

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

MBIA INSURANCE CORPORATION,

Plaintiff,

-against-

GMAC MORTGAGE, LLC (F/K/A GMAC
MORTGAGE CORPORATION),

Defendant.

Index No. 600837/10

**DEFENDANT GMAC MORTGAGE, LLC'S MEMORANDUM OF LAW IN SUPPORT
OF MOTION TO DISMISS THE COMPLAINT**

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Defendant GMAC Mortgage, LLC respectfully submits this memorandum of law in support of its motion to dismiss the Complaint's First, Second and Sixth Causes of Action, and the Prayer for Relief (§§ a.i, a.ii, a.iv, b and c), with prejudice pursuant to CPLR 3211(a)(1) and (a)(7).¹

PRELIMINARY STATEMENT

Faced with widespread calls upon their financial guaranties of investments involving the securitization of real estate loans following the credit market collapse, and the ensuing global recession, plaintiff MBIA Insurance Corporation ("MBIA") has embarked on a dubious scheme, which it has dubbed the "Recovery Litigation." An integral component of this scheme, as the name suggests, is the commencement of multiple legal proceedings in various courts. To that end, MBIA has filed a series of lawsuits in this Court, and in other courts, against a number of major financial corporations. In each lawsuit, MBIA implausibly contends that it was defrauded and duped into stepping into the role of financial guarantor of various investments involving residential mortgage-backed assets. In other words, MBIA now wishes to avoid losses arising from the very risks it voluntarily chose to insure. The instant lawsuit is the latest installment of MBIA's improper scheme.

Factually, here, MBIA in 2004, 2006 and 2007 entered into Insurance Agreements with GMAC Mortgage relating to the securitization of three pools of higher-risk second-lien mortgages. Pursuant to those Agreements, MBIA agreed to issue insurance policies insuring investors in the securitized mortgage pools against the risk of mortgage delinquencies and defaults. That risk has now materialized. As a result of the credit market collapse and follow-on recession, mortgage delinquencies skyrocketed and the risk MBIA was insuring against was

¹ Copies of the documentary evidence referenced in this memorandum are attached as exhibits to the accompanying *Affirmation of David E. Potter* ("Aff.").

realized. Hence, MBIA has been forced to make insurance payments to investors in the three securitized mortgage pools at issue in this case.

With hardly a mention of the credit market collapse and recession in its Complaint, MBIA now contends that GMAC Mortgage fraudulently induced it to enter into the Insurance Agreements. The essence of MBIA's contentions is that GMAC Mortgage provided MBIA with inaccurate information regarding the mortgages being securitized, and that GMAC Mortgage falsely represented the characteristics of those mortgages. Based on these, and other, allegations, MBIA asserts six causes of action: fraud, negligent misrepresentation, breach of contract (three causes of action), and breach of the covenant of good faith and fair dealing.

MBIA's fraud and negligent misrepresentations claims should be dismissed as a matter of law. Sophisticated entities have an affirmative duty to conduct due diligence before entering into a transaction. Absent the faithful discharge of the due diligence obligation, there cannot be any justifiable reliance on any purported misrepresentations as a matter of law. Here, significantly, MBIA admits that it did not conduct due diligence regarding GMAC Mortgage's alleged representations before entering into the transactions. Among other things, MBIA did not bother asking for complete copies of GMAC Mortgage's underwriting guidelines; it did not ask for and review a sample of the subject loans to confirm compliance of those loans to the underwriting guidelines disclosed by GMAC Mortgage to be in use here; it ignored GMAC Mortgage's disclosures about the risks inherent with second-lien mortgages, and it ignored GMAC Mortgage's disclosures about the underwriting standards applied to the subject mortgages.

Presumably because it is well aware that its failure to conduct due diligence is dispositive of its fraud claim, MBIA makes a series of implausible allegations attempting to excuse its failure, many of which allegations are flatly contradicted by the express terms in the parties'

transaction documents. MBIA, for example, alleges that it did not have a contractual right to conduct due diligence. This allegation is flatly contradicted by the Insurance Agreements, which expressly provided MBIA with the right to conduct due diligence. MBIA also makes the remarkable assertion that its failure to conduct due diligence was “customary” in the industry, and in any event, it trusted GMAC Mortgage. There are no such exceptions to MBIA’s affirmative duty to conduct due diligence, and courts have rejected similar excuses before. Accordingly, MBIA’s fraud claim should be dismissed as a matter of law.

With respect to its negligent misrepresentation claim, MBIA likewise resorts to implausible allegations. MBIA, for example, contends that it had a “special relationship of trust and confidence” with GMAC Mortgage that gave rise to a duty to disclose. Courts, however, have repeatedly held that there is no “special relationship” between sophisticated entities such as MBIA and GMAC Mortgage engaging in arms-length transactions. Furthermore, courts have repeatedly held that New York’s Martin Act preempts negligent misrepresentation claims relating to transactions involving securities. In short, MBIA has no factual basis upon which to assert a claim for negligent misrepresentation. Lastly, MBIA’s claim for breach of the covenant of good faith and fair dealing and certain of its requests for relief are improper and should be dismissed, as discussed below.

BACKGROUND INFORMATION

I. MBIA Is A Sophisticated Entity With Substantial Experience Relating To The Transactions At Issue In This Case.

MBIA is “one of the nation’s oldest and largest monoline insurers” providing “financial guaranty insurance and other forms of credit protection[.]” (Compl. ¶ 12 (Aff., Ex. 1)). MBIA describes itself as “a financial guarantee powerhouse with a presence in the structured

finance/asset-backed market unmatched anywhere in the world” and as a “world class manager of credit risk.”² Indisputably, MBIA is one of the most sophisticated entities in the world providing financial guaranty insurance of the type at issue in this lawsuit. And, as a “financial guarantee powerhouse,” MBIA undoubtedly has experienced personnel capable of analyzing each transaction it is guaranteeing, assessing the quality of the collateral underlying the investments it is guaranteeing, and assessing the risk it is undertaking.

Furthermore, in the 2000s, along with most other major financial corporations in the country, MBIA readily jumped into “the boom of structured finance products” and “began insuring a large amount of structured-finance policies.” *ABN Amro Bank N.V. v. MBIA, Inc.*, 2010 N.Y. Misc. LEXIS 281, *2 (Sup. Ct. N.Y. County February 17, 2010) (Yates, J.). It cannot pretend to be ignorant of the risks involved in the transactions at issue in this case.

II. MBIA Willingly Enters Into Three Transactions With GMAC Mortgage Involving The Securitization Of Higher-Risk Second-Lien Mortgages.

In 2004, 2006 and 2007, MBIA issued insurance policies guaranteeing certain payments to investors in three substantial mortgage loan securitizations (collectively, the “Transactions”) (Compl. ¶ 2). Generally, MBIA alleges that GMAC Mortgage originated or acquired the residential mortgage loans underlying the securitizations; that GMAC Mortgage then pooled and conveyed the mortgage loans into trusts; and that the trusts then issued residential mortgage-backed securities to investors. (Compl. ¶ 1, 2). The three Transactions allegedly involved 57,408 mortgages with a face value of \$3.363 billion at the time of closing. (Compl. ¶ 40).

The Transactions involved higher-risk second-lien mortgages, mostly in the form of home equity lines of credit. (Compl. ¶ 40). MBIA alleges that the shadow ratings for the

² See <http://www.mbia.com/investor/mission.html> and <http://www.mbia.com/investor/history.html> (accessed May 28, 2010).

Transactions (*i.e.*, the ratings without financial guaranty insurance) were “BBB” and “Baa3”. (Compl. ¶ 54). Generally, these are the lowest investment grade ratings under Standard & Poor’s and Moody’s rating systems. Indeed, the Prospectus Supplements for the Transactions – which were provided to MBIA – described in detail the risks associated with such second-lien mortgages. *See* 2004 Prospectus Supplement at S-16, S-17, S-18 (Aff., Ex. 3).

The Prospectus Supplement, for example, warned that the mortgages “may have risk of repayment characteristics more similar to unsecured consumer loans”; may have a greater rate of default than “mortgage loans secured by senior mortgages”; and were more exposed to “an overall decline in value” of the “residential real estate market”. (*Id.*). It also warned that “[t]here can be no assurance as to the rate of losses or delinquencies on any of the mortgage loans, however, the rate of losses and delinquencies are likely to be higher than those of traditional first lien mortgage loans[.]” (*Id.* at S-80). As one of the world’s leading financial guaranty insurers, MBIA was undoubtedly aware of the higher-risk nature of the second-lien mortgages involved in the Transactions, regardless of the disclosures in the Prospectus Supplements.

Given the inherently riskier nature of these second-lien mortgages, MBIA alleges that, in order to “make the securities more marketable,” GMAC Mortgage “sought a financial guaranty insurer to guarantee the trusts’ payments to investors in the event that cash flows to the trusts were impaired by the failure of mortgage borrowers to make payments of principal and interest.” (Compl. ¶ 3). MBIA for a substantial premium agreed to insure against this risk and issued policies guaranteeing certain payments to investors for each of the Transactions. (Compl. ¶ 58).

As between MBIA and GMAC Mortgage, the parties’ rights and obligations with respect to the insurance policies are set forth in Insurance Agreements entered into for each of the Transactions. (Compl. ¶ 58). Furthermore, MBIA alleges the Insurance Agreements incorporate

by reference various other documents involved in the transactions, including the purchase and servicing agreements, and the offering materials provided to potential investors (the “Transaction Documents”). (Compl. ¶ 60).³

III. Beginning In 2007 As A Result Of The Unprecedented Deterioration Of Global Credit Markets, MBIA, Just Like Other Insurers Of Securitized Transactions Involving Real Estate Loans, Is Called Upon As The Financial Guarantor Of The Investments To Make Good On Its Guaranty.

MBIA alleges that “[s]ince closing, the Transactions have performed extremely poorly. Delinquencies and charge-offs for mortgage loans in the loan pools have been much higher than would be expected[.]” (Compl. ¶ 70). The first Transaction closed on October 28, 2004. (Compl. ¶ 40). It is simply inexplicable that, if the 2004 Transaction began performing extremely poorly “since closing,” MBIA would have nonetheless chosen to enter into the 2006 and 2007 Transactions, which closed on September 27, 2006 and March 29, 2007, respectively. (Compl. ¶ 40). However, if that is the case, MBIA can hardly come to this Court claiming fraud, having been alerted to the purported risks from the 2004 Transaction.

What MBIA undoubtedly means – but refuses to say in the Complaint – is that the Transactions began to perform poorly with the onset of the unprecedented crisis in the global credit markets beginning in 2007. MBIA is more forthright in its 2008 Form 10-K:

Beginning in the second half of 2007, deterioration of the global credit markets coupled with the re-pricing of credit risk created and continues to create extremely difficult market conditions and volatility in the credit markets. Initially, the concerns on the part of market participants were focused on the subprime segment of the mortgage-backed securities market. However, these concerns have since expanded to include a broad range of mortgage- and asset-backed and other fixed income securities, including those rated investment grade During the fourth quarter of

³ For purposes of this Motion, the relevant portions of the Transaction Documents are the same or substantially similar, whether part of the 2004, 2006 or 2007 transaction. Accordingly, in the interest of brevity, citations and quotes will be given to the 2004 version of the Transaction Documents only. Copies of the relevant 2006 and 2007 transaction documents, however, are contained in the accompanying Affirmation of David E. Potter at Exs. 4-7.

2008, disruptions and volatility in the credit markets reached unprecedented levels. During 2008, partly as a result of concerns about exposure to these assets, some of the largest companies in the financial sector have received government support, been acquired by stronger firms or been allowed to fail.

2008 Form 10-K, Item 1A, Risk Factors (Aff., Ex. 8). As MBIA concedes, these unprecedented market conditions have been the cause of MBIA's losses:

While MBIA Corp. has sought to underwrite direct RMBS, CMBS and CDOs of ABS with levels of subordination and other credit enhancements designed to protect it from loss in the event of poor performance of the underlying assets collateralizing the securities in the insured portfolio, we have since the third quarter of 2007 recorded case basis losses incurred of \$2.1 billion . . . **No assurance can be given that such credit enhancements will prove to be adequate to protect MBIA Corp. from incurring additional material losses in view of the current significantly higher rates of delinquency, foreclosure and losses being observed among residential mortgages and home equity lines of credit.** While further deterioration in some of the asset-backed securities we insure is generally expected, the extent and duration of any future continued deterioration of the credit markets is unknown[.]

(Id. ((emphasis added)).

IV. Faced With The Need To Make Good On Its Financial Guaranty, MBIA Implausibly Contends In This Lawsuit That It Was Duped Into Insuring The Transactions.

MBIA alleges that GMAC Mortgage provided it with certain information in order to induce it to enter into the Insurance Agreements and to issue the insurance policies. Specifically, MBIA alleges that GMAC Mortgage provided it with (1) loan tapes and schedules setting forth certain information regarding the applicable mortgage pools on both a loan-by-loan and a pool-level basis; (2) Prospectus Supplements describing GMAC Mortgage's underwriting standards applicable to the subject mortgages; and (3) ratings from ratings agencies. (Compl. ¶¶ 4, 54).

Implausibly, MBIA now says that the materials GMAC Mortgage provided to it were fraudulent. MBIA contends that the information in the loan tapes and schedules was inaccurate;

that the subject loans did not meet the underwriting standards set forth in the Prospectus Supplements and that the ratings from the ratings agencies were also faulty because they were likewise based on the fraudulent loan tapes and schedules. (Compl. ¶¶ 46-54).

Tellingly, and fatal to its various tort claims, MBIA admits that it did not conduct due diligence to verify the accuracy of the information provided to it by GMAC Mortgage, even though it full well knew the higher-risk nature of the second-lien mortgages involved in the Transactions. (Compl. ¶¶ 85, 104). Instead, MBIA claims that it did not have a “meaningful opportunity” or a contractual right to conduct due diligence. (Compl. ¶¶85, 104). This latter allegation, of course, is flatly contradicted by the Insurance Agreements, which authorized MBIA to conduct whatever due diligence it deemed necessary before the closing of the Transactions, and on an ongoing basis thereafter. *See* Insurance Agreement §§ 2.05(m), 3.01(m) (Aff., Ex. 2). MBIA also attempts to excuse its lack of due diligence by alleging that it was customary in the industry for financial guaranty insurers to rely on the representations of the loan originator, and that, in any event, it trusted GMAC Mortgage. (Compl. ¶85, 104).

V. MBIA’s “Transformation” And Its Misguided “Recovery Litigation” Scheme.

Lastly, this lawsuit can only properly be understood in the context of MBIA’s extraordinary efforts to shield itself from losses for the very risks it voluntarily chose to insure. Those efforts include its 2009 transfer of substantial company assets to a separate corporation, a transfer MBIA euphemistically calls the “Transformation.” As a result of this Transformation, “[t]wenty-three of the world’s largest financial corporations and investment banks” have sued MBIA, claiming that the Transformation “was a massive fraudulent conveyance designed to loot MBIA Insurance Corporation’s assets and to evade its finance guarantee coverage obligations to

them.” *ABN Amro Bank N.V. v. MBIA, Inc.*, 2010 N.Y. Misc. LEXIS 281 (Sup. Ct. N.Y. County February 17, 2010) (Yates, J.) (denying MBIA’s motion to dismiss).

MBIA’s unprecedented efforts to avoid losses on the risks it insured also include a series of cookie-cutter lawsuits filed by MBIA mostly in this Court beginning in 2008. In these lawsuits, MBIA has sued Countrywide, Merrill-Lynch, Credit Suisse, Residential Funding Company, and the Royal Bank of Canada, arguing in each case that it was duped and defrauded in much the same manner alleged in this lawsuit. In other words, MBIA, carrying the reputation of a sophisticated, world-wide leader in the financial guaranty industry, was somehow defrauded not only by GMAC Mortgage, but by numerous other major financial corporations as well in the very business in which it had made its name. MBIA has creatively dubbed this scheme the “Recovery Litigation”. See 2009 Form 10-K, Item 3, Legal Proceedings (Aff., Ex. 9).⁴

ARGUMENT

I. MBIA’s First Cause Of Action – A Fraud Claim – Should Be Dismissed Because MBIA Cannot As A Matter Of Law Show Justifiable Reliance.

In its First Cause of Action, MBIA claims that GMAC Mortgage fraudulently induced MBIA to issue insurance policies for the Transactions. Generally, MBIA’s fraud claim is premised on the assertion that GMAC Mortgage provided it with the following information, all of which MBIA says was fraudulent:

⁴ The other lawsuits filed in this Court as part of MBIA’s “Recovery Litigation” scheme are: (1) *MBIA Insurance Corporation v. Countrywide Home Loans, Inc.*, Index No. 602825/08 (Bransten, J.)(see July 8, 2009 and April 27, 2010 *Countrywide Decisions* (Aff., Exs. 10, 11)); (2) *MBIA Insurance Corporation v. Residential Funding Company, LLC*, Index No. 603552/08 (Fried, J.)(see December 22, 2009 *RFC Decision* (Aff., Ex. 13)); (3) *MBIA Insurance Corporation v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, Index No. 601324/09E (Fried, J.)(see April 7, 2010 *Merrill Lynch Decision* (Aff., Ex. 12)); and (4) *MBIA Insurance Corporation v. Credit Suisse Securities (USA) LLC*, Index No. 603751/09 (Kornreich, J.). MBIA has also filed suit against the Royal Bank of Canada in Westchester County, Index No. 12238/09.

(1) loan tapes detailing attributes of individual borrowers and loans; (2) schedules that set forth statistics about the loan pool; (3) registered initial and final Prospectus Supplements summarizing GMAC Mortgage's Underwriting Guidelines and loan origination criteria; and (4) shadow ratings that GMAC Mortgage represented characterized the credit quality of each loan pool.

(Compl. ¶ 47).

In order to state a claim for fraud, MBIA must establish, among other things, that it justifiably relied on the purported misrepresentations. *New York Univ. v. Continental Ins. Co.*, 87 NY2d 308, 318 (1995). As discussed below, MBIA cannot establish that it justifiably relied on any of the purported misrepresentations in the four categories of material it has identified. Furthermore, in many instances, MBIA's claims with respect to these purported misrepresentations are flatly contradicted by the express terms in the Transaction Documents themselves. See CPLR 3211(a)(1) (authorizing dismissal based on "documentary evidence"); *Wilson v. Hochberg*, 245 AD2d 116, 116-117 (1st Dept 1997) (dismissing claims "flatly contradicted" by documentary evidence). Accordingly, MBIA's fraud claim fails as a matter of law.

A. As A Matter Of Law, MBIA Had An Affirmative Duty To Conduct Due Diligence Regarding GMAC Mortgage's Representations.

As an initial matter, sophisticated entities such as MBIA have an affirmative duty to conduct due diligence before being entitled to claim justifiable reliance on another entity's representations:

"As 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". To sustain a claim for fraud, sophisticated investors, as here, must have discharged their own affirmative duty to exercise ordinary intelligence and conduct an independent appraisal of the risks they are assuming. To sustain a claim

for fraud, sophisticated investors, as here, must have discharged their own affirmative duty to exercise ordinary intelligence and conduct an independent appraisal of the risks they are assuming.

DDJ Mgmt, LLC v. Rhone Group, LLC, 60 AD3d 421, 424 (1st Dept 2009) (citations omitted); see also *Ventur Group, LLC v Finnerty*, 68 A.D.3d 638, 639 (1st Dept 2009); *Dragon Inv. Co. II LLC v. Shanahan*, 49 AD3d 403, 404 (1st Dept 2008); see also *Crigger v. Fahrenstock And Co., Inc.*, 443 F.3d 230, 235 (2nd Cir. 2006).

Here, there can be no doubt that MBIA is a sophisticated entity. MBIA's own Complaint proudly describes itself as "one of the nation's oldest and largest monoline insurers" providing "financial guaranty insurance and other forms of credit protection[.]" (Compl. ¶ 12). Accordingly, under well-established law, MBIA had an affirmative duty to perform due diligence before being entitled to claim justifiable reliance on GMAC Mortgage's representations.

And, courts have repeatedly dismissed fraud claims for lack of justifiable reliance, where a sophisticated entity such as MBIA failed to conduct adequate due diligence. See *DDJ Mgmt, LLC* at 424 (dismissing fraud claims for lack of justifiable reliance where plaintiff failed to conduct due diligence regarding plaintiff's financial statements); *Valassis Communications, Inc. v. Weimer*, 304 AD2d 448, 449 (1st Dept 2003) (dismissing fraud claim where plaintiff failed to verify accuracy of financial information provided to it); *Dragon Inv. Co. II LLC v. Shanahan*, 49 AD3d 403, 404 (1st Dept 2008) (affirming dismissal of fraud claim where plaintiff "made no inquiry until . . . a year after the alleged misrepresentations"). As discussed below, MBIA failed to conduct any due diligence, and as a result, its claim should be dismissed as a matter of law.

B. As A Matter Of Law, MBIA Did Not Justifiably Rely On The Loan Tapes And Schedules.

MBIA alleges that the loan tapes and schedules provided to it were fraudulent. (Compl. ¶¶ 48, 81). MBIA, however, tacitly admits in the Complaint that it did not conduct any due diligence at the time it received them to determine whether the loan tapes and schedules were accurate:

MBIA did not have a contractual right to review loan origination files before closing, nor any meaningful opportunity to do so. GMAC Mortgage also knew that the industry practice was for a 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, rather than to carry out a loan-by-loan review of thousands or tens of thousands of loan origination files.

(Compl. ¶ 104; *see also id.* at ¶ 85). This admission is fatal to, and indeed, dispositive of MBIA's fraud claim.

First, MBIA did, in fact, possess a contractual right to review loan origination files before the closing, and its allegation to the contrary is *flatly contradicted* by the parties' Insurance Agreement. Specifically, section 3.01(m) of the Insurance Agreement provided as follows:

The Insurer shall have received such other documents, instruments, approvals or opinions requested by the Insurer or its counsel as may be reasonably necessary to effect the Transaction, **including, but not limited to, evidence satisfactory to the Insurer and its counsel that the conditions precedent, if any, in the Transaction Documents have been satisfied.**

(Aff., Ex. 2) (emphasis added). In other words, MBIA had a contractual right to review loan origination files, but simply chose not to do so, thereby assuming the risk of the consequences that would flow from that conscious abrogation of its duty to check the quality of the collateral underlying the investment it was guaranteeing. MBIA allegation to the contrary is demonstrably false and its fraud claim should be dismissed as a matter of law. *See DDJ Mgmt, LLC v. Rhone*

Group, LLC, 60 AD3d 421, 424 (1st Dept 2009) (dismissing fraud claim where plaintiff had contractual right to conduct due diligence but failed to do so).

Second, MBIA admits in its Complaint that standard due diligence in the industry involves a sample review of individual loan files:

Underwriters – typically investment banks responsible for selling the mortgage-backed securities—also provide potential insurers with due diligence performed by a third-party accounting or underwriting firm on a sample of the loans in the pool. The due diligence is intended to assess whether the characteristics of the sampled loans, and the underwriting used to originate them, conform to the sponsor’s disclosures and representations.

(Compl. ¶ 30). Yet, remarkably, MBIA fails to allege anywhere in its Complaint that it even bothered to have this industry standard due diligence performed by anyone, whether itself or a third-party. In short, MBIA failed to perform the most fundamental due diligence – a sampling of individual loan files – which it admits is customary within the industry.

Lastly, it simply is not plausible as a matter of law for MBIA to attempt to excuse its failure to conduct due diligence by arguing that it did not have a “meaningful opportunity” to review loan files; that it trusted GMAC Mortgage, or that it was simply following industry practices. There are no such exceptions to a sophisticated entity’s affirmative duty to conduct due diligence, and courts have rejected such excuses before. *See, e.g., Giannacopoulos v. Credit Suisse*, 37 F.Supp. 2d 626, 633 (S.D. N.Y. 1999) (rejecting sophisticated investor’s assertion that it was “customary” to trust and rely on representations from a “major financial institution”). If MBIA felt that it did not have adequate time or opportunity to review the Transactions, it was free to walk away from them. *DDJ Mgmt, LLC v. Rhone Group, LLC*, 60 AD3d 421, 424 (1st Dept 2009) (even in the absence of a contractual right to conduct due diligence, “plaintiffs could have insisted on the right to review the books and records prior to making the loan”).

Rather than walking away from the entire transaction or delaying the closing while it took the time necessary to complete essential due diligence, MBIA chose to proceed with insuring multi-billion dollar transactions. The common sense explanation for MBIA's behavior is that it knowingly chose to accept the risk of not conducting any due diligence at all. One court has succinctly described the situation that MBIA now finds itself in:

Custom is not always the legal standard of when the law protects reliance, however, in part because many customs envision some amount of risk and unprotected trust. We often rely on those we trust without question, recognizing that the trust leaves us vulnerable; we often act on insufficient information to seize fleeting opportunities that are worth the risk. Trust and risk entail vulnerability, even though they are customary practices; it is not always the custom to double-check everybody and everything. The custom of unprotected trust surely exists in this financial community just as it exists in everyday life. The standard for legal protection of reliance, however, is higher. Parties cannot demand judicial protection when they could have protected themselves with a reasonable inquiry into any misrepresented facts.

Giannacopoulos v. Credit Suisse, 37 F.Supp. 2d 626, 633 (S.D.N.Y. 1999). MBIA cannot claim justifiable reliance on the loan tapes and schedules, when it failed to take adequate steps to review their accuracy. MBIA's fraud claim should be dismissed as a matter of law.

C. As A Matter Of Law, MBIA Did Not Justifiably Rely On The Prospectus Supplements.

MBIA also alleges that it was fraudulently induced based on purported misrepresentations in the Prospectus Supplements for the Transactions. (Compl. ¶¶ 47-53). Generally, MBIA contends that the Prospectus Supplements provided that "all mortgage loans contributed to the pools had been underwritten generally in compliance with GMAC Mortgage's underwriting standards." (Compl. ¶ 53). MBIA alleges that GMAC Mortgage must have committed fraud because MBIA purportedly has now discovered that many of the loans, in fact, did not comply with GMAC Mortgage's underwriting standards. (Compl. ¶¶ 75-77).

Once again, a review of the actual disclosures in the Prospectus Supplements flatly contradicts MBIA's claims. The Prospectus Supplement in the 2004 Transaction, for example, provides the following representations regarding GMAC Mortgage's underwriting standards:

- "There can be no assurance that every mortgage loan was originated in conformity with the applicable underwriting standards in all material respects, or that the quality or performance of the mortgage loans will be equivalent under all circumstances." Prosp. Supp. at S-46 (Aff., Ex. 3);
- "GMACM's underwriting standards include a set of specific criteria pursuant to which the underwriting evaluation is made. However the application of those underwriting standards does not imply that each specific criterion was satisfied individually. Rather, a mortgage loan will be considered to be originated in accordance with a given set of underwriting standards, even if one or more specific criteria included in the underwriting standards were not satisfied[.]" (*Id.*);
- "Conformity with the applicable underwriting standards will vary depending on a number of factors relating to the specific mortgage loan" (*Id.*);
- "The underwriting standards set forth in the GMACM underwriting guidelines with respect to mortgage loans originated under the GMACM Home Equity Program may be varied in appropriate cases." Prosp. Supp. at S-46 (Aff. Ex. 3).

These disclosures fatally undercut, and flatly contradict, MBIA's contention that the failure of specific loans to meet particular underwriting criteria somehow renders the Prospectus Supplement fraudulent. To the contrary, the Prospectus Supplement expressly discloses that not every loan "was originated in conformity with the applicable underwriting standards in all material respects." This flat contradiction of MBIA's allegations regarding the Prospectus Supplements warrants dismissal of this aspect of its fraud claim, and dispels any notion that it justifiably relied on some purported representation to the contrary.

Furthermore, MBIA admits in the Complaint that it does not even have "complete versions" of GMAC Mortgage's "Underwriting Guidelines." (Compl. ¶ 73). In other words, prior to closing, MBIA did not bother to obtain complete copies of the underwriting standards

applicable to the mortgage pools it was insuring. There is no justifiable reliance, where, as here, a sophisticated entity simply fails to ask for copies of the documents necessary to verify the accuracy of representations made to it. *See DDJ Mgmt, LLC* at 424; *Valassis Communications* at 449; *Dragon Inv. Co.* at 404.

Lastly, MBIA alleges in the Complaint that, in 2009, it belatedly began “examining loan files” and purportedly has now determined that “89% of the 4,104 delinquent or charged-off loans” it reviewed “were not originated in material compliance” with GMAC Mortgage’s underwriting standards. (Compl. ¶ 6). This allegation – accepting it as true for purposes of this motion only – confirms that MBIA could have discovered the purported inaccuracies in GMAC Mortgages’ representations had it bothered to conduct due diligence when it mattered – before the closing of the Transactions. Having failed to do so, MBIA as a matter of law cannot now claim justifiable reliance on GMAC Mortgage’s representations regarding its underwriting standards. *Dragon Inv. Co.* at 404 (affirming dismissal of fraud claim where plaintiff “made no inquiry until . . . a year after the alleged misrepresentations”). MBIA’s fraud allegations regarding the Prospectus Supplements should be dismissed as a matter of law.

D. As A Matter Of Law, MBIA Did Not Justifiably Rely On The Ratings.

MBIA alleges that it was also fraudulently induced based on faulty ratings from ratings agencies. (Compl. ¶ 54). MBIA alleges that these ratings were faulty because they were based on the “same loan tapes GMAC Mortgage provided to MBIA[.]” (*Id.*) As already discussed, MBIA failed to conduct due diligence with respect to those loan tapes, and accordingly, MBIA cannot claim that it justifiably relied on the ratings either.

The Prospectus Supplements also cautioned against reliance on the ratings. *See* Prosp. Supp. at S-113 (“A securities rating is not a recommendation to buy, sell, or hold securities and

may be subject to revision or withdrawal at any time”) (Aff., Ex. 3). Even without this disclosure, sophisticated entities such as MBIA undoubtedly were already aware of the limited scope of the ratings’ agencies ratings. In any event, the disclosures in the Prospectus Supplements make it clear that MBIA could not have justifiably relied on such ratings without conducting due diligence of its own. *See DDJ Mgmt, LLC* at 424. MBIA’s fraud allegations regarding ratings should be dismissed as a matter of law.⁵

II. MBIA’s Second Cause Of Action For Negligent Misrepresentation Should Be Dismissed As A Matter Of Law.

A. MBIA Has Failed To, And Cannot, Allege A “Special Relationship” Which Would Support Its Negligent Misrepresentation Claim.

In its Second Cause Of Action, MBIA asserts a claim for negligent misrepresentation based on the purported “special relationship” between it and GMAC Mortgage. On three separate occasions -- once in MBIA’s “Recovery Litigation” lawsuit against Residential Funding Company (“RFC”) and twice in its “Recovery Litigation” lawsuit against Countrywide -- this Court has dismissed virtually identical claims made by MBIA. *See December 22, 2009 RFC Decision* at 9-11 (Aff., Ex. 13); *July 8, 2009 Countrywide Decision* at 15-16 (Aff., Ex. 10); *April 27, 2010 Countrywide Decision* at 6-10 (Aff., Ex. 11). The Court should do so here as well.

⁵ This Court also addressed fraud claims in both the Residential Funding Company (“RFC”) and the Countrywide matters. Although this Court sustained the fraud claim in *RFC*, the issue of justifiable reliance was not addressed by the Court. *See December 22, 2009 RFC Decision* (Aff., Ex. 13). Similarly, in *Countrywide*, the Court did not specifically address the arguments presented here regarding, for example, MBIA’s contractual right to conduct due diligence. *See July 8, 2009 Countrywide Decision* (Aff., Ex. 10). To the extent this Court’s *July 8, 2009 Countrywide* decision addressed justifiable reliance, the case cited by the Court does not apply here. Specifically, the Court cited to *P.T. Bank Cent. Asia v. ABN AMRO Bank N.V.*, 301 AD2d 373, 378 (1st Dept 2003). *See July 8, 2009 Countrywide Decision* at 12. In *P.T. Bank*, the court held that plaintiff’s allegations invoked the “special facts” doctrine, under which “a duty to disclose arises ‘where one party’s superior knowledge of essential facts renders a transaction without disclosure inherently unfair[.]’” *Id.* Here, MBIA has not adequately alleged any superior knowledge on the part of GMAC Mortgage that would give rise to any duty outside of the parties’ contracts. MBIA is a sophisticated entity with extensive knowledge and experience with the securitization of mortgage-backed assets, and had a contractual right to obtain whatever documents it deemed necessary from GMAC Mortgage.

“In order to state a claim for negligent misrepresentation, MBIA must plead facts showing a special relationship of trust and confidence between the parties, which created a duty on the part of [defendant] to impart corrected information about the mortgage loans to MBIA, and that MBIA reasonably relied on incorrect information about the mortgage loans to its detriment.” *December 22, 2009 RFC Decision* at 9; *Hudson River Club v. Consolidated Edison Co. of New York*, 275 AD2d 218, 220 (1st Dept 2000)).

Here, as in *RFC* and *Countrywide*, MBIA has failed to allege facts which would give rise to a “special relationship of trust and confidence.” MBIA alleges only that it “relied on the unique and special knowledge and expertise of GMAC Mortgage regarding the mortgage loans” and that it had a “longstanding relationship” with GMAC Mortgage based on “eight prior GMAC Mortgage-sponsored securitizations[.]” (Compl. ¶¶ 55-56). These general and conclusory allegations are not sufficient to establish a special relationship.

First, as this Court recognized, “the requisite ‘special relationship’ does not exist between sophisticated commercial entities that enter into an agreement through an arm’s length business transaction.” *December 22, 2009 RFC Decision* at 9; *see also July 8, 2009 Countrywide Decision* at 6, 8 (same). This is true regardless of the length of the parties’ business relationship or the number of transactions involved. In *Countrywide*, for example, MBIA alleged that it had provided insurance for 17 Countrywide securitizations from 2002 through 2007. *April 27, 2010 Countrywide Decision* at 3. This Court nonetheless concluded that no special relationship existed. *Id.* at 6-10; *see also Huntington Dental & Medical Co. v. 3M*, 1996 U.S. Dist. LEXIS 13350, 10-11 (S.D.N.Y. Sept. 11, 1996) (a fifteen year course of dealing between the parties did not create a special relationship; dismissing negligent misrepresentation claim); *Village On Canon v. Bankers Trust Co.*, 920 F. Supp. 520, 531-532 (S.D.N.Y. 1996) (“a long-standing

financial advisory relationship” between the parties did not give rise to a special relationship; dismissing negligent misrepresentation claim); *United Guaranty Mortgage Indemnity Co. v. Countrywide Financial Corp.*, 660 F.Supp.2d 1163, 1187 (CD Cal. 2009) (40 year business relationship did not give rise to “special relationship”).

Second, “a defendant’s knowledge of ‘the particulars’ of its own business does not constitute the type of ‘specialized knowledge’ that is required.” *April 27, 2010 Countrywide Decision* at 8; *December 22, 2009 RFC Decision* at 11 (same). Rather, MBIA must show that it was a “person wholly without knowledge seeking assurances from one with exclusive knowledge”. *See Heard v. City of New York*, 82 NY2d 66, 75 (1993). If the rule were otherwise, a “special relationship” would exist in virtually every transaction where an insurer such as MBIA agreed to provide insurance. *See JP Morgan Chase Bank v. Winnick*, 350 F. Supp. 2d 393, 402 (S.D. N.Y. 2004) (“every bank would have a claim against every borrower who failed to exercise due care in the context of commercial bank loans”). MBIA – one of the world’s largest and most sophisticated monoline insurers – does not allege, nor could it, that it was “wholly without knowledge” of the transactions at issue in this lawsuit.

Lastly, as noted, this Court has repeatedly dismissed virtually identical claims by MBIA in *RFC* and *Countrywide*. MBIA has not made any materially different allegations in this lawsuit that would alter the outcome here. For the same reasons as in *RFC* and *Countrywide*, the Court should also dismiss MBIA’s negligent misrepresentation claim against GMAC Mortgage.

B. The Martin Act Preempts MBIA’s Negligent Misrepresentation Claim.

New York’s Martin Act prohibits the use of any misrepresentations “to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities[.]” *N.Y. Gen. Bus. Law § 352-c(1)*; *Ashland Inc. v.*

Stanley & Co., Inc., 2010 U.S. Dist. LEXIS 31231 (S.D.N.Y. March 30, 2010). No private right of action exists under the Martin Act – it can only be enforced by the New York State Attorney General. *Ambac Assurance UK Limited v. J.P. Morgan Investment Management, Inc.*, 2010 N.Y. Misc. LEXIS 1004, *16 (Sup. Ct. N.Y. County March 24, 2010). As a result, the “Martin Act preempts negligent misrepresentation claims where the claim is “predicated on the purchase or sale of securities within or from New York[.]” *Ashland* at *46-48; *Ambac* at*15-19; *see also Horn v. 440 East 57th Co.*, 151 A.D.2d 112, 119 (1st Dept. 1989). Allegations regarding venue are sufficient to establish that the relevant conduct occurred in New York. *Ashland* at *48. Here, MBIA alleges venue in New York is appropriate because “GMAC Mortgage participated in negotiations and other activities within the State which led to the transactions that give rise to the claims in the complaint, and the transactions themselves occurred within the State.” (Compl. ¶ 15). The “within or from New York” requirement is clearly met.

MBIA’s claims also relate to purported misrepresentations by GMAC Mortgage designed to promote the sale of securities. MBIA alleges that “GMAC Mortgage misrepresented existing materials facts with respect to the Transactions” (Compl. ¶ 114) and that MBIA’s financial guaranty insurance “enhanced the ability of GMAC Mortgage . . . to market the securities in each Transaction as AAA[.]” (Compl. ¶ 57). MBIA admits the purpose of financial guaranty insurance is “to make the securitization more attractive to investors[.]” (Compl. ¶ 26). In sum, MBIA’s negligent misrepresentation claim falls within the scope of the Martin Act, and is therefore preempted.

III. MBIA's Good Faith And Fair Dealing Claim Is Duplicative Of Its Other Claims And Should Be Dismissed.

In its Sixth Cause of Action, MBIA asserts that GMAC Mortgage breached an implied duty of good faith and fair dealing. While New York law implies a duty of good faith and fair dealing in contracts, courts routinely dismiss good faith and fair dealing claims that are duplicative of a plaintiff's other breach of contract claims. *See, e.g., New York Univ. v. Continental Ins. Co.*, 87 NY2d 308, 319-320 (1995) ("claim based on the alleged breach of the implied covenant of good faith and fair dealing . . . is duplicative of the first cause of action for breach of contract and should have been dismissed"); *R.I. Island House LLC v. North Town Phase II Houses, Inc.*, 51 AD3d 890, 896 (2d Dept 2008) (same). In particular, a good faith and fair dealing claim is considered redundant "if it merely pleads that the defendant did not act in good faith in performing its contractual obligations[.]" *December 22, 2009 RFC Decision* at 12.

Here, MBIA's good faith and fair dealing allegations are simply duplicative of its other breach of contract claims in the Complaint. MBIA alleges that GMAC Mortgage breached the implied duty of good faith and fair dealing by "contributing mortgage loans to the pools" that did not meet "GMAC Mortgage's underwriting standards" (Compl. ¶ 157); by "failing in good faith to employ loan servicing procedures consistent with servicing industry standards" (Compl. ¶ 158); and by failing to provide MBIA with access to information reasonably requested by MBIA, such as the complete versions of the GMAC Mortgage Underwriting Guidelines" (Compl. ¶ 159). Yet, MBIA makes these very same allegations in its Third and Fourth Causes of Action for breach of contract. *See* Compl. ¶¶ 125-128, 137-139. All MBIA has done in its good faith and fair dealing claim is add the assertion that the very same alleged breaches were in bad faith.

In *RFC*, this Court rejected MBIA's similar efforts to dress up its good faith and fair dealing claim. *December 22, 2009 RFC Decision* at 13-14 ("It appears that all MBIA has done is pick out clauses of the parties' written agreements that it feels RFC did not comply with and adding that RFC's non-performance was in 'bad faith'"). Accordingly, as in *RFC*, this Court should likewise dismiss MBIA's good faith and fair dealing claim as a matter of law.

Lastly, a good faith and fair dealing claim "cannot be used to seek damages or remedies not recoverable under the parties' written agreement." *RFC Decision* at 12. Here, MBIA requests "damages including . . . all losses incurred by MBIA whether or not such losses relate directly to non-compliant mortgage loans." (Compl. ¶ 162). MBIA does not point to any remedy provided in the parties' contracts which would permit it to recover "all losses" incurred by MBIA whatsoever. In fact, there are specific remedy provisions in the parties' Insurance Agreement. *See* Insurance Agreement §§ 3.03, 3.04, 3.05A, 5.01, 5.02 (Aff., Ex. 2). None of those provisions give MBIA the right to recover "all losses" irrespective of how or why they were incurred. (*See id.*). MBIA cannot seek an extraordinary remedy not provided for in the parties' written agreements. Its Sixth Cause of Action should be dismissed as a matter of law.

IV. MBIA's Improper Requests For Relief Should Be Dismissed.

A. MBIA Is Not Entitled To A Declaratory Judgment.

MBIA requests a "declaratory judgment" in its Third Cause of Action (Compl. ¶ 133), in its Fifth Cause of Action (Compl. ¶ 152), and in its Prayer for Relief (¶¶ b & c). "A cause of action for a declaratory judgment is unnecessary and inappropriate when the plaintiff has an adequate, alternative remedy in another form of action, such as breach of contract." *Apple Records, Inc. v. Capitol Records, Inc.*, 137 A.D.2d 50, 54 (1st Dept 1988); *see also Artech Info. Sys., L.L.C. v. Tee*, 280 A.D.2d 117, 125 (1st Dept 2001) (dismissing declaratory judgment

action where breach of contract claim afforded plaintiff with adequate remedy); *Niagara Falls Water Board v. City of Niagara Falls*, 64 A.D.3d 1142, 1144 (4th Dept 2009) (same). MBIA does not allege that it has no adequate, alternative remedy, and accordingly, its requests for a “declaratory judgment” are improper and should be dismissed as a matter of law.

B. MBIA Is Not Entitled To Rescissionary Damages.

In its Third Cause of Action for breach of contract, MBIA alleges that, but for GMAC Mortgage’s alleged misrepresentations, “MBIA would not have entered into the Insurance Agreements.” (Compl. ¶ 127). Based on this contention, MBIA wants GMAC Mortgage to “reimburse” it not only for damages resulting directly from the purported breach of contract, but for “all claims payments made to date and all future claims payments under the Policies[.]” (Compl. ¶ 133). MBIA makes similar claims for reimbursement of “all payments” in its Fifth Cause of Action for breach of contract (Compl. ¶ 152) and in its Prayer for Relief (¶ a.i.).

In other words, MBIA is not simply seeking damages arising from the purported breach of contract. Instead, MBIA wants to be restored to its position prior to entering into the Insurance Agreements, *i.e.*, rescission of the contracts. *See Empire 33rd LLC v. The Forward Ass’n Inc.*, 2010 N.Y. Misc. LEXIS 652 at *5 (Sup. Ct. N.Y. County April 1, 2010) (Fried, J.) (looking to substance of allegations, rather than labels, when construing plaintiff’s claim). Rescission is an equitable remedy that can only apply “when there is lacking complete and adequate remedy at law and where the *status quo* may be substantially restored.” *Adrian Family Partners I, L.P. v. Exxon Mobil Corp.*, 61 A.D.3d 901, 903 (2d Dept 2009); *see also MBIA Ins. Corp. v. Merrill Lynch, Pierce, Fenner & Smith Inc.*, Index No. 601324/09E (Sup. Ct. N.Y. County April 7, 2010) (Fried, J.) (Aff., Ex.12) (dismissing request for rescission).

Here, MBIA has not alleged that it lacks an adequate remedy at law. Furthermore, it has not alleged that the status quo could be substantially restored. Indeed, it is difficult to see how it would be possible to unwind the complex transactions, involving multiple parties, which form the basis of this lawsuit. The reality is that they cannot be unwound. Accordingly, MBIA's request for rescissionary "damages" should be dismissed as a matter of law.

C. MBIA Is Not Entitled To Consequential Damages.

In its Prayer for Relief, MBIA requests "compensatory and consequential losses, including lost profits and business opportunities[.]" (Prayer ¶ a.ii.). Consequential damages are only permissible where intended by the parties. *See Kenford Co., Inc. v. County of Erie*, 67 N.Y.2d 257, 261, 502 N.Y.S.2d 131, 132 (1986) (consequential damages must have been "fairly within the contemplation of the parties to the contract at the time it was made"). Here, the parties' Insurance Agreements contain lengthy reimbursement, indemnification and damages provisions, -- but do not provide for the recovery of lost profits, business opportunities or any other such consequential damages anywhere in the lengthy agreements. *See* Insurance Agreement §§ 3.03, 3.04, 3.05A, 5.01, 5.02 (Aff., Ex. 2). Accordingly, MBIA's request for consequential damages should be dismissed as a matter of law.

D. MBIA Is Not Entitled To Punitive Damages.

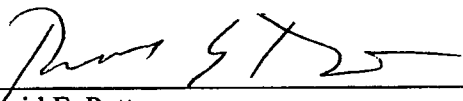
MBIA also requests punitive damages in its Prayer for Relief. (Compl., Prayer ¶ a.iv.). Plaintiff's fraud claim fails as a matter of law as discussed above, and therefore cannot provide the basis for punitive damages. Furthermore, MBIA may not recover punitive damages on its breach of contract claims. *Rocanova v. Equitable Life Assurance Soc'y of the U.S.*, 83 N.Y.2d 603, 613, 612 N.Y.S.2d 339, 342 (1994). Accordingly, there is no basis for punitive damages, and MBIA's request for such damages should be dismissed.

CONCLUSION

For the foregoing reasons, defendant GMAC Mortgage, LLC respectfully requests the Court to grant this motion to dismiss, and to enter an order: (1) dismissing the First, Second and Sixth Causes of Action in their entirety with prejudice; (2) dismissing MBIA's request for declaratory judgment in its Third Cause of Action (Compl. ¶ 133), in its Fifth Cause of Action (Compl. ¶ 152), and in its Prayer for Relief (¶¶ b & c); (3) dismissing MBIA's request for rescissionary damages in its Third Cause of Action (Compl. ¶ 133), in its Fifth Cause of Action (Compl. ¶ 152), and in its Prayer for Relief (¶ a.i.); (4) dismissing MBIA's request for "compensatory and consequential losses, including lost profits and business opportunities" in its Prayer for Relief (Prayer ¶ a.ii.); and (5) dismissing MBIA's request for punitive damages in its Prayer for Relief (Prayer ¶ a.iv.).

Dated: New York, New York
June 4, 2010

Respectfully submitted,



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