIA asserts that such misrepresentations were material to MBIA's decision to enter into the Insurance Agreements and they would not have entered the Agreements knowing that information on the loan tapes was false. (Complaint ¶106).

MBIA also alleges in Count II ("Negligent Misrepresentation") that GMAC should be held liable for negligent misrepresentation because MBIA asserts that it had a "special relationship of trust and confidence" with GMAC, thereby creating a duty on the part of GMAC to report and correct any discrepancies with the loans. (Complaint ¶¶ 113, 115). Specifically, MBIA alleges that they had a business relationship with GMAC since 1999, and that MBIA provided insurance for eight previous GMAC-sponsored securitizations of second-lien mortgage loans. Furthermore, MBIA asserts that GMAC, as the sole originator of these loans, had sole access to individual loan files and thereby had "unique knowledge and expertise about the manner in which the loans had been originated." (Complaint ¶116). Specifically, MBIA contends that GMAC had "unique and special knowledge...regarding both the underwriting of the mortgages generally, and the underwriting of the mortgage loans in the loan pools for the Transactions." (Complaint

¶116). MBIA asserts that GMAC should have known that MBIA would rely on GMAC's representations and that these representations would be material to MBIA's decision to issue the policies. MBIA contends that had it known about these negligent misrepresentations, it would not have issued the policies.

In addition, MBIA alleges in Counts III to V that GMAC breached its representations and warranties in the Insurance Agreements, as well as those made in the Servicing Agreement. MBIA maintains that GMAC violated Section 2.01(j) of the Insurance Agreements, asserting that GMAC breached this provision by not adhering to their own underwriting standards and by providing MBIA with misleading information in the loan tapes, schedules, and Prospectus Statements. Specifically, these documents allegedly provided artificially inflated shadow ratings, and false statistics relating to DTI and CLTV. Likewise, GMAC allegedly failed to repurchase the defective loans upon default, and also failed to service the delinquent loans.

In addition to the breach of contract claims, MBIA alleges in Claim VI ("Breach of Contract: Good Faith and Fair Dealing") that GMAC breached the implied covenant of good faith and fair dealing. MBIA asserts that they entered into the Insurance Agreements with the understanding that the loan documents were evaluated consistently with the underwriting standards of GMAC. (Comp. ¶¶ 155-56, 160). MBIA argues that GMAC breached the duty of good faith and fair dealing by knowingly, deliberately, and routinely contributing mortgage loans to the pools that had not been originated in accordance with GMAC's underwriting standards. MBIA also asserts that GMAC breached the duty of good faith

by failing to make any reasonable effort to collect payments due from borrowers. (Comp. ¶¶ 157-59). Furthermore, it is alleged that GMAC breached this duty by failing to provide MBIA with access to information that they requested, such as a complete version of GMAC's underwriting standards.

In support of its motion for partial dismissal of the complaint, GMAC contends that

MBIA's claims, other than the breach of contract claims, should be dismissed as a matter of law for failure to state a cause of action. GMAC maintains that MBIA is a sophisticated monoline insurer and therefore had a duty to inspect these individual loans. Because MBIA was a sophisticated entity, it could not reasonably rely on GMAC's purported misrepresentations, nor could it claim that it was in a special relationship with GMAC.

CPLR §3211(a)(7) allows a party to move for dismissal of certain claims if they do not "state a cause of action." The "court's attention should be focused on whether the plaintiff has a cause of action rather than on whether he has properly stated one." *Goldman v. Metropolitan Life Ins. Co.,* 5 N.Y.3d 561, 570 (2005). Furthermore, the court must ascertain whether the complaint "manifests any cause of action cognizable at law." *Davis v. CCF Capital Corp.,* 277 A.D. 342, 343 (2d Dept. 2000). Thus, if the complaint successfully states a claim, then the motion to dismiss should be denied.

Turning to Count I ("Fraud"), the sole basis for GMAC's motion for dismissal of the fraud claim is that MBIA could not justifiably rely on any of the purported misrepresentations.

(Defendant's M.O.L., p. 9-17). A fraud cause of action has five elements: (1) a material misrepresentation or omission of fact, (2) made with knowledge of its falsity, (3) with an intent to defraud, and (4) reasonable reliance on the part of the plaintiff, (5) that causes damage to the plaintiff. *See New York City Transit Auth. v. Morris J. Essen, P.C.*, 276 A.D.2d 78, 85 (1st Dept. 2000). "[A] plaintiff...need only plead that he relied on misrepresentations made by the defendant." *Knight Secs. L.P. v. Fiduciary Trust Co.*, 5 A.D.3d 172,173 (1st Dept. 2004). Reasonable reliance is a fact intensive inquiry, which should be reserved for a trier of fact. *See Bank Hapoalin Ltd. v. Banca Intensa S.p.A,* 22 Misc.3d 1104 (A), at*4 (Sup. Ct., N.Y. County 2008) ("[W]hether justifiable reliance exists presents an issue of fact.....A party may be found to have reasonably relied on another party's written representations, if the documents would not, on their face, have alerted the party to potential fraud."); *JP Morgan Chase Bank v. Winnick*, 350 F.Supp. 2d 393, 409 (S.D.N.Y. 2004) ("[I]t cannot be argued that the Banks failed to bargain for adequate safeguards to establish, at least initially, the basis for their reliance on the defendants' representations...").

The Court of Appeals has recently held that during the pleading stage, the reasonable reliance element can be inferred "where a plaintiff has taken reasonable steps to protect itself against deception," such as "specific, written representations." *DDJ Mgmt., LLC v. Rhone Group LLC,* 15 N.Y.3d 147, 154 (2010) The Court of Appeals stated that "the question of what constitutes reasonable reliance is....*fact-intensive*." *DDJ Mgmt.*, 15 N.Y.3d at 155. (emphasis added). The financial statements at issue contained some details that might have provoked concern with a more thorough examination, but at the

plaintiffs' insistence, the Defendant represented and warranted in the loan agreement that the financial statements were accurate. *DDJ Mgmt,* 15 N.Y.3d at 152. A plaintiff "should not be denied recovery merely because hindsight suggests that it might have been possible to detect the fraud when it occurred." *DDJ Mgmt.*, 15 N.Y.3d at 154-55. Even though the plaintiff was a sophisticated entity, the Court held that the Plaintiffs did not have to do more than obtain these representations and warranties to state a sufficient claim for fraud and declined to grant the Defendant's motion to dismiss because the issue of reasonable reliance is an issue of fact. *DDJ Mgmt.*, 15 N.Y.3d at 155.

Here, MBIA alleges in its complaint that "GMAC knew that the industry practice was

financial guaranty insurer to rely upon the representations and warranties of the sponsor regarding the quality of the mortgage loans and the standards under which they were originated." (Comp. ¶ 104). Without representing and warranting the accuracy of the loan information and credit scores, MBIA allegedly would not have entered into the Insurance Agreements. (Comp. ¶ 106). Thus, much like in *DDJ Management*, MBIA has pled that it relied on specific written representations as to the accuracy of the loan information and credit ratings. Whether MBIA was justified in relying on these representations and warranties, however, is a question of fact. *DDJ Mgmt.,* 15 N.Y.3d at 155.

However, assuming that *DDJ Management* is not dispositive, it is not clear whether MBIA could have discovered the alleged misrepresentations concerning the loan characteristics

before entering into the Insurance Agreements. *See Harbinger Capital Partners Master Fund I Ltd. v. Wachovia Capital Markets,* 27 Misc.3d 1236(A), at *7 (slip opinion) (Sup. Ct., N.Y. County May 10, 2010) (Kapnick, J.). In *MBIA Ins. Co. v. Countrywide Home Loans, Inc.,* Justice Bransten dismissed a similar motion to dismiss that was predicated on failure to perform due diligence because she noted that "[e]ven assuming MBIA conducted a full inquiry under the circumstances...it is not conclusive that MBIA could have discovered the alleged fraud." *MBIA Ins. Co. v. Countrywide Home Loans, Inc.,* Index No. 602825/08, at *12 (Sup. Ct., N.Y. County Apr. 7, 2010) (Bransten, J.). It is inappropriate as a matter of law during the pleadings stage to determine whether "plaintiff was justified in relying on [defendant's] misrepresentations." *P.T. Bank Cent. Asia v. ABN AMRO Bank N.V.*, 301 A.D.2d 373, 378 (1st Dept 2003).

Here, GMAC asserts that MBIA had an affirmative duty to conduct an investigation

closing and that failure to do so should foreclose MBIA's ability to claim justifiable reliance. (Defendant's M.O.L., p.11). However, the Agreement purportedly provided that GMAC could populate the mortgage pools with additional loans for three months after the closing date. (Comp. ¶ 41). According to the complaint, many of these mortgage pools were not fully populated at the time of the closing. (Comp. ¶ 41). Much like in *Countrywide,* it is possible that an investigation into the loan files would have been futile, as faulty loans could be added to the mortgage pools after an investigation.

(Comp. ¶ 41). Accordingly, the fraud cause of action survives, and GMAC's request to dismiss the fraud claim is denied.

Turning to Count II ("Negligent Misrepresentation"), a negligent misrepresentation action requires a party to plead facts showing a special relationship of trust and confidence between the parties, which created a duty on the part of one party to impart correct information. *J.A.O. Acquisition Corp. v. Stavitsky,* 8 N.Y.3d 144, 148 (2007). A special relationship exists when (1) the parties are in a relationship of trust and confidence, or (2) one of the parties has superior knowledge. *See Kimmel v. Schaefer,* 89 N.Y.2d 257, 263 (1996). Generally, the requisite "special relationship" does not exist between sophisticated commercial entities that enter into an agreement through an arm's-length business transaction. *Parisi v. Metroflag Polo, LLC,* 51 A.D.3d 424 (1st Dept. 2008).

The basis of MBIA's argument for a special relationship of trust is that MBIA and GMAC previously had engaged in eight similar securitization deals since 1999. According to the complaint, the previous securitization transactions similarly dealt with closed end and HELOC second lien mortgages. (Comp. ¶ 113). Noting these previous transactions with GMAC, MBIA asserts that it had a "special relationship of trust and confidence" with GMAC, thereby creating a duty on the part of GMAC to report and correct any discrepancies with the loans. (Complaint ¶¶ 113, 115). However, the number of years or transactions undertaken by two business entities does not create a relationship of trust.

See, e.g., Sheridan v. Trs. of Columbia Univ., 296 A.D.2d 314, 316 (1st Dept. 2002); *Huntington Dental & Medical Co. v. 3m,* 1996 U.S. Dist. LEXIS 13350, 10-11 (S.D.N.Y. Sept. 11, 1996) (holding that a fifteen year course of dealing between the parties did not create a special relationship). Here, even though the parties engaged in eight similar securitization transactions over the course of six years, the companies were not in a relationship of trust and confidence because both were sophisticated commercial entities that entered into the Insurance Agreements at arm's length.

However, a special relationship may also exist when one party has specialized knowledge, thereby justifying reliance on the knowledgeable party. In *Kimmel v. Schaefer*, the Court of Appeals recognized that a duty to speak with care may be imposed in a commercial transaction, but only "on those persons who possess unique or specialized expertise...such that reliance on the negligent misrepresentation is justified." *Kimmel v. Schaefer,* 89 N.Y.2d 257, 263 (1996). On the other hand, courts have not found specialized knowledge where the alleged area of expertise involves the particulars of the defendant's business. *See Batas v. Prudential Ins. Co. of Am.*, 281 A.2d 260, 264 (1st Dept. 2001) (holding that "defendants' superior knowledge of their products" created no special relationship between an insurance company and its customers). A company's "knowledge of the particulars of its own business is not the type of unique or specialized knowledge that the Court of Appeals was talking about in *Kimmel.*" *MBIA Ins. Co. v. Residential Funding Co., LLC,* 26 Misc.3d 1204(A), at *5 (N.Y. Sup. Ct. Dec. 22, 2009) [hereinafter *MBIA Ins. Co. v. RFC*].

MBIA contends that GMAC had "superior information regarding each of the mortgage loans by virtue of possessing the loan origination and servicing files," while MBIA only had access to the loan tapes. (Plaintiff's M.O.L., p. 18). Thus, GMAC allegedly had superior knowledge of its own Underwriting Standards, and the credit qualities of the mortgage loans, such as the DTI, CLTV and FICO scores. However, the loan information in the origination files and the Underwriting Standards, both of which serve as the basis of MBIA's specialized knowledge argument, are the particulars of GMAC's mortgage lending business. Mere possession of the loan files and servicing files does not create the type of specialized knowledge discussed in *Kimmel.* The knowledge of the information in the loan files is not specialized knowledge because the details of those loan files constitute the particulars of GMAC's business. Accordingly, a special relationship did not exist and the motion to dismiss Count II is granted.

Finally, GMAC moves to dismiss MBIA's good faith and fair dealing claim because it is duplicative of the breach of contract claims. All contracts in New York imply a covenant of good faith and fair dealing in the course of performance. *See 511 West 232nd Owners Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144, 153 (2002); *Security Pacific Natl. Bank v. Evans,* 62 A.D.3d 512, 514 (1st Dept 2009). "This embraces a pledge that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'" *Dalton v. Educational Testing Serv.*, 87 N.Y.2d 384, 389 (1995), quoting *Kirke La Shelle Co. v. Armstrong Co.,* 263 N.Y. 79, 87 (1933).

A breach of the implied covenant of good faith and fair dealing claim that is duplicative of a breach of contract claim must be dismissed. *See New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 319-20 (1995). A good faith claim will be dismissed as redundant if it merely pleads that defendant did not act in good faith in performing its contractual obligations. *See Amcan Holdings, Inc. v. Canadian Imperial Bank of Commerce*, 894 N.Y.S.2d 47, 49-50 (1st Dept. 2010) (dismissing a good faith and fair dealing claim because it arose from the same facts as the breach of contract claims). Claims for breach of good faith and fair dealing are not duplicative when claims are not directed at all of the defendants and where claims are not predicated on contractual terms that form the basis of the breach of contract claim. *See, e.g., Forman v. Guardian Life Ins. Co. of America*, 76 A.D.3d 886 (1st Dept Sept. 21, 2010) (holding that a good faith and fair dealing claim was not duplicative because the breach of contract claim was based on a warranty provision that did not appear in the other contracts).

This action is virtually similar to *MBIA v. Residential Funding Co.*, 26 Misc.3d 1204(A), at *5 (Sup. Ct., N.Y. County Dec. 22, 2009), *contra MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, Index No. 602825/08, at *16 (Sup. Ct., N.Y. County Apr. 7, 2010), in which MBIA pled that the defendant breached its duty of good faith and fair dealing by not performing its obligations as servicer, by not adhering to the Underwriting Standards, and by contributing non conforming loans to the mortgage pools. I held that all MBIA had done was "pick out clauses of the parties' written agreements" that it felt RFC did not comply with and added "that RFC's non-performance was in 'bad faith.'" *Id.* Here,

MBIA has done the same thing by reiterating its breach of contract claims while adding bad faith to its allegations. Virtually identical allegations appear in Count IV (Complaint ¶¶137-140), where MBIA maintains that GMAC breached the Servicing Agreement by failing to collect payments, by failing to initiate contact with the borrowers, and by failing to maintain records for the loans. Likewise, MBIA's allegations of lack of access to information, the failure to comply with the underwriting standards are duplicative of claims, and the contribution of non-conforming loans to the mortgage pools are set forth in Count III of the Complaint. (Comp. ¶¶125-27). Thus, MBIA's claims are duplicative of the allegations set forth in the Third and Fourth Causes of Action. Accordingly, the motion to dismiss the good faith and fair dealing claim is granted.

For the foregoing reasons, it is hereby:

ORDERED that defendant's motion to dismiss Count I of the complaint is denied,

ORDERED that defendant's motion to dismiss Claims II and VI of the complaint is granted, and it is further

ORDERED that defendant shall serve and file an answer to the remaining claims within twenty (20) days of service of a copy of this order with notice of entry.

Dated: 12/14/2010

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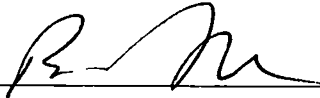

J.S.C.

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