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

MBIA INSURANCE CORPORATION, Plaintiff, - against - CREDIT SUISSE SECURITIES (USA) LLC, DLJ MORTGAGE CAPITAL, INC., and SELECT PORTFOLIO SERVICING, INC. Defendants.	Index No. 603751/09

PLAINTIFF MBIA INSURANCE CORPORATION'S REPLY MEMORANDUM OF LAW IN FURTHER SUPPORT OF ITS MOTION TO RENEW

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MBIA submits this reply memorandum of law in further support of its motion for leave to renew in connection with the Court's June 1, 2011 Order.

PRELIMINARY STATEMENT

Credit Suisse offers no valid opposition to MBIA's narrowly-framed motion for leave to renew. Credit Suisse concedes, as it must, that the First Department's recent decision in *Countrywide*[1] establishes that MBIA's core fraud allegations – based on misrepresentations encompassed and affirmed by contractual warranties (the "Core Misrepresentations") – should not have been dismissed as duplicative of MBIA's contract claims. The resolution of this motion therefore is simple: With the exclusive basis relied upon by this Court for setting aside the Core Misrepresentations superseded by controlling law, MBIA's fraud claim should be reinstated.[2]

Without a viable rejoinder, Credit Suisse resorts to mischaracterization of this Court's June 2011 Order and MBIA's allegations. Credit Suisse misleadingly states that, with respect to the Core Misrepresentations, "duplication was [not] the only ground for the fraud dismissal ... The other two equally important grounds were (i) puffery; and (ii) lack of justifiable reliance..." (Def. Br., Docket No. 154, at 2.) While it is true that the Court dismissed ***other*** MBIA allegations based upon puffery and lack of justifiable reliance, it is false and misleading to suggest that puffery or justifiable reliance played any role in dismissing the Core Misrepresentations.

Contrary to Credit Suisse's attempted obfuscation, the Court's June 2011 Order is clear as to the allegations addressed and the rulings rendered. The Court divided MBIA's

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[1] *MBIA v.Countrywide*, Index No. 602825/08, N.Y. Slip Op. 05640 (1st Dep't June 30, 2011) ("*Countrywide*") (*see* Pl. Br., Docket No. 152, Attachment 3).

[2] MBIA's subordinate request for reinstatement of its jury and fraud damages demands necessarily results from reinstatement of the fraud claim, as this Court held in its January 26, 2011 Order. (*See* Docket No. 74.)

allegations into three categories that it addressed seriatim, only the second of which is relevant to this motion.

First, the Court summarily dismissed as "puffery" MBIA's allegation that Credit Suisse misrepresented its "pedigree and HEMT shelf track record (June 2011 Order, Docket No. 129, at 17-18)," *i.e.*, "the specific financial performance of Credit Suisse's prior HEMT deals, which purportedly were structured similarly to the Transaction," and "the steps it had taken to ensure improved performance in the future." (Compl. ¶ 27.) MBIA respectfully disagrees with the Court's conclusion (and agrees with the Court's prior ruling on this issue from July 2010), and therefore has appealed the issue to the First Department. MBIA did not raise this holding in its motion to renew because *Countrywide* establishes that the fraud claim should be reinstated on the legal sufficiency of the Core Misrepresentations alone. But with Credit Suisse having raised this issue, it warrants noting that new authority has since confirmed the viability of MBIA's allegations. That is, Credit Suisse recently has been fined by its regulator, the Financial Industry Regulatory Authority ("FINRA"), for misrepresentations concerning the performance of its prior mortgage securitizations. According to FINRA, Credit Suisse's misrepresentations concerning its track record are materially misleading – and not mere puffery. This is precisely what MBIA alleged, and it is an actionable allegation of fraud under prevailing law.

Second, the Court identified the Core Misrepresentations, which independently sustain MBIA's fraud claims and are the only allegations raised by MBIA's motion and properly considered on this motion to renew. As the Court recited (June 2011 Order at 19-20), the Core Misrepresentations concern, *inter alia*, (i) the ***attributes*** of the securitized loans (detailed by Credit Suisse on the "loan tape"), (ii) the securitized loans' compliance with the ***actual*** originator and purportedly ***prudent*** underwriting guidelines (which Credit Suisse conveyed to MBIA before

closing), and (iii) Credit Suisse's ***operations***, and purported implementation of quality assurance protocols to ferret out and repurchase defective loans (*e.g.*, protocols disclosed by Credit Suisse in presentations and its offering documents). (*Id.* at 7, 20.) Having correctly concluded that the Core Misrepresentations were encompassed by contractual warranties, the Court correctly ***rejected***, for the second time, Credit Suisse's argument that MBIA could not have justifiably relied upon these representations. But the Court then dismissed MBIA's fraud claim as based on these allegations ***solely as duplicative of the breach of contract claim***, *i.e.*, holding that MBIA was constrained to seek recourse for those misrepresentations of present facts on a breach of contract theory. It is this holding that the First Department rejected in *Countrywide* when addressing virtually identical allegations, and which is the subject of MBIA's motion for leave to renew. Notwithstanding Credit Suisse's half-hearted and unpersuasive efforts to distinguish the decision, *Countrywide* requires the reinstatement of MBIA's fraud claim.

Third, the Court identified a final category of allegations that it characterized as "extra-contractual" representations, *i.e.*, those that the Court found were ***not*** later affirmed by contractual warranty. (*See* June 2011 Order at 21-23.) The Court read MBIA's complaint to allege that one of Credit Suisse's representations, i.e., that the securitized loans adhered to "strict" underwriting guidelines, imposed a higher standard than adherence to the actual guidelines purportedly applied. Moreover, the Court characterized MBIA's allegations that Credit Suisse misrepresented the adequacy and results of the loan level "due diligence" Credit Suisse purportedly performed on the securitized loans as only relevant to Credit Suisse's purported adherence to the "strict" guidelines. The Court then dismissed these (and only these) allegations for lack of justifiable reliance. That is, the Court concluded that MBIA had "notice of contrary facts" from the Prospectus disclosures and thus could not have "justifiably relied"

upon Credit Suisse's representations concerning adherence to "strict" guidelines. MBIA respectfully disagrees with the Court's reading of the allegations, and therefore, its conclusion. But as with the allegations deemed "puffery," this third category of allegations are neither required to sustain the fraudulent inducement claim nor were they the subject of MBIA's motion. Credit Suisse's attempt to transpose the Court's ruling relating to MBIA's justifiable reliance on these allegations to the Core Misrepresentations is inaccurate and improper. The Court already rejected this argument with respect to the Core Misrepresentations.

In the final analysis, Credit Suisse seeks to derail the case by misrepresenting the Court's prior rulings, confusing MBIA's allegations, and transforming MBIA's motion for leave to renew on a single, narrow issue into a plenary reargument of issues already decided by the Court. This motion, however, raises but one legal issue: ***For those allegations of fraudulent representations dismissed solely as duplicative of MBIA's breach of contract claim, does Countrywide require reinstatement?*** Clearly it does.

REPLY ARGUMENT

I. Credit Suisse Fails to Refute That the Core Misrepresentations Sustain MBIA's Fraudulent Inducement Claim

Credit Suisse strains to find an alternate basis for dismissing MBIA's claim of fraudulent inducement based upon the Core Misrepresentations, now that the justification of duplication has been removed by *Countrywide*. Unable to legitimately distinguish *Countrywide*, because the relevant allegations in the two cases are virtually identical, Credit Suisse resurrects its tired justifiable reliance argument, which has twice been rejected by the Court. Credit Suisse cites no new authority and provides no new argument for why the Court should not – for a third time – reject Credit Suisse's arguments in this regard.

A. Credit Suisse Concedes that *Countrywide* Establishes That The Fraudulent Inducement Claim Should Not Have Been Dismissed as "Duplicative"

There simply is no genuine dispute that the Court dismissed MBIA's claim for fraudulent inducement, as stated upon the Core Misrepresentations, ***solely*** on the basis that it "duplicate[s] the second cause of action for breach of contractual representations and warranties . . ." (*Id.* at 19.) This conclusion is plainly inconsistent with *Countrywide*, in which the First Department held that "[a] fraud claim will be upheld when a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, even though the same circumstances also give rise to the plaintiff's breach of contract claim." *Countrywide* at 9, citing *First Bank of Ams. v. Motor Car Funding*, 257 A.D.2d 287, 291-92 (1st Dep't 1999). "It is of no consequence that some of the allegedly false representations are also contained in the agreements as warranties and form a basis of the breach of contract claim." *Countrywide* at 11. Faced with that clear and controlling precedent, ***Credit Suisse does not (and cannot) argue that dismissal based upon duplication should be upheld***. Instead, Credit Suisse's entire opposition is targeted at manufacturing an alternate basis for dismissal.

B. Credit Suisse Does Not and Cannot Validly Distinguish *Countrywide*

To establish an alternate basis for dismissal, Credit Suisse first must (but cannot) distinguish *Countrywide*. As MBIA explained in its opening brief (at 10), this Court and the First Department addressed virtually identical allegations:

***MBIA v. Credit Suisse*:**	***MBIA v. Countrywide*:**
MBIA alleges it "...was fraudulently induced because the loans did not conform to the originators' ***underwriting guidelines***; that the loans purchased from originating banks, other than New Century, did not conform to Credit Suisse's Designated Guidelines; that the information on the ***loan tape was inaccurate***; that the Prospectus and ProSupp ***did not***	MBIA alleges "...false and misleading ***loan tapes and prospectuses***. The fraud claim also lists 4,689 loans that allegedly failed to comply with Countrywide's ***underwriting guidelines***, specifies that the defective loans had ***debt-to-income ratios or combined loan-to-value ratios*** exceeding maximum guideline levels and alleges that the loans were approved on the

adequately disclose information about the loans; and that Credit Suisse would back or vouch for the New Century loans by providing express contractual representations and warranties… Other allegations allegedly constituting fraud … include: qualifying buyers who made ***false statements on loan applications***, and ***stated income that was not subjected to a reasonableness test.***" (June 2011 Order at 19 (emphasis added).)	basis of ***unverified borrower-stated income that was patently unreasonable.***" *Countrywide* at 12 (emphasis added)

Each of the purported distinctions asserted by Credit Suisse between this case and *Countrywide* is illusory and irrelevant. First, Credit Suisse asserts that *Countrywide* is distinguishable because Countrywide did not provide MBIA with investor risk disclosures. (Def. Mem. at 10.) That statement is false. The First Department expressly noted that, like Credit Suisse here, Countrywide "gave MBIA prospectuses for the securities MBIA was going to insure."[3] (*Countrywide* at 7.) More to the point, Credit Suisse's argument is a red herring. After detailed and full consideration of the ProSupp disclosures in this matter, this Court has twice ***rejected*** as "foreclosed by *DDJ*"[4] Credit Suisse's argument that the investor disclosures bar MBIA's justifiable reliance upon the Core Misrepresentations. (June 2011 Order at 18; July 2010 Order, Docket No. 40, at 10-13.) In other words, even if this *were* a distinction between the two cases (it is not), it would be irrelevant in light of this Court's prior rulings.

Second, Credit Suisse contends that in this case, as distinguished from *Countrywide*, MBIA admits that it "failed to conduct any investigation in the face of these disclosures." (Def. Mem. at 11.) This, too, is false. The essence of MBIA's claim in both cases is that as part of the due diligence it ***did*** conduct, MBIA demanded, obtained, and relied upon

[3] In truth, the ProSupp disclosures in the transactions at issue in *Countrywide* were vast, spanning many years, well into 2007, and address the same risks as set forth in the Credit Suisse ProSupp.

[4] *DDJ Mgt. LLC v. Rhone Group, LLC*, 15 N.Y.3d 147 (2010).

pre-contractual representations that were subsequently affirmed by contractual warranties. Moreover, this purported distinction is irrelevant, as well. As noted above, the Court already considered and rejected the argument that MBIA did not adequately protect itself by obtaining contractual warranties concerning the Core Misrepresentations: "[D]efendants' argument that, as a matter of law, MBIA was not justified in relying on defendants' contractual representations and warranties, instead of doing its own due diligence, is foreclosed by the Court of Appeals decision in [*DDJ*]." (June 2011 Order at 18.)

Finally, Credit Suisse asserts that "[n]o party in this case is subject to MBIA's fraud and contract claims." (Def. Mem. at 10.) But CS Securities, against which MBIA asserts its fraud claim here, is situated in precisely the same position as Countrywide Securities in *Countrywide,* and for that matter, defendants Rhone and Quilvest in *DDJ.* In each of these cases, one or more defendant is alleged to have made fraudulent misrepresentations, while a different defendant provided the contractual warranties (Countrywide Home in *Countrywide* and ARI in *DDJ*). *See Countrywide* at 4, 6; *DDJ*, 15 N.Y.3d at 151 and 153. Credit Suisse's final attempt to distinguish instead highlights the commonality between this action, *Countrywide*, and *DDJ.*

The truth is that the core allegations and legal theories underlying this case and *Countrywide* (and the many other insurer-brought RMBS securitization fraud cases progressing through the courts) are the same: MBIA claims it was fraudulently induced to issue a financial guaranty by the underwriter of a securitization, which provided false and misleading information about its business practices and the loans in the securitization. Those misrepresentations were also the subject of contractual warranties from the sponsor. Accordingly, MBIA's claim should be upheld against Credit Suisse as it was by the First Department against Countrywide.

C. Credit Suisse Improperly Seeks to Reargue the Court's Correct and Repeated Holding That Justifiable Reliance is Adequately Pleaded Under *DDJ*

Without presenting any new authority or facts, Credit Suisse asks this Court to revisit and reverse its prior rulings that, under *DDJ*, MBIA properly pleaded justifiable reliance as to the Core Misrepresentations. This issue is not properly before the Court on a motion to renew. *See* CPLR R 2221(e) (requiring party to show "new facts" or "change in the law" that would change prior determination). Credit Suisse simply seeks to transform MBIA's narrow and properly framed motion to renew into a motion to reargue, which Credit Suisse did not make, or an appeal of the ruling, which it did not take.

This Court has ***twice*** correctly held that *DDJ* "forecloses" Credit Suisse's argument. In its July 2010 Order, this Court examined in detail the application of the Court of Appeals' decision to the allegations, disclosures and warranties in this case. (*See* July 2010 Order at 10-13.) And after another exhaustive recitation of the record, this Court expressly held in its June 2011 Order, even ***before reaching the issue of duplication***, that Credit Suisse's justifiable-reliance argument regarding the Core Misrepresentations is "foreclosed by the Court of Appeals decision in [*DDJ*]." (June 2011 Order at 18.) This Court further observed that "*DDJ* holds that it is a question of fact whether a sophisticated party reasonably relies on facts contained in a bargained for contractual representation." (June 2011 Order at 18.) Credit Suisse fails to refute the Court's correct adherence to the Court of Appeals directive.

Indeed, Credit Suisse's argument is belied even by its own authority. The single case cited by Credit Suisse, which was decided more than ten years ***before*** *DDJ*, proves the point that dismissal on the pleadings is not appropriate. In *Schlaifer Nance & Co. v. Estate of Andy Warhol*, 119 F.3d 91 (2d Cir. 1997), the court had the benefit of a complete evidentiary record, ***including a trial***, before reaching a conclusion on justifiable reliance. *Id.* at 101 (grounding its

conclusion in the "testimony of SNC lawyers, the documentary evidence, the Agreement, and the notes of the attorneys negotiating the Agreement"). Here, Credit Suisse seeks to terminate the case before it starts, or as it were, after eleven months of disclosure during which MBIA obtained corroborative evidence of Credit Suisse's fraud.

Finally, in a failed attempt to distinguish *DDJ*, Credit Suisse points to certain disclosures it gave to MBIA, *e.g.*, the loan tape, due diligence spreadsheets, and statements in the investor disclosures, including that Credit Suisse had "quality assurance procedures designed to ensure that the applicable qualified correspondent from which it purchased the related mortgage loans properly applied the underwriting criteria designated by [Credit Suisse]." (Def. Br. at 14; Prospectus Supplement, Docket No. 85 at S-33.) This is truly absurd; those "disclosures" are the very false and misleading statements that make up the Core Misrepresentations giving rise to MBIA's fraud claim. Credit Suisse's fraudulent representations do not inoculate it from a fraud claim.

D. Credit Suisse's New Argument That MBIA Fails to State a Claim" is Improper and Lacks Merit

Again without any regard to the proper procedural posture of this motion, Credit Suisse raises without any new authority a novel argument concerning one Core Misrepresentation, *i.e.*, that Credit Suisse was "backing" the loans, and would repurchase the loans if they proved defective. (Complaint ¶¶ 25, 30; June 2011 Order at 20.) Credit Suisse asserts that this allegation "cannot support a fraud claim, because it is not a statement of present fact; rather, it is a non-actionable statement of future intent." (Def. Mem. at 17.)[5] Credit Suisse is attacking a straw man. MBIA's allegation is ***not*** that Credit Suisse falsely represented an

[5] Credit Suisse also argues that the pre-contractual is not actionable because DLJ later agreed to the Repurchase Protocol as a contractual term. (Def. Mem. at 17.) This is an analog of its argument that the claim is duplicative, which was rejected in *Countrywide*.

intent to perform in the future its contractual repurchase obligation.[6] Rather, MBIA asserts that Credit Suisse knowingly misrepresented its then-existing operations by falsely asserting that supposed rigorous and reliable systems were in place to identify and repurchase defective loans from securitizations. (*See* Compl. ¶ 30.) As the Court correctly analyzed, Credit Suisse's representation that it had such protocols in place as of the closing of the Transaction was a representation of present fact and stated in the Prospectus Supplement. And it was encompassed by the Accuracy of Information Warranty, which warranted the truth and completeness of information supplied to MBIA concerning, among other things, the Mortgage Loans or Credit Suisse's "operations." (*See* June 2011 Order at 12, 19.) Such allegations of false statements of fact are actionable as fraud. *See Countrywide* at 11-12.

II. Credit Suisse Misconstrues the Court's Opinion Regarding Puffery and Disregards the Only New Relevant Precedent

Credit Suisse misleadingly suggests that the Court dismissed the Core Misrepresentations not just "on duplication grounds," but on the "equally important" grounds of puffery. (Def Br. at 2.) There is no legitimate reading of the June 2011 Order or MBIA's allegations that affords this conclusion; the Court applied the puffery doctrine only to one allegation – that Credit Suisse misrepresented its "pedigree and HEMT shelf track record." (June 2011 Order at 17.) These are not the Core Misrepresentations that are the subject of this motion, and Credit Suisse's arguments as to puffery, therefore, are irrelevant here.

Having raised the issue, however, Credit Suisse then disregards the only relevant new precedent, which demonstrate the viability of MBIA's claim. Specifically, Credit Suisse fails to mention that it recently was fined by FINRA for misrepresenting the prior performance

[6] Moreover, the allegation is viable even if deemed a misrepresentation made "with a preconceived and undisclosed intention of not performing it." *Deerfield Communications Corp. v. Cheseborough-Ponds, Inc.*, 68 N.Y.2d 954, 956 (1986).

of its securitization shelves. (*See* Attachment 1, "FINRA Fines Credit Suisse Securities $4.5 Million and Merrill Lynch $3 Million for Misrepresentations Related to Subprime Securitizations," FINRA News Release, May 26, 2011.[7]) The historical loan delinquency rates that Credit Suisse misrepresented both in the securitizations cited by FINRA, and in advance of this Transaction, are material information as a matter of federal law. *See* 17 CFR § 229.1121. As FINRA noted:

> Such data may affect the ability of an investor to evaluate the fair market value, the yields on the certificates and the anticipated holding periods of subprime securitizations. Investors may consider this information in assessing the profitability of subprime securitizations and determining whether future returns would be disrupted by mortgage holders who fail to make loan payments.

(Attachment 2, Financial Industry Regulatory Authority, Letter of Acceptance, Waiver, No. 2008012808901 at 4.[8]) As the guarantor of the investors' payments, the information was equally material to MBIA's evaluation of the risk in issuing the Policy.

Credit Suisse similarly does not address any decisions rendered since the initial decision on its motion to dismiss, which have rejected defenses of puffery and upheld analogous claims based upon misrepresentations of prior performance. *See, e.g.*, *MBIA Ins. Corp. v. Royal Bank of Canada*, No. 12238/09, 2010 WL 3294302 at *5, *29 (Westchester Sup. Ct., Aug. 19, 2010) (upholding fraud claim based upon allegation that defendants misrepresented "high quality collateral and structural protections as [prior transactions]," and "reject[ing] Defendants' attempts to cast the representations ... as statements/promises of future actions rather than present facts"), *Barneli & Clie S.A. v. Dutch Book Funds, SPC, Ltd.*, No. 600871/08, 2010 WL 3504780 at *9, *11 (N.Y. Sup. Ct. Aug. 9, 2010) (holding that allegations an investment fund

[7] *Available at* http://www.finra.org/Newsroom/NewsReleases/2011/P123731.

[8] *Available at* http://disciplinaryactions.finra.org/viewDocument.aspx?DocNb=17033.

misrepresented its "algorithms *and [the fund's] past performance*," do not "relate to future performance") (Attachment 3).

In sum, the detailed information Credit Suisse provided about prior securitizations was not mere "puffing" about future results that CS Securities hoped to achieve; rather, they were false and misleading statements about ***historical*** results insofar as they omitted the critical fact that those prior securitizations were built upon the same hidden defects and misrepresentations that plagued the transaction at issue here. (*See* Complaint ¶ 27.) MBIA has noticed an appeal of this issue in the event the June 2011 Order otherwise stands.

III. Credit Suisse Misconstrues the Court's Ruling On the "Extra-Contractual" Representations

Credit Suisse misleadingly suggests that the Court's dismissal of the third category of allegations for lack of justifiable reliance – the "extra-contractual" representations – is applicable and grounds for dismissal of the fraud claim as a whole. (Def. Br. at 2.) But as discussed *supra*, the Court correctly twice rejected Credit Suisse's position that the Core Misrepresentations fail for lack of justifiable reliance, and in view of *Countrywide*, the Core Misrepresentations are sufficient to sustain MBIA's fraud claim. Thus, the "extra-contractual" representations have no bearing on this motion.

But with Credit Suisse having has raised these allegations, MBIA respectfully submits that one of the representations the Court classified as "extra-contractual" properly is classified as a Core Misrepresentation, and the other is not material to MBIA's claim. The Court categorized as "extra-contractual" Credit Suisse's representations that (i) the securitized loans adhered to "strict" underwriting guidelines and (ii) it conducted reasoned "due diligence" that purported to demonstrate the quality of the securitized loans and their adherence to the applicable

guidelines. (June 2011 at 21-23.) The latter representation, regarding due diligence, is encompassed by Credit Suisse's contractual warranties.

Credit Suisse represented that it had overseen rigorous loan-level due diligence, evaluating the loans to assure that they conformed to applicable underwriting guidelines, and then "only buy[ing] the loans approved." (Compl. ¶ 29.) Credit Suisse also provided MBIA with detailed spreadsheets showing the results of the due diligence, which purportedly reflected Credit Suisse's verification of the loans' compliance with ***originators (or Credit Suisse's) underwriting guidelines***. (*Id.*) MBIA alleges that these representations were knowingly false: Credit Suisse did not perform due diligence as represented, the results were false and misleading, and the loans did not adhere to the ***originators underwriting guidelines***. The misrepresentations thus fall squarely within the purview of Credit Suisse's contractual warranties (i) that the loans complied with the "originators" as well as "customary and prudent" underwriting guidelines (June 2011 Order at 9), and (ii) that the information provided by Credit Suisse to MBIA concerning Credit Suisse's "operations," would not be "untrue or misleading in any material adverse respect." (*Id* at 12, 18.) MBIA is entitled to the benefit of that plain reading of its allegations at this juncture. *See, e.g., Leon v. Martinez*, 84 N.Y.2d 83, 87-88 (1994) ("A pleading is to be afforded a liberal construction," and the court should "accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts alleged fit within any cognizable theory.").

The Court, however, drew the inference that the "[t]he ***only*** material part of the alleged representation [concerning the loan due diligence Credit Suisse purportedly performed] is the result of the due diligence, *i.e.*, that the loans complied with ***'strict'*** underwriting standards, which is not actionable due to MBIA's notice of contrary facts, lack of due diligence and failure

to obtain a warranty." (*Id.* at 23) (emphasis added.) We respectfully submit that reading the due diligence allegations as relevant only to whether Credit Suisse complied with "strict" underwriting guidelines is not an appropriate inference.

In the end, regardless of whether the guidelines are characterized as "strict," MBIA alleged with particularity that the securitized loans did not comply with the guidelines that should have been applied. The Prospectus clearly states that ***even reduced document loans are subject to underwriting guidelines***, including a "reasonableness test" applied to determine whether a borrower evidences the ability and willingness to repay. (Prospectus, Docket No. 85 at 32.)[9] And the Prospectus Supplement states that Credit Suisse had "quality assurance procedures" to assure compliance with these guidelines. (ProSupp, Docket No. 85 at S-33.) Moreover, the Complaint clearly alleges that the purpose of the loan due diligence as represented by Credit Suisse was to assure compliance with the applicable underwriting guidelines (whether those guidelines were characterized as "strict" or not) because ***the loans' compliance with guidelines is presumed by MBIA – based on the representations and warranties – in assessing the risk of issuing the policy***. (*See* Complaint ¶ 8, 31, 33.) The "materiality" of MBIA's allegation that Credit Suisse misrepresented its due diligence practices is that Credit Suisse misrepresented that the due diligence assured ***compliance*** with the guidelines, however strict.

None of this was raised by MBIA's motion for leave to renew, and need not be addressed on this motion. But insofar as Credit Suisse seeks to conflate the Core Misrepresentations with what the Court found were "extra-contractual" representations, the Court may wish to revisit its ruling and reinstate the correct reasoning found in its July 2010 Order. The June 2011 Order failed to give MBIA the benefit of inferences to be drawn from the

[9] The Court even noted that compliance with "a reasonableness test" was one of the Core Representations. (*See* June 2011 Order at 20.)

Complaint, and made premature findings concerning materiality, contrary to *Leon*, 84 N.Y.2d at 84, and *Brunetti v. Musallam*, 11 A.D.3d 280 (1st Dep't 2004) (reversing summary determination of materiality). MBIA has, respectfully, noticed its appeal of this issue, too.

IV. MBIA's Jury and Fraud Damages Demands Should Be Reinstated

The June 2011 Order struck MBIA's jury and damages demands solely on the grounds that the fraudulent inducement claim was dismissed. (June 2011 Order at 26.) Nonetheless, Credit Suisse makes a plenary reargument on this point, as well. For the reasons stated in the trial court's January 26, 2011 Order, because MBIA's fraudulent inducement claim should be reinstated, the jury and damages demands should also be reinstated.

CONCLUSION

For the foregoing reasons, MBIA respectfully requests the Court to (i) vacate its June 1, 2011 Order; and (ii) reinstate its July 30, 2010 and January 26, 2011 Orders, *inter alia*, denying Defendants' motion to dismiss MBIA's claim for fraudulent inducement, and its jury and damages demands.

Dated: New York, New York
August 26, 2011

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Attachment 1

FINRA
Financial Industry Regulatory Authority

NEWS RELEASE

For Release: **Thursday, May 26, 2011**
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Credit Suisse Securities (USA) LLC Action
Merrill Lynch Action

FINRA Fines Credit Suisse Securities $4.5 Million and Merrill Lynch $3 Million for Misrepresentations Related to Subprime Securitizations

WASHINGTON — The Financial Industry Regulatory Authority (FINRA) announced today that it has fined Credit Suisse Securities (USA) LLC $4.5 million, and Merrill Lynch $3 million for misrepresenting delinquency data and inadequate supervision in connection with the issuance of residential subprime mortgage securitizations (RMBS).

Issuers of subprime RMBS are required to disclose historical performance information for past securitizations that contain mortgage loans similar to those in the RMBS being offered to investors. Historical delinquency rates are material to investors in assessing the value of RMBS and in determining whether future returns may be disrupted by mortgage holders' failures to make loan payments. As there are different standards for calculating delinquencies, issuers are required to disclose the specific method it used to calculate delinquencies.

FINRA found that in 2006, Credit Suisse misrepresented the historical delinquency rates for 21 subprime RMBS it underwrote and sold. Although Credit Suisse knew of these inaccuracies, it did not sufficiently investigate the delinquency errors, inform clients who invested in these securitizations of the specific reporting discrepancies or correct the information on the website where the information was displayed. Credit Suisse also failed to name or define the methodology used to calculate mortgage delinquencies in five other subprime securitizations. Additionally, Credit Suisse failed to establish an adequate system to supervise the maintenance and updating of relevant disclosure on its website.

For six of the 21 securitizations, the delinquency errors were significant enough to affect an investor's assessment of subsequent securitizations, as it was referenced in four subsequent RMBS investments.

In a separate case, FINRA found that Merrill Lynch negligently misrepresented the historical delinquency rates for 61 subprime RMBS it underwrote and sold. However, in June 2007, after learning of the delinquency errors, Merrill Lynch promptly recalculated the information and posted the corrected historical delinquency rates on its website. Merrill Lynch also failed to establish a reasonable system to supervise and review its reporting of historical delinquency information. On January 1, 2009, Merrill Lynch was acquired by Bank of America, but the firm continues to do brokerage business under its own individual broker-dealer registration.

In eight instances, the delinquencies were significant enough to affect an investor's assessment of subsequent securitizations, as it was referenced in five subsequent RMBS investments.

Brad Bennett, FINRA Executive Vice President and Chief of Enforcement, said, "Firms must provide accurate information about the products they offer so that their customers can make informed investment decisions. Credit Suisse and Merrill Lynch failed to monitor and supervise the reporting of historical delinquency rates, depriving investors of information essential to assessing the profitability of mortgage-backed investments."

In settling this matter, Credit Suisse and Merrill Lynch neither admitted nor denied the charges, but both broker-dealers consented to the entry of FINRA's findings.

The investigations of Credit Suisse and Merrill Lynch were conducted by Allen D. Boyer, Andrew Kampel and Penny Rosenberg, under the supervision of Susan Light, Enforcement Chief Counsel.

Investors can obtain more information about, and the disciplinary record of, any FINRA-registered broker or brokerage firm by using FINRA's BrokerCheck. FINRA makes BrokerCheck available at no charge. In 2010, members of the public used this service to conduct 17.2 million reviews of broker or firm records. Investors can access BrokerCheck at www.finra.org/brokercheck or by calling (800) 289-9999.

FINRA, the Financial Industry Regulatory Authority, is the largest independent regulator for all securities firms doing business in the United States. FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA touches virtually every aspect of the securities business – from registering and educating all industry participants to examining securities firms, writing rules, enforcing those rules and the federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering the largest dispute resolution forum for investors and firms. For more information, please visit www.finra.org.

Attachment 2

FINANCIAL INDUSTRY REGULATORY AUTHORITY
LETTER OF ACCEPTANCE, WAIVER AND CONSENT
NO. 2008012808901

TO: Department of Enforcement
Financial Industry Regulatory Authority ("FINRA")

RE: Credit Suisse Securities (USA) LLC, ("Credit Suisse" or "the Firm")
[CRD No. 816]

Pursuant to FINRA Rule 9216 of FINRA's Code of Procedure, Credit Suisse submits this Letter of Acceptance, Waiver and Consent ("AWC") for the purpose of proposing a settlement of the alleged rule violations described below. This AWC is submitted on the condition that, if accepted, FINRA will not bring any future actions against it alleging violations based on the same factual findings described herein.

I.

ACCEPTANCE AND CONSENT

A. Credit Suisse hereby accepts and consents, without admitting or denying the findings, and solely for the purposes of this proceeding and any other proceeding brought by or on behalf of FINRA, or to which FINRA is a party, prior to a hearing and without an adjudication of any issue of law or fact, to the entry of the following findings by FINRA:

BACKGROUND

Credit Suisse Securities (USA) LLC, a member of FINRA, NYSE Euronext, and Securities Investor Protection Corporation ("SIPC"), has been a registered broker-dealer since 1936. The Firm is a full-service broker-dealer with its headquarters in New York City. The Firm is a subsidiary of Credit Suisse Group, which is headquartered in Switzerland. Credit Suisse is a global investment banking and multi-service brokerage firm.

RELEVANT DISCIPLINARY HISTORY

Credit Suisse has the following prior relevant disciplinary history:

In August 2009, by AWC No. 2008013339901, FINRA found that Credit Suisse had failed to fully comply with a requirement of the 2003 Global Research Analyst Settlement that the Firm make independent research available to its customers. As early as 2004, Credit Suisse failed on a number of occasions to post all of the required, current independent research to its Web site. The Firm's lack of adequate safeguards, controls and oversight caused Credit Suisse, between December 2004 through July 2008, to experience three significant failures to make independent research available to its customers. The sanction imposed was a censure and a fine of $275,000.

On September 7, 2007, in N.Y.S.E. Hearing Panel Decision 07-130, the NYSE disciplined Credit Suisse for failing to ensure delivery of prospectuses, in violation of Sec. 5(b)(2) of the Securities

Act of 1933 and NYSE Rule 1100(b), and for failure to supervise in violation of NYSE Rule 342. The Firm consented to a censure, a $500,000 fine, and a regulatory undertaking.

On July 17, 2006, pursuant to AWC No. EAF0401490001, NASD found that Credit Suisse violated NASD Conduct Rules 2110, 2711(h)(7) and (h)(10), and 3010(a), for regularly publishing research reports that used vague, generic or unclear language to describe its price target valuation methods and the risks that might impede achievement of the price targets; and for failing to enforce written supervisory procedures. This misconduct was sanctioned with a censure, a fine of $225,000, and a regulatory undertaking.

On April 18, 2006, in N.Y.S.E. Hearing Panel Decision 06-54, the NYSE disciplined Credit Suisse for failing to transmit accurate proxy solicitation information to customers, submitting more proxy votes than it was entitled to submit, failing to accurately tally its stock ownership records to accurately tally votes of beneficial owners, and failing to supervise, in violation of NYSE Rules 342, 401, 451, 452, and 476. The Firm consented to a censure and a fine of $250,000.

OVERVIEW

During 2006 and 2007, Credit Suisse underwrote subprime residential mortgage backed securities ("RMBS" or "securitizations"). Credit Suisse employees assisted in the preparation of the offering documents, including prospectuses, and sold these securities to institutional investors.

Regulation AB is the source of various disclosure items and requirements for "asset-backed securities" filings under the Securities Act of 1933 and the Securities Exchange Act of 1934. Regulation AB became effective on December 5, 2005. Regulation AB required the Firm to maintain a website for each newly-issued RMBS (the "Reg AB website") that presented historical delinquency data, also known as static pool information, for prior similar deals to illustrate the past performance of securitizations that contained similar collateral. Regulation AB also required that each RMBS disclose the method employed for calculating delinquencies.

Credit Suisse failed to provide accurate delinquency rates with regard to 21 subprime securitizations that were referenced on its Reg AB website. For these securitizations, the Reg AB website displayed up to nine months of inaccurate historical delinquency data, for the period from January through September 2006, variously underreporting and overreporting delinquencies for different securitizations within this period. The delinquency reporting errors for six of these securitizations may have affected an investor's assessment of subsequent securitizations. These errors were referenced as static pool information in four subprime securitizations after Credit Suisse had learned of the errors.

After Credit Suisse learned that inaccurate delinquency calculations had been posted on its Reg AB website for the above period, Credit Suisse failed to investigate whether static pool information posted on the website for the period from February 2001 through December 2005 also contained inaccuracies.

Credit Suisse did not sufficiently investigate these delinquency errors, has not directly informed clients who invested in these securitizations of the specific reporting discrepancies and has not

revised its Reg AB websites to correct these errors. As a result, this misreporting of historical delinquency data violated NASD Rule 2110.

Further, Credit Suisse failed to name or define the methodology it used to calculate the mortgage delinquency rates for five subprime RMBS it underwrote and sold in 2006, as required by Regulation AB. As a result, Credit Suisse violated NASD Rule 2110.

Credit Suisse also failed to establish a reasonable system to supervise the maintenance and updating of its Reg AB website and did not act reasonably to ensure that its Reg AB website presented accurate static pool information. As a result, the Firm violated NASD Rules 3010 and 2110.

FACTS AND VIOLATIVE CONDUCT

Background

Subprime RMBS securities are created when pools of subprime mortgages are collected and the cash flows are redistributed to different bond classes called tranches. In order of seniority, the tranches typically include senior, mezzanine and subordinate levels of debt. Each tranche represents a different beneficial ownership interest in the particular securitization and carries a correspondingly different level of risk. The tranche classification depends on its priority in receiving payments from the collateral pool.

As underwriter, Credit Suisse was involved both in preparing the offering documents for subprime RMBS and in selling the securities to institutional investors. Credit Suisse employees in the Firm's RMBS Group assisted in the underwriting and securitization process for subprime RMBS. This group gathered all the pertinent information regarding the residential mortgage loans pooled in connection with subprime RMBS as of the cut-off date, including the loan tapes, which set forth data related to the type of collateral, location of the homes, borrowers' FICO scores, and payment status. Credit Suisse employees then coordinated with outside counsel to draft the prospectus materials and provided outside accountants with the delinquency numbers calculated to verify the data contained in the prospectus supplement. Credit Suisse employees reviewed all offering materials for completeness and accuracy prior to its issuance to institutional investors.

Among the offering documents that Credit Suisse assisted in preparing for the RMBS was a prospectus supplement, which describes in detail the characteristics of the mortgage pool, including the percentage of delinquent mortgage loans in the underlying collateral of the particular offering as of the cut-off date. The prospectus supplement also refers the reader to the Firm's Reg AB website, which provides the public with historical performance information, also known as static pool information, including delinquency rates. The Reg AB website sets forth, for each new securitization, information on the performance of prior securitizations that were similar in structure, characteristics and make-up. The delinquency data for the Reg AB website may be compiled from loan level information and/or information provided by servicers, trustees or other parties. Prospectus supplements containing this information were prepared for each RMBS offering and filed with the Securities and Exchange Commission.

Mortgage securitizations typically involve a Trust created by a Depositor, a separate legal entity from the underwriter, and certain of the other parties to the securitization. The Trust is administered by a Trustee. The underwriter structures an asset pool of underlying mortgages comprising the collateral for a securitization into classes of certificates that comprise the different tranches of the securitization. The Depositor then transfers to the Trust the underlying asset pool. As underwriter, Credit Suisse purchased the certificates issued by each of the Trusts and sold those to institutional investors, each of which was provided with a prospectus supplement.

The Trustee administers the trust through a Servicer and/or Master Servicer. The Servicer and/or Master Servicer is responsible for collecting the loan payments from the borrowers. The Trustee distributes the interest and principal from the loan payments to the investors. Based on information received from the Servicer and/or the Master Servicer, the Trustee issues monthly reports to the certificate holders that provide performance information about the underlying collateral, such as payments, delinquencies, foreclosures, and pre-payment penalties.

Regulation AB Requires That Broker-Dealers Supply Investors With Accurate Static Pool Information For Mortgage-Backed Securitizations

On December 5, 2005, Regulation AB became effective. Under Regulation AB, issuers of RMBS are required to disclose historical performance information, including delinquency rates, for prior securitizations that contain similar mortgage loans as collateral. Several items in Regulation AB require the presentation of historical information and data on delinquencies and loss information, including (1) the total amount of delinquent assets as a percentage of the aggregate asset pool, (2) the present loss and cumulative loss information and (3) other material information regarding delinquencies and losses particular to the pool asset types.

As noted by SEC Regulation AB, delinquency rates constitute material information. Such data may affect the ability of an investor to evaluate the fair market value, the yields on the certificates and the anticipated holding periods of subprime securitizations. Investors may consider this information in assessing the profitability of subprime securitizations and determining whether future returns would be disrupted by mortgage holders who fail to make loan payments.

Thus, in order to sell a new securitization, Credit Suisse was required to post data on how similar securitizations that it had underwritten had performed in the past. This disclosure requirement could be satisfied by posting the historical delinquency data on a Reg AB website, which for securitizations issued on or after January 1, 2006, is deemed to be part of the prospectus.

After January 2006, Credit Suisse prospectus supplements for new subprime RMBS offerings informed investors that they could view static pool information for prior securitizations on its Reg AB website. The Reg AB website contained hyperlinks to each securitization. When the investors clicked onto the hyperlink for a particular deal, they would see static pool information for a set of similar deals previously underwritten by the Firm, dating in some cases back to February 2001. Credit Suisse retained a third party vendor to develop and maintain its Reg AB website. The vendor obtained all relevant static pool information from the monthly reports

issued by the Trustee to investors in each of the RMBS.

Credit Suisse Referred Investors to Inaccurate Static Pool Information in Connection with its Offer and Sale of Certain HEAT Subprime Securitizations

On or about November 1, 2006, Credit Suisse was informed that one of its Master Servicers had provided erroneous information to a Trustee in connection with delinquency data for certain subprime RMBS.

The Master Servicer determined that, for the period between January 2006 and September 2006, it had provided inaccurate delinquency data for approximately 21 subprime RMBS. These securitizations were issued on the Firm's Home Equity Asset Trust ("HEAT") shelf and were referenced on the Firm's Reg AB website. The Master Servicer advised the Firm that it had already identified and corrected the cause of those errors. The Master Servicer's correction of the cause of the errors did not correct the errors in the static pool information posted on the Reg AB website. Upon learning of the errors from the Master Servicer, Credit Suisse discussed the issue internally, followed up with the Master Servicer, and received data from the Master Servicer quantifying the errors for particular securitizations and months. After further analysis and discussions with Credit Suisse, the Master Servicer and Trustee informed Credit Suisse that they believed that the errors were immaterial and that they did not intend to provide investors with amended monthly reports. The Depositor, a Credit Suisse affiliate, made Form 10-K filings with the SEC describing the inaccuracies as a general platform error affecting the Master Servicer's operations. Some of these Form 10-K filings included servicer attestations that described the nature of the error and listed securitizations that might have been affected, but these filings did not set forth specific inaccuracies in the delinquency data for any individual securitization. Credit Suisse has not directly informed investors in these securitizations of the specific reporting discrepancies, and has not revised its Reg AB websites to correct these errors.

Credit Suisse did not sufficiently investigate the extent or the materiality of the delinquency errors reported to it by the Master Servicer. Additionally, Credit Suisse did not investigate whether static pool information for the period from February 2001 through December 2005 posted on the Reg AB website also contained inaccuracies.

Of the 21 HEAT subprime securitizations for which inaccurate delinquency information had been reported, the underreporting or overreporting of delinquencies for six securitizations may have affected an investor's assessment of subsequent securitizations. Delinquency data for these six securitizations continued to be posted on the Firm's Reg AB websites after Credit Suisse learned of the reporting error. Specifically, the inaccurate information for the six HEAT securitizations described above was hyperlinked to four subsequent RMBS securitizations involving a combined total of $3,764,275,250 in notes issued and resulted in these four subsequent securitizations being sold with reference to inaccurate data.[1]

[1] The six RMBS that were affected by these Servicer errors, as described above, were HEAT 2005-3, HEAT 2005-6, HEAT 2005-7, HEAT 2005-8, HEAT 2006-5 and HEAT 2006-6. The four securitizations that referenced the static pool information for these securitizations after Credit Suisse learned of the Servicer errors were HEAT 2007-1, HEAT 2007-2 and HEAT 2007-3, and HEAT 2006-8.

Because of these errors, which variously underreported and overreported the extent of delinquent loans in the referenced securitizations, the fair market value, the yields on the certificates and the anticipated holding periods of each of the four HEAT RMBS may have been improperly evaluated by potential investors.

As set forth above, by not conducting sufficient inquiry upon learning that the servicer had caused errors in monthly delinquency data contained in trustee reports during the period January through September 2006 for RMBS offerings, by not sufficiently investigating that servicer's determination that those errors were not material, and by allowing its Reg AB website for certain subsequent offerings to be populated with that erroneous data, Credit Suisse misrepresented historical delinquency data affecting four RMBS offerings and thereby violated NASD Rule 2110.

Credit Suisse Fails to Name or Define the Method it Used to Calculate Delinquencies in Five HEAT RMBS Issued in 2006

Regulation AB requires that the method of calculating delinquencies be disclosed. Industry participants generally employ two methods to calculate delinquency rates: the Mortgage Banker Association ("MBA") method and the Office of Thrift Supervision ("OTS") method.[1]

Under the MBA method, a mortgage loan is considered to be delinquent when a payment due on any due date remains unpaid as of the close of business by the end of the day immediately preceding the loan's next due date. The MBA method, therefore, begins to count delinquency as soon as a payment is not received. In contrast to the MBA method, the OTS method begins to count delinquency one month after the first payment is missed by the mortgagee. Thus, the number of delinquent loans is generally lower when calculated under the OTS method than under the MBA method.

Credit Suisse used the MBA method to calculate the number of delinquent loans that were deposited into the Trusts for HEAT 2006-3, HEAT 2006-4, HEAT 2006-5, HEAT 2006-6 and HEAT 2006-7 as of the cut-off date for establishing the mortgage pool. Credit Suisse, however, failed to name or define its use of the MBA method to calculate mortgage delinquency rates for these securitizations. The value of these five securitizations is approximately $5,673,200,250. Since the delinquency figures referenced in the five prospectus supplements were calculated using the MBA method, Credit Suisse reported between 0.8% and 1.5% more delinquencies than would have been reported had the OTS method been employed.

[1] Section 1101(d) of Reg AB provides: "Delinquent, for purposes of determining if a pool asset is delinquent, means if a pool asset is more than 30 or 31 days or a single payment cycle, as applicable, past due from the contractual due date, as determined in accordance with any of the following: (1) The transaction agreements for the asset-backed securities; (2) The delinquency recognition policies of the sponsor, any affiliate of the sponsor that originated the pool asset or the servicer of the pool asset; or (3) The delinquency recognition policies applicable to such pool asset established by the primary safety and soundness regulator of any entity listed in paragraph (2) or the program or regulatory entity that oversees the program under which the pool asset was originated."

In connection with these five HEAT RMBS, Credit Suisse failed to provide investors with adequate guidance regarding the method of delinquency calculation. As a result, the fair market value, the yields on the certificates and the anticipated holding periods of each of the five HEAT RMBS may have been improperly evaluated by potential investors. By virtue of the foregoing, Credit Suisse violated NASD Rule 2110.

Credit Suisse's Failure to Supervise

NASD Conduct Rule 3010(a) requires that each member "establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with the Rules of this Association."

As the underwriter and seller of subprime RMBS, Credit Suisse failed to: (1) provide an adequate system for follow-up and review to ensure that its Reg AB website presented accurate static pool information; (2) provide accurate information on RMBS delinquency rates on the Reg AB website: and (3) pursue its own review of the accuracy of posted information for RMBS deals that the Firm should have known were likely to contain erroneous calculations.

As part of the Firm's underwriting obligations, it was required to include static pool information for new subprime securitizations it was offering. Although Credit Suisse was aware that delinquency data was inaccurate for certain RMBS securitizations, Credit Suisse continued to reference delinquency data that had been variously underreported and/or overreported as part of static pool information for subsequent securitizations underwritten and sold by the Firm. In addition, Credit Suisse did not review other static pool information that the Firm was aware was potentially inaccurate and was posted on the Reg AB website.

Credit Suisse failed to take adequate steps to review and correct the inaccurate static pool information contained on its Reg AB website and incorporated by reference in prospectus supplements for four securitizations.

By virtue of the foregoing, Credit Suisse failed to establish an adequate system to supervise its business of underwriting and trading subprime RMBS securitizations, in violation of NASD Conduct Rules 3010 and 2110.

B. Credit Suisse consents to the imposition of the following sanctions:

1. A censure and

2. A fine of $4,500,000.

Credit Suisse agrees to pay the monetary sanction upon notice that this AWC has been accepted and that such payment is due and payable. Credit Suisse has submitted an Election of Payment Form showing the method by which it proposes to pay the fine imposed.

Credit Suisse specifically and voluntarily waives any right to claim that it is unable to pay, now or at any time thereafter, the monetary sanction imposed in this matter.

The sanction imposed herein shall be effective on a date set by FINRA staff.

II.

WAIVER OF PROCEDURAL RIGHTS

Credit Suisse specifically and voluntarily waives the following rights granted under FINRA's Code of Procedure:

A. To have a Complaint issued specifying the allegations against it;

B. To be notified of the Complaint and have the opportunity to answer the allegations in writing;

C. To defend against the allegations in a disciplinary hearing before a hearing panel, to have a written record of the hearing made and to have a written decision issued; and

D. To appeal any such decision to the National Adjudicatory Council ("NAC") and then to the U.S. Securities and Exchange Commission and a U.S. Court of Appeals.

Further, Credit Suisse specifically and voluntarily waives any right to claim bias or prejudgment of the General Counsel, the NAC, or any member of the NAC, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including acceptance or rejection of this AWC.

Credit Suisse further specifically and voluntarily waive any right to claim that a person violated the ex parte prohibitions of FINRA Rule 9143 or the separation of functions prohibitions of FINRA Rule 9144, in connection with such person's or body's participation in discussions regarding the terms and conditions of this AWC, or other consideration of this AWC, including its acceptance or rejection.

III.

OTHER MATTERS

Credit Suisse understands that:

A. Submission of this AWC is voluntary and will not resolve this matter unless and until it has been reviewed and accepted by the NAC, a Review Subcommittee of the NAC, or the Office of Disciplinary Affairs ("ODA"), pursuant to FINRA Rule 9216;

B. If this AWC is not accepted, its submission will not be used as evidence to prove any of the allegations against Credit Suisse; and

C. If accepted:

1. this AWC will become part of Credit Suisse's permanent disciplinary record and may be considered in any future actions brought by FINRA or any other regulator against it;

2. this AWC will be made available through FINRA's public disclosure program in response to public inquiries about its disciplinary record;

3. FINRA may make a public announcement concerning this agreement and the subject matter thereof in accordance with FINRA Rule 8313; and

4. Credit Suisse may not take any action or make or permit to be made any public statement, including in regulatory filings or otherwise, denying, directly or indirectly, any finding in this AWC or create the impression that the AWC is without factual basis. Credit Suisse may not take any position in any proceeding brought by or on behalf of FINRA, or to which FINRA is a party, that is inconsistent with any part of this AWC. Nothing in this provision affects Credit Suisse's right to take legal or factual positions in connection with or regarding litigation or other legal proceedings in which FINRA is not a party.

D. Credit Suisse may attach a Corrective Action Statement to this AWC that is a statement of demonstrable corrective steps taken to prevent future misconduct. Credit Suisse understands that it may not deny the charges or make any statement that is inconsistent with the AWC in this Statement. This Statement does not constitute factual or legal findings by FINRA, nor does it reflect the views of FINRA or its staff.

The undersigned, on behalf of Credit Suisse, certifies that a person duly authorized to act on its behalf has read and understands all of the provisions of this AWC and have been given a full opportunity to ask questions about it; that Credit Suisse has agreed to its provisions voluntarily; and that no offer, threat, inducement, or promise of any kind, other than the terms set forth herein and the prospect of avoiding the issuance of a Complaint, has been made to induce Credit Suisse to submit it.

5/11/11
Date (mm/dd/yyyy)

Credit Suisse Securities (USA) LLC
Respondent

By:

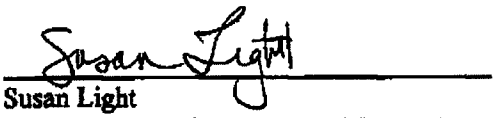
Reviewed by:

Barry W. Rashkover, Esq.
Counsel for Respondent
Sidley Austin LLP
787 Seventh Avenue
New York, N.Y. 10019
(212) 839-7324

Accepted by FINRA:

5/19/11
Date

Signed on behalf of the
Director of ODA, by delegated authority



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Attachment 3

Slip Copy, 28 Misc.3d 1232(A), 2010 WL 3504780 (N.Y.Sup.), 2010 N.Y. Slip Op. 51571(U)
(Table, Text in WESTLAW), Unreported Disposition
(Cite as: 2010 WL 3504780 (N.Y.Sup.))

H

NOTE: THIS OPINION WILL NOT APPEAR IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE.

Supreme Court, New York County, New York.
BARNELI & CIE S.A., Plaintiff,
v.
DUTCH BOOK FUNDS, SPC, LTD., Dutch Book Partners, LLC and Stanley R. Jonas, Defendants.

No. 600871/08.
Aug. 9, 2010.

Jamie B.W. Stecher, Esq. and Jaclyn J. Leader, Esq. of Tannenbaum Helpern Syracuse & Hirschtritt LLP, for Defendants.

Joel M. Wolosky, Esq. and Jillian M. Searles, Esq. of Hodgson Russ LLP, for Plaintiff.

EILEEN BRANSTEN, J.

*1 Defendants Dutch Book Funds SPC, Ltd (the "Fund"), Dutch Book Partners, LLC ("Partners") and Stanley R. Jonas (collectively with the Fund and Partners, "Defendants") move, pursuant to CPLR 3211(a)(1), (a)(7) and 3016(b), for an order dismissing the Complaint. Plaintiff Barnelli & Cie S.A. ("B & C") opposes the motion.

BACKGROUND

B & C is a Panamanian corporation with an office located in the Republic of Panama. Stecher Affirmation in Support of Defendants' Motion to Dismiss, Ex. 1, the Amended Complaint ("Amended Complaint"), at ¶ 1. The Fund is a Cayman Islands corporation with an office located in New York, New York. Amended Complaint at ¶ 2. Partners is a Delaware Limited Liability Company with an office located in New York,

* The court would like to acknowledge and thank intern Alyssa J. Astiz, Fordham University School of Law

J.D. Candidate 2012, for her able assistance with the instant decision.

New York. *Id.* at ¶ 3. Jonas is a New York resident and a director of the Fund, as well as the Chief Executive Officer and Chief Financial Officer of Partners. *Id.* at ¶ 4. The parties do not contest that this action is properly before this court.

The Fund is a segregated portfolio company that offered shares in various investment portfolios. *Id.* at ¶ 5. Each portfolio constitutes a separate pool of assets in which the holders of shares therein have an interest in the net assets of that portfolio only. *Id.* at ¶ 5. The Fund offered shares in the Dutch Book Segregated Portfolio I (the "Portfolio") pursuant to an Information Memorandum dated July 1, 2006 (the "Memorandum"). Amended Complaint ¶ 6.

B & C alleges in its amended complaint that Jonas, on behalf of himself, Partners and the Fund, provided B & C with a copy of the Memorandum. *Id.* at ¶ 10. The Memorandum stated that the Fund, through Partners, will "seek to create a Dutch Book' on the movement of market expectations." *Id.* The Memorandum defined a "Dutch Book" as "a set of positions betting' on a particular action that, in sum, earns a positive return for the owner of the Dutch Book' regardless of the outcome." *Id.* In pursuit of this positive return, the Memorandum represented: (i) that the Fund had "developed a proprietary set of algorithms based on standard probability theory;" (ii) that the algorithms were "arithmetic," "based on standard probability axioms" and had been "successfully used by [Defendants] in the past;" and (iii) that the Portfolio "is structured by the Investment Adviser to make money whether the Federal Reserve raises, raises a lot, lowers, lowers a lot, or stays put" and "earns a positive return regardless of the outcome on market expectations regarding central bank activity." *Id.* at ¶ 11.

Pursuant to a July 21, 2006, written Subscription Agreement (the "Subscription Agreement"), B & C purchased 50,000 shares in the Portfolio for an aggregate purchase price of $50,000,000. Amended Complaint ¶ 7. B & C was the Portfolio's only investor. *Id.* The Fund retained Partners as an investment adviser for the Portfolio pursuant to an Investor Adviser Agreement dated July 1, 2006. *Id.* at ¶ 8.

*2 B & C now alleges that the Defendants made representations in the Memorandum that were materially false and misleading and known by the Defendants to be materially false and misleading when made. *Id.* at ¶ 12. B & C alleges that the Defendants knew, but failed to disclose: (i) that they had no "proprietary set of algorithms" and therefore could not and would not create a Dutch Book; (ii) that the Fund could not be structured so as to create a Dutch Book in accordance with the investment strategy set forth in the Memorandum, therefore exposing B & C to an undisclosed amount of risk; and (iii) that Partners could not have possibly used the proprietary algorithms in the past since Partners had been organized on April 28, 2006, less than two months before the Fund's inception. *Id.* at ¶¶ 13-14, 16. B & C, however, does not provide the Fund's inception date in its Amended Complaint.

B & C further alleges that, despite the exercise of reasonable due diligence, it could not have discovered the truth regarding Defendants' misrepresentations because the nature and existence of the proprietary algorithms were peculiarly within the Defendants' knowledge and technical expertise. *Id.* at ¶ 20.

B & C alleges that, rather than creating a Dutch Book, Defendants engaged in an excessive number of transactions in speculative investments that were incompatible with the investment strategy set forth in the Memorandum. *Id.* at ¶ 18. The Portfolio lost approximately $4,000,000 as of October 31, 2006. *Id.* B & C then withdrew $30,000,000 from the Portfolio. *Id.* Thereafter, the Portfolio continued to incur losses, and in a period of less than one year, lost in excess of $8,000,000 while generating fees and commissions in excess of $2,000,000. *Id.*

B & C commenced this action on March 25, 2008, and amended its complaint on February 9, 2009.[FN1] In its Amended Complaint, B & C asserts causes of action for (i) breach of contract; (ii) breach of fiduciary duty; (iii) negligence; (iv) fraud; and (v) personal liability against Jonas based upon an alter ego theory.

FN1. During oral argument for the original complaint, the Defendants agreed to produce documentary evidence regarding the algorithms in accordance with a discovery agreement. On April 14, 2009, this Court issued a Decision and Order granting Defendants' motion to dismiss the original complaint. On May 20, 2009, after the parties notified the Court that B & C had filed its Amended Complaint on March 10, 2009, this Court recalled and vacated that Decision and Order and restored B & C's action.

Defendants now move for an order dismissing the Amended Complaint.

ANALYSIS

In a CPLR 3211 motion to dismiss, the scope of a court's inquiry is "narrowly circumscribed." *P.T. Bank Cent. Asia v. ABN AMRO Bank N.V.*, 301 A.D.2d 373, 376, 754 N.Y.S.2d 245 (1st Dep't 2003). On a motion to dismiss pursuant to CPLR 3211(a)(7), "the court must afford the pleadings a liberal construction, accept the allegations of the complaint as true and provide plaintiff the benefit of every possible favorable inference." *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.*, 5 N.Y.3d 582, 591, 808 N.Y.S.2d 573, 842 N.E.2d 471 (2005). "[O]ur sole criterion is whether the pleading states a cause of action, and if from its four corners factual allegations are discerned which taken together manifest any cause of action cognizable at law a motion for dismissal will fail.' " *Polonetsky v. Better Homes Depot, Inc.*, 97 N.Y.2d 46,

54, 735 N.Y.S.2d 479, 760 N.E.2d 1274 (2001), *quoting Guggenheimer v. Ginzburg,* 43 N.Y.2d 268, 277, 401 N.Y.S.2d 182, 372 N.E.2d 17 (1977). The court "must accept as true the facts as alleged in the complaint and submissions in opposition to the motion and determine only whether the facts as alleged fit within any cognizable legal theory." *Sokoloff v. Harriman Estates Dev. Corp.,* 96 N.Y.2d 409, 414, 729 N.Y.S.2d 425, 754 N.E.2d 184 (2001). A motion brought pursuant to CPLR 3211(a)(1) "may be granted where documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law." *Held v. Kaufman,* 91 N.Y.2d 425, 430-31, 671 N.Y.S.2d 429, 694 N.E.2d 430 (1998).

1. Breach of Contract

***3** B & C asserts its first cause of action for breach of contract against Partners and the Fund. B & C alleges that the Memorandum created contractual obligations between B & C and Partners and the Fund that required Partners and the Fund to invest B & C's money in the manner set forth in the Memorandum. Amended Complaint at ¶ 22. B & C contends that Partners and the Fund breached the contract in failing to invest the money in accordance with the strategy set forth in the Memorandum. *Id.* at ¶ 23, 671 N.Y.S.2d 429, 694 N.E.2d 430.

To state a cause of action for breach of contract, a plaintiff must allege the existence of a contract, performance by the plaintiff, breach by the defendant, and damages resulting from the breach. *Kraus v. Visa Int'l Serv. Ass'n,* 304 A.D.2d 408, 408, 756 N.Y.S.2d 853 (1st Dep't 2003).

The Fund

In moving to dismiss B & C's breach of contract claim against the Fund, Defendants argue that the Subscription Agreement did not impose an obligation upon the Fund to create a Dutch Book. Rather, Defendants contend the Memorandum contains aspirational statements that Partners was to "seek to create" a Dutch Book and that Partners "believe[d] it [could] create and manage a Dutch Book.' " Memorandum at iii, iv, v. Defendants assert that the Memorandum further provides that "THERE CAN BE NO ASSURANCE THAT THE INVESTMENT OBJECTIVE OF THE DUTCH BOOK SEGREGATED PORTFOLIO I OR ANY OTHER PORTFOLIO OF THE FUND WILL BE ACHIEVED." *Id.* at v (emphasis in original).

B & C's allegation that the Fund breached its contractual obligation by failing to create a Dutch Book is plainly contradicted by the Memorandum. The Fund was not required to *achieve* the investment objective of the Dutch Book, but merely to attempt to do so. Documentary evidence provides the Fund a defense as a matter of law. *Robinson v. Robinson,* 303 A.D.2d 234, 235, 757 N.Y.S.2d 13 (1st Dep't 2003). The breach of contract cause of action against the Fund must therefore be dismissed. CPLR 3211(a)(1); *Robinson,* 303 A.D.2d at 235, 757 N.Y.S.2d 13.

Partners

Defendants argue that there are no contractual obligations between B & C and Partners. Defendants contend that the cause of action against Partners should therefore be dismissed.

B & C contends that Partners' contractual obligations are derived from the Memorandum, which indicates that Partners will be the "sole investment adviser" of the Portfolio. Memorandum at 7. B & C asserts that Partners was charged with creating a Dutch Book on behalf of the Fund through the Subscription Agreement. Amended Complaint at ¶ 22.

The Subscription Agreement is between B & C and the Fund. Affidavit of Stanley R. Jonas in Support of Defendants' Motion to Dismiss, ("Jonas Aff."), Ex. 2. The Memorandum is incorporated into, and thus a part of, the Subscription Agreement. The Memorandum specifically states that Partners has been retained by the Fund in accordance with a July 1, 2006, Investment Adviser Agreement. Jonas Aff., Ex. 3, at 7. Partners' contractual obligations, therefore, are owed only to the Fund. B & C has alleged no facts placing it in privity with Partners. In

the absence of a valid and binding contract between B & C and Partners, B & C has pleaded no basis upon which it may assert a breach of contract cause of action against Partners. *Leonard v. Gateway II,* 68 A.D.2d 408, 409 (1st Dep't 2009).

*4 Furthermore, even if Partners did owe contractual obligations to B & C, B & C's breach of contract claim against Partners would be unable to be sustained, based on documentary evidence that provides Partners a defense as a matter of law. B & C's allegation that Partners breached its contractual obligation by failing to invest in accordance with the investment strategy set forth in the Memorandum is plainly contradicted by the terms of the Memorandum. The Memorandum states that "the Investment Adviser may pursue additional strategies, in its sole discretion" in pursuit of the Fund's investment objective. Memorandum at 5. Partners, therefore, was not contractually bound to follow any particular strategy in its attempt to create a Dutch Book. Additionally, B & C's allegation that Partners breached its contractual obligation by failing to create a Dutch Book is contradicted by the Memorandum's aspirational statements.

B & C's first cause of action for breach of contract against Partners is therefore dismissed.

2. Breach of Fiduciary Duty

B & C asserts its second cause of action for breach of fiduciary duty against all Defendants. B & C contends that because it was the only investor in the Fund, Defendants stood as fiduciaries to B & C. Amended Complaint at ¶ 27. B & C contends that due to the fiduciary relationship, Defendants were required to invest in accordance with the investment strategy set forth in the Memorandum. *Id.* at ¶ 28. B & C alleges that Defendants breached their duty by mismanaging the investment and failing to create a Dutch Book, thereby damaging B & C in an amount not less than $10,000,000. *Id.* at ¶¶ 29-31.

Defendants contend that the detailed Subscription Agreement, which incorporated the Memorandum, contained no provision regarding fiduciary or fiduciary-like obligations toward B & C. Defendants argue that the Subscription Agreement therefore precludes imposition of a fiduciary duty upon the Fund. Defendants further argue that B & C, as a shareholder of the Fund, cannot assert a cause of action against Partners in Partners' capacity as investment adviser. Defendants also contend that Jonas has no fiduciary obligation to B & C because his dealings with B & C were completed solely in his capacity as a Fund/Partners corporate representative.

"A fiduciary relationship arises between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation.' " *Eurycleia Partners, LP v. Seward & Kissel, LLP,* 12 N.Y.3d 553, 561, 883 N.Y.S.2d 147, 910 N.E.2d 976 (2009) *quoting EBC I v. Goldman Sachs & Co.,* 5 N.Y.3d 11, 19, 799 N.Y.S.2d 170, 832 N.E.2d 26 (2005). Such a relationship is grounded on a "higher trust" than normally present in the marketplace between those involved in arm's length business transactions. *HF Mgmt. Servs., LLC v. Pistone,* 34 A.D.3d 82, 85, 818 N.Y.S.2d 40 (1st Dep't 2006). Under *North Shore Bottling Company v. C. Schmidt & Sons, Inc.,* "a contracting party may be charged with a separate tort liability arising from a breach of a duty distinct from, or in addition to, the breach of contract." *North Shore Bottling Company v. C. Schmidt & Sons, Inc.,* 22 N.Y.2d 171, 179, 292 N.Y.S.2d 86, 239 N.E.2d 189 (1968). It is fundamental, however, that fiduciary liability is not dependent solely upon an agreement or contractual relation. *Kassover v. Prism Venture Partners, LLC,* 53 A.D.3d 444, 449, 862 N.Y.S.2d 493 (1st Dep't 2008). If the parties to a contract "do not create their own relationship of higher trust, courts should not ordinarily transport them to the higher realm of relationship and fashion the stricter duty for them." *Northeast Gen. Corp. v. Wellington Advertising,* 82 N.Y.2d 158, 162, 604 N.Y.S.2d 1, 624 N.E.2d 129 (1993).

***5** B & C argues that the "ongoing conduct between the parties," B & C's investment and the Defendants' role as investment adviser and manager, gives rise to a fiduciary relationship between plaintiff and each defendant. B & C alleges that Defendants retained complete control over its investment and described Jonas as a "renowned industry expert" and the "key" person making investment decisions. B & C contends that Defendants therefore acted in a role which imposed fiduciary obligations independent of any contractual relationship.

The Fund

B & C cites to *Sergeants Benevolent Association Annuity Fund v. Renck* in support of its argument that Defendants owed B & C a fiduciary duty. *Sergeants Benevolent Association Annuity Fund v. Renck,* 19 A.D.3d 107, 796 N.Y.S.2d 77 (1st Dep't 2005). Unlike the plaintiffs in *Sergeants,* however, B & C is a sophisticated investor. *Cf. id.* at 110, 796 N.Y.S.2d 77 (reversing the dismissal of a breach of fiduciary duty claim asserted by trustees against an investment adviser based on allegations that the trustees, who lacked "sophisticated knowledge of investment management," relied on the adviser's statements regarding his expertise). B & C acknowledged its sophistication in the Subscription Agreement and allowed that it possessed the requisite knowledge and experience to properly evaluate the investment decision.

Furthermore, B & C alleges that Defendants' fiduciary duty is based on B & C's investment in the Portfolio, pursuant to the Subscription Agreement. A cause of action for breach of fiduciary duty cannot stand when there is a "formal written agreement covering the precise subject matter of the alleged fiduciary duty" and a breach of contract claim has been asserted based on that agreement. *Fesseha v. TD Waterhouse Investor Servs.,* 305 A.D.2d 268, 269, 761 N.Y.S.2d 22 (1st Dep't 2003). Because the Subscription Agreement covers the precise subject matter of the alleged fiduciary duty, and B & C does not allege a separate tort liability independent from or in addition to the contract claim, B & C's breach of fiduciary duty claim against the Fund must be dismissed. *See Celle v. Barclays Bank PLC,* 48 A.D.3d 301, 301, 851 N.Y.S.2d 500 (1st Dep't 2008).

Jonas

B & C further relies on *Sergeants Benevolent Association Annuity Fund* for its fiduciary duty claim against Jonas. In *Sergeants,* the court reinstated a breach of fiduciary duty claim against individual Defendants who were the president and vice president of an investment advisory and management firm and who had "held themselves out as experienced in the field of investment consulting and management." *Sergeants Benevolent Association Annuity Fund,* 19 A.D.3d at 109, 796 N.Y.S.2d 77. As noted above, the *Sergeants* court determined that there was an issue of fact whether a fiduciary relationship existed because the plaintiffs-trustees lacked "sophisticated knowledge of investment management." *Id.* at 110, 796 N.Y.S.2d 77. B & C's admitted sophistication in the investment arena precludes its analogy to *Sergeants.* For this reason, and because B & C does not allege facts that Jonas acted at any time outside of his capacity as corporate representative, the cause of action for breach of fiduciary duty against Jonas must therefore be dismissed. *See Solow v. New Northern Brokerage Facilities, Inc.,* 255 A.D.2d 198, 198, 680 N.Y.S.2d 92 (1st Dep't 1998).

Partners

***6** In support of its breach of fiduciary duty claim against Partners, B & C relies primarily on *Bullmore v. Ernst & Young Cayman Island,* 45 A.D.3d 461, 846 N.Y.S.2d 145 (1st Dep't 2007). *Bullmore* involved a breach of fiduciary duty action asserted by liquidators on behalf of a collapsed hedge fund against the fund's managing investment advisers. *Id.* at 463, 846 N.Y.S.2d 145. The liquidators alleged that the advisers failed to disclose the extent of the hedge fund's losses during its five year existence and misrepresented the fund's valuation procedures. *Id.* at 462, 846 N.Y.S.2d 145. The court found that the investment advisers owed a fiduciary

duty to the hedge fund. *Id.* at 463, 846 N.Y.S.2d 145.

Unlike the liquidator plaintiffs in *Bullmore,* who sued the advisers on the fund's behalf, B & C asserts its fiduciary duty claim in its capacity as a shareholder of the Fund. While a fiduciary duty may exist between an investment adviser and client, B & C is not Partners' client: rather, the Fund is Partners' client. B & C has no direct relationship with Partners, therefore Partners owes B & C no fiduciary duty. B & C's cause of action for breach of fiduciary duty against Partners must therefore be dismissed. *See Northeast Gen. Corp.,* 82 N.Y.2d at 162, 604 N.Y.S.2d 1, 624 N.E.2d 129.

3. Negligence

B & C asserts its third cause of action for negligence against all Defendants. B & C alleges that each of the Defendants owed a "duty to manage the Portfolio in a skillful, prudent, reasonable, and professionally expert manner." Amended Complaint at ¶ 33. B & C contends that Defendants breached this duty when they "imprudently, negligently, and recklessly failed to invest in accordance with the investment strategy set forth in the Memorandum" and engaged in transactions "that were incompatible with the investment strategy set forth in the Memorandum." *Id.* at ¶ 34, 604 N.Y.S.2d 1, 624 N.E.2d 129.

Defendants contend that the negligence cause of action should be dismissed because it is a breach of contract claim improperly recast as a tort claim. Defendants further contend that B & C, as a shareholder of the Fund, cannot assert a cause of action against Partners in its capacity as investment adviser. Defendants also argue that Jonas, in his capacity as a Fund officer, cannot be liable in a negligence action against the Fund because he does not owe a duty directly to B & C.

To plead a cause of action for negligence, a plaintiff must show that a defendant owed a duty to the plaintiff, that defendant breached the duty, and that plaintiff was injured as a proximate result of defendant's breach. *See Freidman v. Anderson,* 23 A.D.3d 163, 165, 803 N.Y.S.2d 514 (1st Dep't 2005). "[A] claim arising out of an alleged breach of contract may not be converted into a tort action absent the violation of a legal duty independent of that created in the contract." *Givoldi, Inc. v. UPS,* 286 A.D.2d 220, 221, 729 N.Y.S.2d 25 (1st Dep't 2001). "This legal duty must spring from circumstances extraneous to, and not constituting elements of, the contract, although it may be connected with and dependent on the contract." *Clark-Fitzpatrick, Inc. v. Long Island R. Co.,* 70 N.Y.2d 382, 389, 521 N.Y.S.2d 653, 516 N.E.2d 190 (1987).

The Fund

*7 B & C argues that negligent performance of a contract may give rise to a tort claim in addition to a breach of contract claim. B & C cites to *Clark-Fitzpatrick* for the proposition that negligence and breach of contract claims may coexist. B & C has not, however, provided any factual support for its allegation that the Fund owes B & C a legal duty beyond the terms of the Memorandum. B & C's negligence allegations are based solely on the terms of the Memorandum and are thus duplicative of its contract claim. B & C attempts to assert a cause of action for negligent breach of contract, which New York law does not recognize. *Megaris Furs, Inc. v. Gimbel Brothers, Inc.,* 172 A.D.2d 209, 211, 568 N.Y.S.2d 581 (1st Dep't 1991). The negligence cause of action against the Fund must therefore be dismissed.

Partners

B & C relies primarily on *Bullmore v. Ernst & Young Cayman Island* in support of its negligence claim against Partners. *Bullmore v. Ernst & Young Cayman Island,* 45 A.D.3d 461, 846 N.Y.S.2d 145 (1st Dep't 2007). In *Bullmore,* the court sustained the liquidators' negligence claim and found that the advisers had fiduciary obligations to the fund which gave rise to a duty to exercise reasonable care independent of the contractual obligations. *Id.* at 463, 846 N.Y.S.2d 145. Here, there is no basis for a fiduciary duty between B & C and any of the three

Defendants. As discussed with regard to B & C's breach of fiduciary duty claim against Partners, Partners owes no legal duty to B & C. Partner's client is the Fund, not B & C. The negligence cause of action against Partners must therefore be dismissed.

Jonas

In support of its negligence action against Jonas, B & C argues that Jonas beyond a capacity as merely a director or principal of the Fund or Partners. B & C points to the Memorandum which described Jonas as the "key" person at Partners providing investment advice and a "renowned industry expert" who developed many of the "leading strategies and instruments in the derivatives marketplace." Memorandum at 5-6. These statements, however, relate to Jonas' contractual obligations as a director of the Fund or principal of Partners. The statements do not show that Jonas undertook a duty independent of the Subscription Agreement between B & C and the Fund or the Investment Adviser Agreement between the Fund and Partners. The negligence cause of action against Jonas must therefore be dismissed.

4. Fraud

B & C asserts its fourth cause of action for fraud against all Defendants. B & C alleges that in order to induce B & C to invest in the Fund, the Defendants represented that previously successful proprietary algorithms would be used to manage the investment. Amended Complaint at ¶ 11b.[FN2] B & C alleges that these representations were materially false when made and Defendants knew, but concealed, that they had no proprietary algorithms. *Id.* at ¶ 38, 846 N.Y.S.2d 145. B & C contends that the Defendants made these representations with the intent to deceive B & C and that it relied to its detriment on Defendants' representations (*id.* at ¶¶ 39-40, 846 N.Y.S.2d 145).

> FN2. In ¶ 37 of the fraud allegations in the Amended Complaint, B & C alleges that the Defendants represented that the algorithms had been "unsuccessful used" in the past. Because B & C alleges in ¶ 11b that Defendants represented that the algorithms had been "successfully used" in the past, and the parties brief the fraud cause of action in accordance with the allegations as stated in ¶ 11b, the court similarly addresses the fraud allegations in accordance with ¶ 11b.

***8** Defendants contend that plaintiff's fraud claim should be dismissed because: (a) the Memorandum contains only aspirational statements regarding the creation of a Dutch Book; (b) the Memorandum's risk disclosures negate any claim of reliance; (c) B & C acknowledged that it had the opportunity to ask questions regarding the Memorandum's terms and obtain information necessary to evaluate the investment, and B & C's failure to request to see the allegedly non-existent algorithms is fatal to the fraud claim; and (d) B & C's fraud allegations are duplicative of its contract claim.

To posit a claim of fraud, the complaint must allege a representation of material fact, falsity, scienter, reliance and injury. *Small v. Lorillard Tobacco Co., Inc.,* 94 N.Y.2d 43, 57, 698 N.Y.S.2d 615, 720 N.E.2d 892 (1999). Because Defendants do not address B & C's fraud allegations toward each individual defendant, the court applies B & C's allegations and Defendants' arguments in support of its motion to dismiss to all Defendants as a class.

(a) "Aspirational Statements"

Defendants contend that the Memorandum's assertions of "forward-looking hopes" do not support a claim of fraud. Defendants' Memorandum in Support of Their Motion to Dismiss the Amended Complaint ("Def. Mem in Support"), at 11. Defendants contend that statements that are merely "speculation and expressions of hope for the future do not constitute actionable representations of fact." *Citing Zaref v. Berk Michaels, P.C.,* 192 A.D.2d 346, 348-49, 595 N.Y.S.2d 772 (1st Dep't 1993).

In opposition, B & C points to the allegations

set forth in the complaint. B & C alleges that Defendants misrepresented that the proprietary algorithms had been successfully used in the past. Amended Complaint at ¶¶ 11b, 38. Additionally, B & C alleges that the Defendants knew, but concealed, that there were no proprietary algorithms. *Id.* at ¶ 38, 595 N.Y.S.2d 772. B & C asserts that the Defendants knew that without the proprietary algorithms, the Portfolio could not and would not be "structured" so as to create a Dutch Book. *Id.*

Contrary to Defendants' contentions, these alleged misrepresentations are not merely aspirational, but, rather, are statements concerning the existence of the proprietary algorithms that, "taken together and in context," may have mislead a reasonable investor. *Hunt v. Alliance North Am. Gov't Income Trust, Inc.,* 159 F.3d 723, 728 (2d Cir.1998) (applying New York law and holding that alleged misrepresentations contained in a written prospectus regarding the intended use of hedging techniques constituted an actionable claim for misrepresentation). The Defendants' statements regarding the algorithms can be characterized as alleged misrepresentations of existing material fact purportedly known by Defendants to be false when made. On a motion to dismiss, these allegations must be accepted as true and may serve as the basis for a fraud claim. *Houbigant, Inc. v. Deloitte & Touche LLP,* 303 A.D.2d 92, 753 N.Y.S.2d 493 (1st Dep't.2003).

(b) Risk Disclosures

***9** Next, Defendants argue that the Memorandum's risk disclosures, provided in pages 22-30 of the Memorandum, stated that there was "no assurance" that the investment objective would be achieved and that the investment presented a high degree of risk. Defendants contend that these risk disclosures negate any claim of reliance.

The cases Defendants cite for support arise under different factual circumstances than the case at bar, and, thus, are inapposite. Defendants' cases do not address B & C's allegations that Defendants knowingly misrepresented that proprietary algorithms existed. "While the use of cautionary language in offering materials may render any alleged misrepresentations immaterial as a matter of law," cautionary language will not insulate a defendant who has failed to disclose current conditions adverse to the offering from liability. *Ackerman v. Price Waterhouse,* 252 A.D.2d 179, 683 N.Y.S.2d 179 (1st Dep't 1998); *see also Scantek Med. Inc. v. Sabella,* 583 F.Supp.2d 477, 496 (S.D.N.Y.2008) (applying New York law). B & C alleges that Defendants knowingly misrepresented current conditions related to the existence of the algorithms and their past performance, and that these conditions were adverse to the Fund's likelihood of success. Amended Complaint at ¶¶ 11b, 38.

Furthermore, B & C's allegations that it relied on the existence of the proprietary algorithms in making its investment decision involve more than allegations that the Fund failed to perform as expected. *Hunt,* 159 F.3d at 729 (applying New York law and explaining that the defendant was not afforded a defense to a fraud claim based on cautionary language contained in a prospectus because such language "warned that the Fund's hedging maneuvers might fail, not that the Fund would have no opportunity to use hedging maneuvers That the prospectus disclosed the possible inefficacy of hedges does not shield the Fund from liability for misrepresenting the availability of hedging opportunities"). In addition, a disclaimer is generally enforceable only if it tracks the substance of the alleged misrepresentation. *JP Morgan Chase ex rel. Mahonia Ltd. v. Liberty Mut. Ins. Co.,* 189 F.Supp.2d 24, 27 (S.D.N.Y.2002) (applying New York law and noting that a disclaimer must be sufficiently specific to provide a "clear indication that the disclaiming party has knowingly disclaimed reliance on the specific representations that form the basis of the fraud claim"). Here, the Defendants point to the Memorandum's risk disclosures in support of its motion to dismiss the fraud claim, but none of these disclosures even mention the algorithms.

As a result, taking B & C's allegations as true

on this motion to dismiss, the risk disclosures do not negate a claim of reasonable reliance on Defendants' statements regarding the existence and efficacy of the algorithms. *Hunt,* 159 F.3d at 729.

(c) Plaintiff's Sophistication as an Investor

B & C asserts that, despite its representations in the Subscription Agreement regarding its sophistication and ability to evaluate the investment decision, it should not be precluded from claiming reliance on Defendants' alleged misrepresentations. B & C contends that its reliance on Defendants' misrepresentations was reasonable because knowledge regarding the nature and existence of the proprietary algorithms was peculiarly the Defendants.

***10** Defendants contend that, even if the algorithms do not exist, B & C's own representations in the Subscription Agreement (1) that it "possesses requisite knowledge and experience in financial matters such that it is capable of evaluating the risks and merits" of the investment, Subscription Agreement at S-10, ¶ (e), and (2) that it had the "opportunity to ask questions of and receive answers" concerning the terms of the investment and "obtain any additional information necessary to verify the information" it received regarding the investment, *id.* at ¶ (h), preclude its fraud claim. Defendants argue that when a party has access to all relevant information, there can be no reliance on alleged misrepresentations.

Despite B & C's representations, B & C may have justifiably relied upon Defendants' alleged misrepresentations regarding the algorithms. *See National Western Life Ins. Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 89 F. App'x 287, 294-95 (2d Cir.2004) (applying New York law and noting that "sophisticated' entities can justifiably rely on fraudulent statements," and whether such entities did so in a particular case "is a genuine issue of material fact"). The Amended Complaint alleges that, despite the exercise of reasonable due diligence, B & C could not have discovered the truth regarding Defendants' misrepresentations because the nature and existence of the algorithms was peculiarly within the Defendants' knowledge. Amended Complaint at ¶ 20. B & C further contends that it did not have the technical training or required expertise in algorithms or probability theory to determine whether the algorithms existed. *Id.* B & C alleges that it relied on the Defendants' statements for these reasons and because of Jonas' purported status as a "renowned industry expert in the field of global derivatives." *Id.*

Accepting these allegations as true, B & C's reliance, particularly where the Defendants were in exclusive possession of details regarding the algorithms, can be characterized as reasonable. *See Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC,* 376 F.Supp.2d 385, 411 (S.D.N.Y.2005) (applying New York law and noting that a hedge fund investor could reasonably rely on information provided by the defendants concerning the fund's performance because defendants were "uniquely positioned to know" the fund's value). Thus, it is not apparent at this early stage of the litigation that details about the proprietary algorithms would have been revealed upon B & C's inspection. While the evidence might ultimately demonstrate that Defendants did not have any special knowledge or that B & C could have ascertained information about the algorithms by exercising reasonable diligence, these issues are "inappropriate to determine as a matter of law solely on the allegations in [the] complaint." *P.T. Bank Cent. Asia, N.Y. Branch,* 301 A.D.2d at 383, 753 N.Y.S.2d 463.

(d) Fraud as Duplicative of Breach of Contract Claim

***11** Defendants next, and finally, argue that B & C's fraud claim is based solely on the Memorandum and Subscription Agreement, the documents that underlie B & C's breach of contract claim. Defendants contend that B & C's fraud claim should therefore be dismissed because it is duplicative of B & C's breach of contract claim. Defendants are incorrect. "If a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented material facts, the plaintiff has stated a

claim for fraud even though the same circumstances also give rise to the plaintiff's breach of contract claim." *First Bank of the Ams. v. Motor Car Funding, Inc.*, 257 A.D.2d 287, 291-92, 690 N.Y.S.2d 17 (1st Dep't 1999) (reinstating plaintiff's fraud claim because the allegations of misrepresentation were not regarding a future intent to perform, but were related to pertinent facts about individual loans plaintiff purchased through a written agreement). B & C's fraud claim is premised on allegations that the algorithms Defendants represented to have "successfully used in the past" simply do not exist. Amended Complaint at ¶¶ 11b, 38. B & C's allegations that Defendants misrepresented existing material facts does not relate to future performance, and the allegations are sufficiently independent from its contract claim to stand on their own. *See First Bank of the Ams.*, 257 A.D.2d at 291-92, 690 N.Y.S.2d 17.

For the above reasons Defendants' motion to dismiss B & C's fraud claim is therefore denied.

5. Alter Ego

B & C alleges that Jonas is personally liable as the alter ego of Partners because he "exercised complete domination and control of the operation, management, and financial affairs of Partners" and that he "used his power over Partners to further his personal interests and comingled the assets and economic activity of Partners with his own." Amended Complaint at ¶¶ 44-45. B & C alleges that in doing so Jonas repeatedly disregarded the required corporate formalities. *Id.* at ¶ 46, 690 N.Y.S.2d 17. B & C further alleges that Jonas left Partners undercapitalized and unable to meet its debts. *Id.* at ¶ 47, 690 N.Y.S.2d 17.

Defendants contend that B & C's alter ego allegations are insufficient under CPLR 3016(b) to support the cause of action because they fail to plead with particularity the manner in which Jonas used complete domination to commit wrongdoing against the bank.

To state a cause of action for alter ego liability, a plaintiff must allege that "the owner exercised complete domination of the corporation in respect to the transaction attacked, and that such domination was used to commit a fraud or a wrong against the plaintiff which resulted in plaintiff's injury." *Teachers Ins. Annuity Assn. of Am. v. Cohen's Fashion Opt. of 485 Lexington Ave. Inc.*, 45 A.D.3d 317, 318, 847 N.Y.S.2d 2 (1st Dep't 2007) *citing Matter of Morris v. New York State Dep't of Taxation and Fin.*, 82 N.Y.2d 135, 141, 603 N.Y.S.2d 807, 623 N.E.2d 1157 (1993). While wholly conclusory allegations are insufficient to maintain a cause of action for alter ego liability, *Andejo Corp. v. South Street Seaport Ltd. Partnership Corp.*, 40 A.D.3d 407, 407, 836 N.Y.S.2d 571 (1st Dep't 2007), on a motion to dismiss the "sole criterion is whether the pleading states a cause of action and if from its four corners factual allegations are discerned with taken together manifest any cause of action cognizable at law." *Polonetsky*, 97 N.Y.2d at 54, 735 N.Y.S.2d 479, 760 N.E.2d 1274.

***12** Viewing the complaint in the light most favorable to B & C, as required on a motion to dismiss, and taking the complaint as a whole, B & C has sufficiently raised material issues of fact as to whether Jonas was an alter ego of Partners. *See Trans Int'l Corp. v. Clear View Techs.*, 278 A.D.2d 1, 2, 717 N.Y.S.2d 146 (1st Dep't 2000). B & C alleges that Jonas was a director of the Fund, as well as the Chief Executive Officer and Chief Financial Officer of Partners, and that Partners' place of business was located at Jonas' New York residence. Amended Complaint at ¶¶ 3-4. B & C further alleges that Jonas provided B & C with a copy of the Memorandum and arranged for B & C to execute the Subscription Agreement. *Id.* at ¶ 3, 717 N.Y.S.2d 146. Following execution of the Subscription Agreement, B & C alleges that Jonas communicated directly with B & C regarding its investment in the Portfolio. *Id.* Additionally, the Memorandum designates Jonas as one of only three of the Fund's directors, the other two individuals being employees of Ogier Fiduciary Services Limited, a Cayman Island based company, retained by the

Fund for an annual fee of $5,000 per director. Memorandum at 5-6. The Memorandum also designates Jonas as one of only two of the "key persons" of Partners, the Fund-appointed Investment Adviser. *Id.* at 7, 717 N.Y.S.2d 146. As such, on this motion to dismiss, B & C's allegations have resulted in a "fact-laden claim to pierce the corporate veil" that is unsuited for addressing at this early stage in the litigation. *Ledy v. Wilson,* 38 A.D.3d 214, 215, 831 N.Y.S.2d 61 (1st Dep't 2007). Defendants' motion to dismiss the alter ego claim against Jonas must therefore be denied. *See Kralic v. Helmsley,* 294 AD3d 234, 236 (1st Dep't 2002).

Accordingly, it is hereby

ORDERED that Defendants Dutch Book Funds SPC, Ltd, Dutch Book Partners, LLC, and Stanley R. Jonas's motion to dismiss the complaint is granted as to:

(a) B & C's breach of contract claim against Dutch Book Funds SPC, Ltd;

(b) B & C's breach of contract claim against Dutch Book Partners, LLC;

(c) B & C's breach of fiduciary duty claim against Dutch Book Funds SPC, Ltd;

(d) B & C's breach of fiduciary duty claim against Dutch Book Partners, LLC;

(e) B & C's breach of fiduciary duty claim against Stanley R. Jonas;

(f) B & C's breach of negligence claim against Dutch Book Funds SPC, Ltd;

(g) B & C's breach of negligence claim against Dutch Book Partners, LLC; and

(h) B & C's breach of negligence claim against Stanley R. Jonas; and it is further

ORDERED that Defendants Dutch Book Funds SPC, Ltd, Dutch Book Partners, LLC, and Stanley R. Jonas's motion to dismiss is otherwise denied, and it is further;

ORDERED that Defendants Dutch Book Funds SPC, Ltd, Dutch Book Partners, LLC, and Stanley R. Jonas are directed to answer the remaining claims in the Amended Complaint within ten (10) days after the service of a copy of this order with notice of entry.

This constitutes the decision and order of the Court.

N.Y.Sup.,2010.
Barneli & Cie S.A. v. Dutch Book Funds, SPC, Ltd.
Slip Copy, 28 Misc.3d 1232(A), 2010 WL 3504780 (N.Y.Sup.), 2010 N.Y. Slip Op. 51571(U)

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