To Be Argued By:
PHILIPPE Z. SELENDY

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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

MBIA INSURANCE CORPORATION,

Plaintiff-Respondent/Cross-Appellant,

—against—

COUNTRYWIDE HOME LOANS, INC.,
COUNTRYWIDE SECURITIES CORP., COUNTRYWIDE FINANCIAL CORP.,
COUNTRYWIDE HOME LOANS SERVICING, L.P.,

Defendants-Appellants/Cross-Respondents,

—and—

BANK OF AMERICA CORP.,

Defendant-Respondent.

BRIEF FOR PLAINTIFF-RESPONDENT/CROSS-APPELLANT

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Plaintiff-Respondent-Cross-Appellant MBIA Insurance Corporation ("MBIA") respectfully submits this brief in support of affirmance of an order of the Supreme Court, New York County, I.A.S. Part 3 (Bransten, J.), dated January 3, 2012 (the "Order"). In one limited respect discussed in MBIA's cross-appeal at the conclusion of this brief, MBIA seeks reversal of the Order.

PRELIMINARY STATEMENT

Both in New York and nationwide, it is a well-settled rule of insurance law that, when an applicant's misrepresentations induce an insurer into issuing an insurance policy, "it is immaterial that there is no causal or other relationship between the actual loss which is sustained under the policy and the falsity of the representation." 6 COUCH ON INSURANCE § 82:20 (3d ed. June 2011). Instead, the only question is whether "knowledge by the insurer of the facts misrepresented would have led to a refusal by the insurer to make such contract." N.Y. Ins. L. § 3105(b)(1). A similar test applies to claims for breach of warranty, asking whether the breach "materially increase[d] the *risk* of loss" at the time the policy was issued, N.Y. Ins. L. § 3106(b) (emphasis added), not whether that specific risk came to pass during the policy.

For example, where an applicant misrepresented in his life insurance application that he had not received medical treatment subsequent to his examination by the insurer's physician (when in fact he had received treatment for

an intestinal ulcer), and the insured later died from "coronary sclerosis, a disease unrelated to the intestinal ulcer," the court held that the insurer could not be bound, explaining that "[t]he fact that the applicant died from another cause does not disprove the increase of risk" to the insurer on day one of the policy. *Glickman v. N.Y. Life Ins. Co.*, 291 N.Y. 45, 49, 50, 52 (1943). Similarly, in a property insurance case, where the applicant misrepresented that the property would not be used as a motel, it did not matter that the fire that damaged the property was unrelated to use of the property as a motel. *Royal Indem. Co. v. Patel*, No. 5:03-cv-999, 2005 WL 2573514, at *4 (N.D.N.Y. Oct. 13, 2005). In both cases, the only inquiry was whether the misrepresentation materially increased the *risk* to the insurer at the time the policy was issued, such that the insurer would not have issued the policy or would not have issued it on the same terms.

This rule rests on two important rationales. From the insurer's standpoint, it allows the insurer to obtain and rely upon the applicant's representations as to the risk being insured *before* the insurer commits to provide the insurance. *See, e.g.*, *Vander Veer v. Cont'l Cas. Co.*, 34 N.Y.2d 50, 52-53 (1974) ("As an insurer, the defendant is free to select its risks and it makes inquiry of matters which it deems material to the risk."). From the applicant's standpoint, it removes the perverse incentive that would exist if "the insured could freely misrepresent information specifically requested and still recover on the policy if the causal connection could

not be traced." *Ginsburg v. Pac. Mut. Life Ins. Co.*, 89 F.2d 158, 159 (2d Cir. 1937); *accord*, John D. Ingram, *Misrepresentations In Applications For Insurance*, 14 U. Miami Bus. L. Rev. 103, 111 (2005) ("If the cause of loss is connected to the misrepresented fact, the insured has lost nothing, because he wouldn't have had coverage anyway. If the cause of loss is not connected, he has coverage he otherwise couldn't have obtained. Thus, he had nothing to lose by misrepresenting.").

Defendants-Appellants Countrywide Home Loans, Inc., Countrywide Securities Corp., Countrywide Financial Corp., and Countrywide Home Loans Servicing, L.P. (collectively, "Countrywide") are exactly the sort of "unscrupulous … applicant" with which the insurance-law rule is concerned. *Mut. Benefit Life Ins. Co. v. JMR Elec. Corp.*, 848 F.2d 30, 34 (2d Cir. 1988). Countrywide embarked upon an ambitious plan to dominate the nation's residential mortgage-lending market, including by "securitizing" the loans it made. Securitization here involves grouping the loans into a pool and selling (for cash) the residential mortgage-backed securities ("RMBS") to the investing public, with the RMBS giving their owners a share of the principal and interest payments made by the borrowers on the underlying loans. With respect to the fifteen securitizations at issue in this case, Countrywide was not only the primary lender and servicer of the loans, but also the securitizer of the loans, controlling virtually every element of

each transaction. In its multiple roles, Countrywide had unique knowledge of the credit characteristics of each loan, property, and borrower—characteristics that must be considered by the loan originator to determine whether the borrower can reasonably be expected to repay the loan. Countrywide did not want to retain the risk of non-payment on its own books, so it set out to "securitize" the loans.

Countrywide knew that prospective investors were sensitive to the risks that the underlying loans would fail to produce income; accordingly, to make the RMBS more marketable, Countrywide sought to lower the risk to prospective investors by soliciting MBIA to provide insurance (known as "financial guaranty insurance") for the benefit of the RMBS investors to cover potential shortfalls in the cash flows from the underlying loans. MBIA, like insurers in all other fields, had a keen interest in evaluating the degree of risk *before* committing to issue the requested policy. Accordingly, it demanded, and Countrywide provided, extremely detailed representations as to the attributes of each of the 389,000 borrowers and loans in the fifteen securitizations. These representations were so important that MBIA made Countrywide confirm their truth in warranties that were conditions precedent to MBIA's issuance of the insurance policies. Had MBIA known that these representation and warranties were materially false, such that the risk of loss on the loans was materially higher than represented by Countrywide as

the insurance applicant, MBIA would never have issued the policies in the first place.

As MBIA discovered only after issuing the policies, Countrywide's representations and warranties were materially false, at the time they were made, as to an overwhelming percentage of loans in the securitizations. MBIA filed this suit, alleging, *inter alia*, claims for fraudulent inducement and breach of warranty, and seeking a remedy that would return MBIA to the position it would have occupied had it never issued the policies. Countrywide, having profited from policies that never would have been issued (insofar as those policies enabled Countrywide to sell the RMBS to investors), now seeks to retain its unjustly received benefit by arguing, like the unsuccessful parties in *Glickman*, *Royal Indemnity*, and other cases, that an extraneous post-policy issuance event—here, Countrywide asserts, the housing crisis—caused the losses under the policies.

The IAS Court broke no new ground in rejecting Countrywide's argument, but simply applied the well-settled insurance law rule of causation in the modern context of financial guaranty insurance on a mortgage-loan securitization.[1] The IAS Court's decision has since been expressly followed by two federal judges in

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[1] Financial guaranty insurance is covered by the New York Insurance Law. *See* N.Y. Ins. L. § 6908 ("An insurer issuing policies of financial guaranty insurance shall be subject to all of the provisions of this chapter applicable to property/casualty insurers to the extent that such provisions are not inconsistent with the provisions of this article.").

similar cases. *See Syncora Guar. Inc. v. EMC Mortg. Corp.*, No. 09 Civ. 3106, 2012 WL 2326068, at *7 (S.D.N.Y. June 19, 2012) (quoting decision of IAS Court below that there is "'no basis in law … to mandate that MBIA establish a direct causal link between the misrepresentations allegedly made by Countrywide and claims made under the policy'" and finding that "[t]he same reasoning applies in this case") (quoting *MBIA Ins. Co. v. Countrywide Home Loans, Inc.*, 936 N.Y.S.2d 513, 521-22 (Sup. Ct. N.Y. Cnty. 2012) (R.83)); *Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, No. 11 Civ. 2375, 2012 WL 4373327, at *5 (S.D.N.Y. Sept. 25, 2012) ("materiality of breach depends on the 'risk of loss'") (quoting *MBIA*, 936 N.Y.S.2d at 522 (R.84)).

Much of Countrywide's brief—indeed, its entire Argument Point I—ignores the insurance-law rule and instead invokes a "loss causation" requirement from general common law. The insurance-law rule applies fully here and disposes of Countrywide's argument. But even if the insurance-law rule could be ignored, Countrywide is wrong that the causation requirement of general common law *always* requires a showing that the defendant's misconduct caused losses during the term of the contract. To the contrary, the causation requirement can be satisfied by harms incurred at closing of the contract. For example, where a plaintiff claims that the defendant's misrepresentations concerning a business caused the plaintiff to overpay for the business, causation is satisfied by showing

that the misrepresentations caused the plaintiff to acquire the business at the price it paid, with no need to show a further "causal link between the [business's] ultimate failure and [defendant's] misrepresentations." *Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc.*, 500 F.3d 171, 182-83 (2d Cir. 2007). Similarly here, MBIA's claims focus on the harm it suffered on day one when it issued policies with a substantially increased risk profile over that which they would have had absent Countrywide's misconduct. And MBIA's requested "rescissory damages" relief is consistent with this focus because it seeks to "restore [MBIA] to the position occupied before the defendant's wrongful acts." BLACK'S LAW DICTIONARY, "Damages" (9th ed. 2009).

When Countrywide finally acknowledges the insurance-law rule, it unpersuasively attempts to divorce the rule from the equally fundamental principle that New York courts may "grant any type of relief … appropriate to the proof," N.Y. C.P.L.R. 3017(a), including "damages … in lieu of equitable relief 'where the granting of equitable relief appears to be impossible or *impracticable*.'" *Ungewitter v. Toch,* 31 A.D.2d 583, 584 (3d Dep't 1968) (quoting *Doyle v. Allstate Ins. Co.*, 1 N.Y.2d 439, 443 (1956)) (emphasis in original), *aff'd,* 26 N.Y.2d 687 (1970). Again, there is nothing novel in granting rescissory damages to an insurer to place it in the position it occupied before issuing the policy. In *Equitable Life Assurance Society v. Kushman*, 276 N.Y. 178 (1937), for example, where "the

insured made false statements in his application for the policies, and … the company relied upon such statements in issuing the policies," *id.* at 181, the Court of Appeals affirmed the insurer's ability to recover "[d]amages … as incident to an action in equity for a rescission," *id.* at 184, in the amount of the disability payments that the insurer had made to the insured, *id.* at 181. More recently, in the context of insurance on a securitization, a federal court emphasized that "[t]here is no question as to the Court's equitable powers" to award "claim payments less premiums." *Syncora*, 2012 WL 2326068, at *10.

Rescission is plainly impracticable here, and rescissory damages therefore warranted, because it would be impossible, and in any event unfair, for MBIA to rescind its obligations under the insurance policies to hundreds of innocent RMBS certificateholders who had no involvement in Countrywide's misrepresentations. The IAS Court was well within its equitable powers in recognizing that the more appropriate course is for MBIA to seek rescissory damages against Countrywide, the wrongdoing entity that procured the policies by misrepresentation and the entity that benefited by receiving a huge payout (and off-loading of its own risk) from the securitizations. Countrywide's objection (Br. 3) that such damages will effectively transform it (rather than MBIA) into the insurer mischaracterizes the issue; it is Countrywide's misrepresentations that led to MBIA becoming an insurer in the first place, and MBIA is entitled under well-settled law to a remedy

from Countrywide that returns MBIA to the position it should have occupied. As the IAS Court explained, such damages will not provide a windfall to MBIA because MBIA may recover only "the amount it has been required to pay pursuant to the Insurance Policies, *less premiums MBIA received under the policies*." R.87 (emphasis added).

The IAS Court, cognizant of its role at the partial-summary-judgment stage, did not *grant* rescissory damages to MBIA. Rather, the court held that MBIA will be entitled to such damages *if* MBIA establishes its claims for fraudulent inducement and/or breach of warranty on full summary judgment or at trial. That "if" will "not be an easy task." R.84. Specifically, MBIA must prove for its fraudulent inducement claim that Countrywide's misrepresentations caused MBIA to "issu[e] the Insurance Policies" insofar as MBIA "would not have [issued the policies] or would have issued the policies on different terms had the alleged misrepresentations not been made." R.84. Similarly, MBIA must prove for its breach of warranty claim that Countrywide's misrepresentations caused a "materia[l] increas[e in] MBIA's risk of loss." *Id.* But Countrywide may not, in disregard of well-settled New York insurance and remedial law, require that MBIA *additionally* prove a link between the misrepresentation and a loss incurred during the life of the policy. The IAS Court's Order should be affirmed.

COUNTERSTATEMENT OF QUESTIONS INVOLVED

1. Does an insurer establish a claim for fraudulent inducement of an insurance policy by demonstrating that the applicant's misrepresentations caused the insurer to issue a policy on terms to which it would not otherwise have agreed, with no requirement that the insurer show a further causal link between the misrepresentations and any losses during the life of the policy?

Answer of the IAS Court: The IAS Court correctly answered "yes."

2. Does an insurer establish a claim for breach of warranty by showing that the breach caused a material increase in the risk of loss under the policy, with no requirement that the insurer show a further causal link between the warranty breaches and any losses during the life of the policy?

Answer of the IAS Court: The IAS Court correctly answered "yes."

3. Is an insurer who so establishes a claim for fraudulent inducement or breach of warranty entitled to rescissory damages, where rescission is impracticable because (a) the applicant, not the insureds, is responsible for the wrongdoing and the applicant already profited from the provision of the insurance; and (b) the insurer's policies with the insureds prohibit rescission?

Answer of the IAS Court: The IAS Court correctly answered "yes."

COUNTERSTATEMENT OF THE CASE

MBIA filed this suit against Countrywide, alleging, *inter alia*, that Countrywide made misrepresentations that induced MBIA to provide financial guaranty insurance on 15 securitizations and that Countrywide breached warranties in the transaction documents. R.212-13. MBIA subsequently filed an amended complaint. R.368. The IAS Court denied in relevant part Countrywide's motion to dismiss the amended complaint, and this Court affirmed. *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 36 Misc.3d 1215(A) (Sup. Ct. N.Y. Cnty. Apr. 27, 2010), *aff'd*, 87 A.D.3d 287 (1st Dep't 2011).

On January 3, 2012, the IAS Court granted in relevant part MBIA's motion for partial summary judgment. R.94. Countrywide filed a notice of appeal on January 25, 2012, R.52, and perfected its appeal on November 7, 2012.

COUNTERSTATEMENT OF FACTS

A. Countrywide Made Representations And Warranties To Induce MBIA To Insure The Securitizations

This action involves fifteen securitizations of residential mortgage loans, each of which contained between approximately 8,000 and 48,000 loans. R.309. Countrywide originated the vast majority of the loans by making the loan to the borrower, and thus had unique knowledge of the characteristics of the loans (such as the borrower's income) that bear on the risk of non-payment. R.309-12. The specific details of each securitization involved the sale of the loans from

Countrywide to a trust, the trust's issuance of RMBS certificates entitling the holder to a share of the principal and interest payments on the underlying loans, and the trust's payment to Countrywide of the proceeds from the sale of the RMBS certificates. R.309-10.

To make the RMBS certificates more marketable to potential investors, Countrywide asked MBIA to provide insurance in the event the cash flow from the underlying loans was insufficient to make the promised payments to the certificateholders. R.299. To induce MBIA to issue the policies, Countrywide elected to make highly specific representations regarding loan and borrower attributes, and to back up those representations with express guarantees of truthfulness in the form of express contractual warranties. R.42, 315, 316.

For example, consistent with its duties as an insurance applicant, Countrywide made a broad guarantee that the information it had provided to MBIA did not "contain[] any statement of a material fact by [Countrywide] which was untrue or misleading in any material respect when made." *E.g.*, R.802. Countrywide also made representations and warranties about characteristics of the loans relevant to the risk that the borrower would fail to repay the loan. These included promises that Countrywide, in making the loans, had complied with its guidelines concerning the ratio of the loan balance to the value of

the mortgaged property, the ratio of borrower's debt to his income, and the borrower's credit score. *E.g.*, R.802-03.

As MBIA's CEO Jay Brown testified before the New York State Assembly Standing Committee On Insurance, "these reps and warranties were critical to us, as these criteria were a key determinant of the quality of loans eligible to be included in the loan pool—and consequently, how the pool could be expected to perform." R.3700. Underscoring the importance of the representations and warranties, the transaction documents expressly described their accuracy as "conditions precedent" to MBIA's issuance of the insurance policies. *E.g.*, R.1955. In relying on the representations and warranties, MBIA acted entirely in accord with the standard practice of insurers. *See, e.g.*, *Syncora*, 2012 WL 2326068, at *9 ("[A]n insurer relies on receiving complete and accurate information when deciding whether to issue a policy and how to price risk.").[2]

[2] Contrary to Countrywide's assertion (Br. 9) that MBIA could "request any additional information" before deciding to insure, MBIA did not have a pre-closing right of access to loan files and thus had no means to verify the truth of Countrywide's representations. *E.g.*, R.1936-37 (granting MBIA the right to request information only "during the Term of the Insurance Agreement"). In any event, a party that receives a representation and warranty ordinarily need not engage in due diligence concerning the fact represented. *See, e.g.*, *DDJ Mgmt. LLC v. Rhone Group LLC*, 15 N.Y.3d 147, 154-55 (2010).

B. Countrywide's Representations And Warranties Were Materially False

In fact, unbeknownst to MBIA when it agreed to issue the policies, Countrywide's representations and warranties were materially false with respect to a substantial majority of the underlying mortgage loans. The genesis of the misrepresentations was Countrywide's internal plan to dominate the mortgage-lending industry at virtually any cost, including by ignoring its own guidelines. Countrywide, among other things, imposed intense pressure on its employees to approve mortgage loans, in some instances requiring them to process 60 to 70 loan applications in a single day. R.332. Countrywide's loan officers not only failed to obtain required documentation, but actually coached applicants with inadequate income to lie about that fact to secure approval. R.331.

As a result, Countrywide soon had a stable of thousands of loans that breached its own underwriting guidelines, which required, for example, that Countrywide verify the borrower's employment and current salary by reviewing relevant documentation such as pay stubs, employer letters, bank accounts, and tax returns. R.322, 324-25, 329-30. When it came time for Countrywide to securitize the loans and to obtain financial guaranty insurance for the securitizations, Countrywide, wary of disclosing the truth about the loans (because the truth would have indicated an extremely high risk of non-payment), chose to misrepresent the

loans' attributes. As Mr. Brown testified before the New York State Assembly Standing Committee On Insurance:

> We learned that over 80% of the loans in the pools we insured were in fact not eligible to be included in the transactions, because they violated the guidelines and other terms of the contracts. For example, [Countrywide and other securitizers] repeatedly approved loans even though they had combined loan-to-value ratios that exceeded the limits set forth in the guidelines. In some cases they far exceeded the guidelines, with ratios over 100%. Loans were regularly approved even though the borrower's debt-to-income ratio—a crucial indicator of a borrower's ability to meet his or her debt obligations—exceeded the maximums set forth in the guidelines. … As it turns out, it was much harder to find loans that were actually eligible for inclusion in the pools, than it was to find loans with multiple breaches.

R.3701-02; *see also* R.322, 324, 327.

MBIA is not alone in making such allegations. In June 2009, the United States Securities and Exchange Commission filed a civil complaint against several former executives of Countrywide for their fraudulent disclosures to the investing public relating to Countrywide's purported adherence to conservative loan origination and underwriting guidelines. *See* R.333; *see also, e.g.*, *United States ex rel. O'Donnell v. Bank of Am. Corp.*, No. 12 Civ. 1422 (S.D.N.Y.) (alleging that Countrywide defrauded Freddie Mac and Fannie Mae, *inter alia*, by misrepresenting the quality of loans Countrywide was selling to Fannie Mae and Freddie Mac); *Federal Housing Finance Agency v. Countrywide*, No. 12-01059 (C.D. Cal.) (alleging that Countrywide misrepresented that loans underlying RMBS purchased by Freddie Mac and Fannie Mae were underwritten in

accordance with guidelines). Several states and numerous private parties have likewise filed suits against Countrywide. R.334-37.

As of August 2009, MBIA had paid claims of more than $1.4 billion under policies that it never would have issued but for Countrywide's misrepresentations. R.338.

C. The IAS Court's Order

Pursuant to N.Y. C.P.L.R. 3212(e), MBIA moved for partial summary judgment that, under the New York insurance-law rule that informs common-law causes of action such as those for fraud, misrepresentation, and breach of warranty, MBIA can establish causation by showing that Countrywide's misrepresentations materially and adversely affected MBIA's risk on day one of the policies, and that MBIA need not establish an *additional* causal link between Countrywide's misrepresentations and losses during the life of the policies.

In a comprehensive 26-page decision, which has since been cited approvingly by two federal judges,[3] the IAS Court granted MBIA's motion in relevant part. R.94. The court quoted N.Y. Ins. L. §§ 3105 and 3106, which respectively inform MBIA's claims for fraud and breach of warranty. R.80-81. Section 3105(b)(1) provides that a misrepresentation is "'material'" where "'knowledge by the insurer of the facts misrepresented would have led to a refusal

[3] *See Syncora*, 2012 WL 2326068, at *7; *Assured*, 2012 WL 4373327, at *5.

by the insurer to make such contract,'" R.80 (quoting N.Y. Ins. L. § 3015(b)(1)), and Section 3106(b) similarly defines a "'materia[l]'" breach of warranty as one that "'materially increases the risk of loss, damage or injury within the coverage of the contract,'" R.81 (quoting N.Y. Ins. L. § 3106(b)). The court noted that Section 3105 explicitly covers representations by an "'applicant for insurance'" *or* the "'prospective insured,'" R.82 (quoting N.Y. Ins. L. § 3105(a)); Section 4106, in referring to a "breach of warranty," similarly covers representations by the maker, whether the maker is the applicant or the prospective insured, N.Y. Ins. L. § 3106(b).

The IAS Court then turned to the specific issue of the causation element in a claim by an insurer for fraudulent inducement or breach of warranty. The court held that, "in this insurance context, with MBIA as an insurance company and Countrywide as an applicant for insurance … the claims are informed by New York common law and Insurance Law Sections 3105 and 3106." R.82. As indicated by the portions of those statutes the court quoted, they focus the inquiry on the time the "insurer … ma[d]e such contract." N.Y. Ins. L. § 3105(b)(1); *see also id.* § 3106(b) (similarly focusing on whether the breach "materially increases the *risk* of loss" at the time the policy is issued) (emphasis added). After citing numerous cases of similar import, the court held that the causation required by the insurance-law rule is causation between the applicant's misrepresentations and the

risk of loss on day one of the policy. Specifically, MBIA must prove for its fraud claim that Countrywide's representations caused MBIA to "issu[e] the Insurance Policies" and that MBIA "would not have done so or would have issued the policies on different terms had the alleged misrepresentations not been made." R.84. Similarly, MBIA must prove for its breach of warranty claim that Countrywide's misrepresentations caused a "materia[l] increas[e in] MBIA's risk of loss." *Id.* But there is "no basis in law … to mandate that MBIA establish a [further] direct causal link between the misrepresentations allegedly made by Countrywide and claims made under the policy." R.83.

The IAS Court next held that, if MBIA establishes its claims for fraudulent inducement and/or breach of warranty, it will be entitled to "rescissory damages in the amount that it has been required to pay pursuant to the Insurance Policies, less premiums MBIA received under the policies." R.87. Citing N.Y. C.P.L.R. 3017(a) ("the court may grant any type of relief within its jurisdiction appropriate to the proof") and numerous cases from New York and other states, the IAS Court recognized that rescissory damages may be awarded "where the equitable remedy of rescission is impractical but otherwise warranted." R.86 (internal quotation marks omitted); *see also* R. 87 ("'Damages may be recovered as incident to an action in equity for a rescission.'") (quoting *Equitable Life*, 276 N.Y. at 184). The court then found that "rescission may be warranted should MBIA prove its claims,

but it is impractical" here because "to rescind the Insurance Policies would be to harm the policies' beneficiaries, the Noteholders, and may lead to greater economic harm," R.86, and "rescission is further impractical, if not impossible under the governing Transaction Documents," which provide that "MBIA 'unconditionally and irrevocably guarantees' payments under the policies," *id.* (citation omitted). Accordingly, the court held that "rescissory damages are appropriate in this instance." R.86-87. The court noted that such damages, because they will subtract "premiums MBIA received under the policies," will not confer a "windfall" upon MBIA, but merely place it in the position it would have occupied had it not issued the policies. R.87.

ARGUMENT

I. THE IAS COURT CORRECTLY HELD THAT THE INSURANCE-LAW RULE CODIFIED BY NEW YORK STATUTE ALLOWS MBIA TO ESTABLISH CAUSATION BY SHOWING THAT COUNTRYWIDE'S MISREPRESENTATIONS MATERIALLY INCREASED THE RISK ON DAY ONE OF THE POLICIES

The IAS Court correctly applied the long-standing insurance-law rule that an insurance applicant's misrepresentations are evaluated as of the time the policy is issued and post-policy events are irrelevant. Countrywide's Argument Point I ignores the insurance-law rule. Even if that rule could somehow be ignored, the causation requirement of general common law does not invariably require a showing as to events post-dating the contract. To the contrary, that causation

requirement is satisfied by claims asserting a harm incurred at closing of the contract, such as overpayment for acquisition of a partnership interest or business asset, or assumption of an inflated risk to pay claims under an insurance policy. That MBIA's claims concern day one harm is further evident from the rescissory relief it requests, which by definition places the plaintiff in the position it occupied before the defendant's wrongful acts.

A. The Insurance-Law Rule Focuses Upon Risks To The Insurer On Day One Of The Policy And Deems Post-Policy Events Irrelevant

Under the New York common law of insurance, as codified in N.Y. Ins. L. §§ 3105 and 3106,[4] the test for establishing causation is "'whether the company has been induced to accept an application which it *might otherwise have refused*.'" *Greene v. United Mut. Life Ins. Co.*, 238 N.Y.S.2d 809, 813 (1963) (quoting *Geer v. Union Mut. Life Ins. Co.*, 273 N.Y. 261, 269 (1937)) (emphasis in original). This test focuses upon the time the policy was issued, and disregards subsequent events: "[I]t is immaterial that there is no causal or other relationship between the

[4] *See* Kaplan & Gross, *Commentaries on the Revised New York Insurance Law* (1940) (Section 149, the precursor to Section 3105, "restates … in codified form, common law principles long established in the field of insurance"). Countrywide (Br. 32) notes that the amendment of that precursor in 1939 clarified that only a "material" misrepresentation suffices. But, as the numerous post-1939 cases discussed in text have confirmed, that amendment did not change the long-standing view that the impact of the misrepresentation is evaluated as of day one of the policy, and there is no need to show a causal relationship between the misrepresentation and any loss that occurred during the life of the policy.

actual loss which is sustained under the policy and the falsity of the representation." 6 COUCH ON INSURANCE § 82:20.

This rule applies equally to a claim for inducement of a policy by material misrepresentation as to a claim for breach of warranty in the policy. Concerning the former, the relevant statute is Section 3105(b), which defines a "material" misrepresentation as one that "would have led to a refusal by the insurer to make such a contract." N.Y. Ins. L. § 3105(b); *see also, e.g.*, 6 COUCH ON INSURANCE § 82:20; *Royal Indem. Co.*, 2005 WL 2573514, at *4 ("[N]othing in section 3105 of New York's Insurance Law or in the case law interpreting it supports the proposition that a misrepresentation is material only if it pertains to the particular occurrence causing the loss."). Concerning breach of warranty, the relevant statute is Section 3106(b), which similarly focuses on day one of the policy in providing that "[a] breach of warranty shall not avoid an insurance contract or defeat recovery thereunder unless such breach materially increases the *risk* of loss, damage or injury within the coverage of the contract." N.Y. Ins. L. § 3106(b) (emphasis added); *see also, e.g.*, 6 COUCH ON INSURANCE § 83:19 ("The effect of a breach of warranty is not altered by the fact that the breach did not, in any way, relate to or cause the loss sustained."); 1-6 NEW APPLEMAN N.Y. INS. L. § 6.09[4][a] (2d ed. 2009) ("[B]reach of an express warranty permits the policy to be avoided … regardless of whether the breach had any causal connection with the

loss."); *Syncora*, 2012 WL 2326068, at *7 (approvingly quoting IAS Court's holding in this case that there is "'no basis in law … to mandate that MBIA establish a direct causal link between the misrepresentations allegedly made by Countrywide and claims made under the policy'") (quoting *MBIA*, 936 N.Y.S.2d at 521-22 (R.83)); *Assured*, 2012 WL 4373327, at *5 (approvingly quoting IAS Court's holding that "materiality of breach depends on the 'risk of loss'") (quoting *MBIA*, 936 N.Y.S.2d at 522 (R.84)). For both types of claims, the statute does not itself furnish the cause of action, but rather informs the elements of common-law causes of action as applied in this special insurance context.[5]

Ample case law illustrates the application of this insurance-law rule. In addition to the *Glickman* and *Royal Indemnity* examples discussed in the Preliminary Statement, *supra*, at 1-2, *see, e.g.*, *Levine v. Aetna Ins. Co.*, 139 F.2d 217, 217-18 (2d Cir. 1943) (where an applicant for boat insurance misrepresented that the boat was equipped with a searchlight, the insurer could not fairly be held responsible for a subsequent accident even though it was caused by a submerged

[5] *See, e.g.*, *GuideOne Specialty Mut. Ins. Co. v. Congregation Adas Yereim*, 593 F. Supp. 2d 471, 486 (E.D.N.Y. 2009) ("§ 3105(b) lacks any language creating causes of action relating to misrepresentations by an insured or defining any defenses to such an action. This silence does not impede rescission rights, of course, for an insurer's right to seek to void an insurance contract *ab initio* derives from the common law."); *Seneca Ins. Co. v. Wilcock*, No. 01 Civ. 7620, 2002 WL 1067828, at *4-5 (S.D.N.Y. May 28, 2002) (similarly treating common-law claim as informed by N.Y. Ins. L. § 3105). Because the statutes do not create MBIA's claims, MBIA was not required to cite the statutes in its complaint.

obstruction undetectable by searchlight); *Ginsburg*, 89 F.2d at 158-59 (where an applicant for disability insurance misrepresented that he had never had bronchitis, and he later fell ill with multiple sclerosis and applied for benefits, insurer could not be bound because "it makes no difference that [the misrepresented illness] was an illness unrelated to the disease upon which the present claim for indemnity is based").

The insurance-law rule is not only well-established, but sound. It derives from the basic principle that an applicant must make truthful disclosure to the insurer, and the insurer is entitled to rely upon that disclosure in deciding whether to issue a policy. *See Vander Veer*, 34 N.Y.2d at 52 ("As an insurer, the defendant is free to select its risks and it makes inquiry of matters which it deems material to the risk."). If the applicant misrepresents material facts, it "deprive[s] the defendant of freedom of choice in determining whether to accept or reject the risk." *Id.* at 53. It is that harm, which takes place on day one of the policy, that the insurance-law rule deems relevant; whether the misrepresented facts actually cause any losses or claims during the life of the policy is irrelevant.

The insurance-law rule also makes evident sense from the standpoint of deterring wrongful behavior by the applicant. "If the rule were otherwise, the insured [or applicant] could freely misrepresent information specifically requested and still recover on the policy if the causal connection could not be traced."

Ginsburg, 89 F.2d at 159. More specifically, "[i]f the cause of loss is connected to the misrepresented fact, the insured has lost nothing, because he wouldn't have had coverage anyway. If the cause of loss is not connected, he has coverage he otherwise couldn't have obtained. Thus, he had nothing to lose by misrepresenting." Ingram, 14 U. MIAMI BUS. L. REV. at 111.

Countrywide is exactly the "unscrupulous … applicant" with which the insurance-law rule is concerned. *Mut. Benefit Life Ins. Co.*, 848 F.2d at 34. MBIA never would have insured the transactions had Countrywide represented the true facts in its applications for insurance. Countrywide was able to obtain insurance, and reap enormous benefits from its sales to RMBS certificateholders, only because of its rampant misrepresentations to MBIA and its breaches of conditions precedent to the insurance agreements. Under the well-settled insurance law of New York, Countrywide cannot now avoid liability by interposing inapposite causal tests between Countrywide's own misrepresentations and ultimate payments made under insurance it never could have procured without wrongdoing.

B. Even If The Insurance-Law Rule Could Be Ignored, General Common Law's Causation Requirement Does Not Always Require A Showing As To Post-Contract Events, And Does Not So Require Here

Point I of Countrywide's brief entirely ignores the insurance-law rule, instead citing common-law sources concerning "transaction causation and loss causation." Br. 19. As shown above, the *insurance-law rule* for causation focuses

exclusively on the situation at day one of the policy and deems subsequent events irrelevant. Application of this rule suffices to reject Countrywide's argument.[6]

But even if the insurance-law rule could be ignored, the causation requirement in general common law does not invariably require a showing that the defendant's misconduct at or prior to contract formation caused losses during the term of the contract. "[A]s any first year law student knows, 'causation' is far from a self-defining term, and raises all sorts of questions, such as whether the causation must be direct or indirect, transactional, proximate, risk-related, or whatever." *Assured*, 2012 WL 4373327, at *3. As relevant here, general common law's causation requirement can be satisfied by a plaintiff who asserts that it incurred harm on day one of the contract. For example, as the Court of Appeals recently explained in the context of "fraud that induces an investment," injury may be proven by "showing the amount of the claimed overvaluation of the portfolio *on the day of [plaintiffs'] respective investments*," and should not take into account

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[6] The IAS Court correctly rejected (R.78-79) Countrywide's argument that this Court's decision denying Countrywide's motion to dismiss the amended complaint held, without discussing the insurance-law rule, that MBIA must show loss causation here. The insurance-law rule was not invoked in the parties' briefs on that appeal or addressed in this Court's decision; instead, this Court sensibly affirmed on the ground that, even under Countrywide's proposed notion of causation, fact issues precluded dismissing the case on the pleadings. Because there was no "[a]ctual decision of [the] issue" whether MBIA must (contrary to the insurance-law rule) prove loss causation, the "law of the case" doctrine does not apply. 18B CHARLES ALAN WRIGHT, *ET AL.*, FED. PRAC. & PROC. JURIS. § 4478 (2d ed.).

"losses after the date of their investments." *Cont'l Cas. Co. v. PricewaterhouseCoopers, LLP*, 15 N.Y.3d 264, 271-72 (2010) (emphasis added).

As the Second Circuit similarly explained in the context of the sale of a business, "New York law … follows the well-established common law rule that fraud damages represent the difference between the purchase price of the asset and its true value, plus interest, generally *measured as of the date of sale*." *Merrill Lynch*, 500 F.3d at 183 (emphasis added) (citing, *inter alia*, *Hanlon v. MacFadden Publ'ns*, 302 N.Y. 502, 511 (1951)); *see also Merrill Lynch*, 500 F.3d at 185 (breach of warranty claim likewise evaluated "at the time of the transaction"). Relying on this rule, the Second Circuit rejected the defendant's argument that causation was lacking because of the plaintiff's failure to demonstrate a "causal link between [the acquired business's] ultimate failure and [defendant's] misrepresentations." *Id.* at 182-83; *see also id.* at 185 (same reasoning as to breach of warranty claim). The Circuit distinguished, as an "easily explained departure from common law guidelines," cases involving liquid securities, where consideration of post-transaction events is required. *Id.* at 183; *see also* 14 N.Y. PRAC., NEW YORK LAW OF TORTS § 1:74 ("[I]n a common law fraud case, the issue

of causation is governed by the traditional doctrine of proximate cause, rather than the 'loss causation' formulation applicable in securities fraud cases.").[7]

Here, even if the insurance-law rule could somehow be disregarded and general common law's causation requirement applied, that requirement would be satisfied by MBIA's theory that it suffered harm on day one of the policies by assuming a risk (to pay claims under the policies) that was materially different from and greater than was represented by Countrywide. As in *Merrill Lynch*, MBIA's theory focuses on day one harm and seeks to place the "claimant in the same position that claimant would have occupied had claimant not been defrauded." 14 N.Y. PRAC., NEW YORK LAW OF TORTS § 1:74 (discussing *Merrill Lynch*). This is further corroborated by the fact that MBIA seeks rescissory damages, which by definition "restore a plaintiff to the position occupied before the defendant's wrongful acts." BLACK'S LAW DICTIONARY, "Damages" (9th ed. 2009). Accordingly, general common law's causation requirement, even if

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[7] The rationale for this exception is that, for a liquid asset, "the inflated purchase payment made for a misrepresented stock is 'offset by ownership of a share that *at that instant* possesses equivalent value'" because the truth has not yet been revealed to the market or reflected in the market price (the truth by definition comes out only post-purchase). *Merrill Lynch*, 500 F.3d at 183. Because the purchaser can sell without any harm before the truth comes out, it is necessary to examine post-purchase events to tease out whether any subsequent decline in the stock's price derived from revelation of the truth rather than other causes. *Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84, 87-88 (1928), like *Merrill Lynch*, states both the general rule and an "exception" to it. *See Continental Cas.*, 15 N.Y.3d at 271 (describing *Hotaling*).

applicable, would not require consideration of events subsequent to issuance of the policies. This result is all the more clear when the insurance-law causation rule is applied.

C. Countrywide's Authorities Are Inapposite

Countrywide's authorities regarding fraud claims under general common law are inapposite, most obviously, because they did not involve insurance or discuss the insurance-law rule,[8] but in any event because they did not involve a day one harm theory of harm (together with a request for rescissory damages) like that invoked by MBIA here. Several involved liquid securities for which a day one harm theory is not allowed. *See supra*, at 26-27 & n.10; *Laub v. Faessel*, 297 A.D.2d 28, 31 (1st Dep't 2002) (stocks); *Starr Found. v. American Int'l Group, Inc.,* 76 A.D.3d 25, 26-27 (1st Dep't 2010) (stocks); DAN B. DOBBS *ET AL.*, THE LAW OF TORTS § 693 (2d ed. 1991) (stocks); Restatement (Second) of Torts § 548A, cmt. b (stocks); *id.*, Illusts. 1 & 2 (bonds). Others merely stated in the abstract the requirement that the plaintiff show "resulting injury," *Centro Empresarial Cempresa S.A. v. America Movil*, 17 N.Y.3d 269, 276 (2011); *see also Small v. Lorillard Tobacco Co.*, 94 N.Y.2d 43, 57 (1999) (similar); *Nat'l Union Fire Ins. Co. v. Christopher Assocs.*, 257 A.D.2d 1, 9 (1st Dep't 1999) (similar),

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[8] *Stutman v. Chemical Bank*, 95 N.Y.2d 24, 30 n.2 (2000) (cited at Countrywide Br. 18), does recognize that there are situations where "the materiality of the omission or misstatement satisfies the causation requirement." As shown in Point I.A, *supra*, the insurance context is one example.

without precluding the possibility that injury can "result" on day one of the contract.[9]

Countrywide's authorities concerning breach of warranty claims are similarly inapposite. Again, most obviously, none involved insurance or discussed the insurance-law rule of causation. Even apart from that distinction, each involved a breach during the course of the contract's term, not a breach of a warranty as to facts in existence on day one of the contract. *See Losei Realty Corp. v. City of N.Y.*, 254 N.Y. 41, 45-46 (1930) (defendant failed to perform a contract to move dredged material); *Kenford Co. v. County of Erie*, 73 N.Y.2d 312, 317 (1989) (defendant failed to perform a contract to build a stadium); *Fruition, Inc. v. Rhoda Lee, Inc.*, 1 A.D.3d 124, 125 (1st Dep't 2003) (defendant failed to perform a contract to supply fabric). In a breach of warranty case like this one, the breach occurs on day one because the facts as represented (here, the risk-affecting characteristics of the mortgage loans) are on that very day untrue. Courts therefore, applying the "well established principle that contract damages are measured at the time of the breach," *Merrill Lynch*, 500 F.3d at 185 (citing, *inter*

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[9] Countrywide's other authorities are similarly distinguishable. *See Megaris Furs, Inc. v. Gimbel Bros., Inc.*, 172 A.D.2d 209, 213 (1st Dep't 1991) (causation discussed only in connection with claim for fraud during performance of contract, not fraud in inducement of contract); *First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 772 (2d Cir. 1994) (claim under federal RICO statute, not New York common law of fraud).

alia, *Simon v. Electrospace Corp.*, 28 N.Y.2d 136, 145 (1971)), measure harm "at the time of the transaction," *Merrill Lynch*, 500 F.3d at 185.

II. THE IAS COURT CORRECTLY HELD THAT, IF MBIA ESTABLISHES ITS CLAIMS FOR FRAUD OR BREACH OF WARRANTY, IT WILL BE ENTITLED TO RESCISSORY DAMAGES

When Countrywide finally acknowledges the insurance-law rule of causation in Point II of its brief, it attempts to divorce the rule from the equally well-established principle that "the court may grant any type of relief within its jurisdiction appropriate to the proof," N.Y. C.P.L.R. § 3017(a), including a grant of "damages … in lieu of equitable relief 'where the granting of equitable relief appears to be impossible or *impracticable*,'" *Ungewitter,* 31 A.D.2d at 584 (quoting *Doyle*, 1 N.Y.2d at 443) (emphasis in original). Case law confirms that insurers may avail themselves of both the insurance-law causation rule and the rescissory damages remedy. Contrary to Countrywide's suggestion (Br. 3, 27), rescissory damages do not transform Countrywide into the financial guaranty insurer; rather, they rectify Countrywide's misconduct in inducing MBIA to become the insurer in the first instance.

MBIA begins by showing that rescissory damages are clearly available under New York law where rescission is appropriate but impracticable, and then explains that the IAS Court correctly held that rescission is impracticable here.

MBIA then refutes Countrywide's additional attempts to deny MBIA this long-standing remedy.

A. New York Law Allows An Award of Rescissory Damages Where Rescission Is Otherwise Warranted But Impracticable

The general principle that "the court may grant any type of relief within its jurisdiction appropriate to the proof whether or not demanded, imposing such terms as may be just," N.Y. C.P.L.R. § 3017(a), derives from a 1920 statute and is "intended to allow the widest discretion as to the type of relief." Historical & Statutory Notes to N.Y. C.P.L.R. § 3017(a). The availability of rescissory damages in New York similarly pre-dates the insurance-law cases and statutes discussed in Point I, *supra*. For example, in *Valentine v. Richardt*, 126 N.Y. 272 (1891), the defendant defrauded the plaintiff's mother into selling her property and then resold the property to a good-faith purchaser before the plaintiff could bring suit against the defendant. The Court of Appeals held that, because rescission would unjustly involve taking the property from the good-faith purchaser, rescissory damages should be awarded: "[I]t is but just and equitable that [defendant] should restore to the plaintiff its equivalent in money, not as damages

but as a substitute for the land itself." *Id.* at 277. The Court of Appeals later described *Valentine* and other pre-1939[10] cases as reflecting the

> "familiar principle that a court of equity, having obtained jurisdiction of the parties and the subject-matter of the action, will adapt its relief to the exigencies of the case. It may order a sum of money to be paid to the plaintiff and give him a personal judgment therefor when that form of relief becomes necessary in order to prevent a failure of justice."

Doyle, 1 N.Y.2d at 443 (quoting *Valentine*, 126 N.Y. at 277, and citing, *inter alia*, *Murtha v. Curley*, 90 N.Y. 372 (Sup. Ct. N.Y. Cnty. 1882)). This remedy continues to be recognized by modern courts. *See, e.g.*, *Loengard v. Santa Fe Indus., Inc.*, 70 N.Y.2d 262, 266 n.* (1987); *Ambac Assur. Corp. v. EMC Mortg. Corp.*, No. 08 Civ. 9464, 2009 WL 734073, at *2 (S.D.N.Y. Mar. 16, 2009) (rejecting argument that "New York [law] does not recognize rescissory damages").[11]

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[10] 1939 was the year in which the predecessor provisions to N.Y. Ins. L. §§ 3105 and 3106 were enacted. *See* N.Y. Ins. L. § 3105, Historical and Statutory Notes; N.Y. Ins. L. § 3106, Historical and Statutory Notes.

[11] Because New York law clearly recognizes rescissory damages as an available remedy, this Court need not decide whether Delaware law does so. In any event, Countrywide mischaracterizes Delaware law as allowing such damages only in the "very specific circumstances" of a "freeze-out merger or similar transaction." Br. 38. In *Telstra Corp. v. Dynegy, Inc.*, No. Civ. A. 19369, 2003 WL 1016984 (Del. Ch. Mar. 4, 2003), for example, no such transaction was involved, and the court did not hesitate to declare that "[r]escission *or rescissory damages* can be an appropriate remedy, at law or in equity, where a promise is fraudulently induced." *Id.* at *8 (emphasis added). Courts in other states agree. *See, e.g.*, *Outdoor Life Network, LLC v. EMTA Corp.*, No. 2:06-cv-00463, 2006 WL 3834287, at *5 (D.

Because N.Y. Ins. L. §§ 3105 and 3106 (and their predecessor provisions) were enacted against the clear background rule that rescissory damages could be substituted for rescission where the latter was warranted but impracticable, Countrywide is wrong to construe the words "avoid any contract of insurance," N.Y. Ins. L. § 3105(b); *see also id.* § 3106(b) (similar), as *implicitly* rejecting the availability of rescissory damages, *see Arbegast v. Bd. of Educ. of S. New Berlin Cent. Sch.*, 65 N.Y.2d 161, 169 (1985) ("The Legislature … is presumed to be aware of the decisional and statute law in existence at the time of an enactment and to have abrogated the common law only to the extent that the clear import of the language used in the statute requires.") (internal citation omitted).[12]

Several courts, including the IAS Court below, have expressly held that the insurance-law causation rule of N.Y. Ins. L. §§ 3105 and 3106 informs common-law claims that seek rescissory damages, and is not limited to the contexts of

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Ariz. Dec. 29, 2006) (awarding rescissory damages for breach of contract); BLACK'S LAW DICTIONARY, "Damages" (9th ed. 2009) ("rescissory damages" "restore a plaintiff to the position occupied before the defendant's wrongful acts").

[12] Countrywide asserts that, at common law, rescissory damages were not available and post-contract causation was always required, and thus characterizes (Br. 31) *MBIA* as having the burden to show that that the insurance-law statutes abrogated the common law. Countrywide's premises are mistaken: The common law recognized the insurance-law causation rule and the availability of rescissory damages. *See supra*, at 31-32. Accordingly, it is Countrywide that must show that the insurance-law statutes clearly express an intent to abrogate these common-law principles. As discussed in text, they do not do so, and to the contrary, their reference to rescission is most sensibly construed to carry with it rescission's alternative, *i.e.*, rescissory damages.

claims for rescission or affirmative defenses to an insured's claim for coverage. For example, in *Seneca Ins. Co. v. Wilcock*, No. 01 Civ. 7620, 2002 WL 1067828 (S.D.N.Y. May 28, 2002), an insurance broker applied for insurance from an insurer (Seneca) for Kid Express, a child-care center. In the application, the broker misrepresented that Kid Express had no prior business losses, when in truth it had suffered such losses resulting from allegations of child abuse. Relying on N.Y. Ins. L. § 3105, the court held that Seneca was entitled to reimbursement from the broker for payments Seneca had made under a policy that would not have been issued in the first place but for the broker's misrepresentation:

> Section 3105 governs when an insurer may rescind an insurance contract *or recover insurance payments* due to misrepresentations by an applicant or an insured. … Seneca is not attempting to rescind its contract with or recover payments from Kid Express [the insured]. Instead, Seneca seeks indemnification of the Kid Express claim based on [the broker's] duty … to make truthful representations. As Southwest's brokers, Wilcock and Southwest owed Seneca a duty to report truthfully with respect to the information requested on the applications. That duty may give rise to an action for indemnification of Seneca's payments under the Kid Express policy.

2002 WL 1067828, at *5 (internal citations and quotation marks omitted; emphasis and alterations added except for second ellipsis). Similarly here, as the IAS correctly held, MBIA may invoke N.Y. Ins. L §§ 3105 and 3106 in support of a remedy against the applicant (Countrywide) rather than the insureds (the certificateholders) of "the amount [MBIA] has been required to pay pursuant to the Insurance Policies, less premiums MBIA received under the policies." R.87. The

federal court in *Syncora* (which like this case involves insurance on a mortgage-loan securitization), after favorably citing the IAS Court's decision and N.Y. Ins. L. § 3106's causation rule, similarly held that "[t]here is no question as to the Court's equitable powers" "to award relief equivalent to rescission, namely claim payments less premiums." 2012 WL 2326068, at *9; *see also Equitable Life*, 276 N.Y. at 181, 184 (insurer sued, *inter alia*, to recover damages in the amount of the disability payments made to the insured under a disability/life insurance policy, and the Court of Appeals allowed the suit for "[d]amages … as incident to an action in equity for rescission").

B. The IAS Court Correctly Held Rescission Impracticable Here

Just as the IAS Court correctly held that the insurance-law causation rule may be employed in support of common-law claims seeking rescissory damages, the court correctly held that the prerequisites to rescissory damages are satisfied here. As noted above, a plaintiff may recover rescissory damages if rescission is warranted but "'impossible or *impracticable*,'" *Ungewitter,* 31 A.D.2d at 584 (quoting *Doyle*, 1 N.Y.2d at 443) (emphasis in original). Under N.Y. Ins. L. §§ 3105 and 3106, rescission is warranted if MBIA establishes that its risk of loss was materially increased on day one of the policies by the true facts that Countrywide misrepresented, with no need to make an additional showing of a causal link between those misrepresentations and losses during the life of the policy. *See*

Point I, *supra*. For several reasons, however, rescission is impracticable, and therefore rescissory damages are appropriate, if MBIA establishes liability on its claims for misrepresentation and/or breach of warranty.

First, as the IAS Court explained, "to rescind the Insurance Policies would be to harm the policies' beneficiaries, the Noteholders, and may lead to greater economic harm." R.86. Those certificateholders had no involvement in Countrywide's misrepresentations, yet they would be harmed by the rescission of the policies because they would be left without the protection of financial guaranty insurance that they thought would remain in place when they decided to purchase the certificates. By contrast, ordering that the wrongdoer, Countrywide, pay rescissory damages to MBIA will return MBIA to its day one position while protecting the innocent certificateholders. (MBIA has stood by its obligations to the certificateholders, paying some $1.4 billion in claims as of August 2009. R.300.) In this respect, the situation is much like the automobile-insurance context, where a New York statute bars insurers from rescinding insurance policies (even if the insured committed fraud in the application) because rescission might leave an innocent third party injured by the insured without a remedy. In that context, courts have deemed rescission warranted but impracticable, and thus have allowed the insurers to recover rescissory damages from the wrongdoer in the amount of the claims paid under the policy. *See Reliance Ins. Cos. v. Daly*, 38

A.D.2d 715, 716 (2d Dep't 1972) (the "public interest is unaffected by a suit for damages which in no way impinges upon the injured [innocent third] party's recovery"); *Mooney v. Nationwide Mut. Ins. Co.*, 172 A.D.2d 144, 149 (3d Dep't 1991) (similar, citing *Reliance*).

Second, as the IAS Court also held, "rescission is further impractical, if not impossible under the governing Transaction Documents," which provide that MBIA "unconditionally and irrevocably guarantees" payments under the policies. R.86 (internal quotation marks omitted). This source of impracticability relates to the one just discussed, insofar as the promise of irrevocability in financial guaranty insurance is necessary in the first instance to give prospective purchasers of certificates the comfort to make the purchase. Contrary to Countrywide's suggestion (Br. 45), that the requirement is one of business reality rather than of statute does not distinguish the automobile-insurance cases, for rescissory damages turn on "impracticability," not absolute "impossibility," of rescission. Moreover, MBIA never would have issued the policies (and thus would not be bound by their irrevocability language) had Countrywide told the truth about the mortgage loans in the securitizations. In these circumstances, it is hardly unfair to allow MBIA to seek recovery from the wrongdoing Countrywide.[13]

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[13] *Stein v. Security Mutual Ins. Co.*, 38 A.D.3d 977 (3d Dep't 2007), relied on by Countrywide (Br. 36), is inapposite. There, after learning that prior losses had been misrepresented in a homeowners insurance application, rescission was

C. Countrywide's Remaining Arguments Against Rescissory Damages Are Unpersuasive

Having failed to show that rescissory damages are unavailable in the context of a common-law claim informed by the insurance-law causation rule, or that the prerequisites to rescissory damages are not satisfied here, Countrywide offers several additional arguments against such relief. None is persuasive.

1. MBIA's Acceptance Of Premiums From The RMBS Certificateholders Does Not Preclude It From Seeking Rescissory Relief Against Countrywide

As noted above, MBIA has stood by its irrevocable obligations to the certificateholders, paying some $1.4 billion in claims as of August 2009. During this time, MBIA has also collected from the trusts the relatively small premiums for which the policies provide. The IAS Court took care to note that the remedy of rescissory damages will not confer a windfall on MBIA because its damages amount of the claims it has paid will be reduced by the premiums it has received. R.87; *see also Syncora*, 2012 WL 2326068, at *10 (finding "no question as to the Court's equitable powers" to award "claims payments less premiums").

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available but the insurer chose not to rescind. Subsequently, a tree fell on the house. The court rejected the insurer's claim against the broker not because of a lack of causal connection between the misrepresentations in the application and the tree incident, but because the insurer had made an affirmative choice not to rescind. *Stein*, 38 A.D.3d at 979. Here, by contrast, rescission was impracticable, if not impossible; thus, MBIA had no choice but to continue to perform under the policies and seek rescissory damages.

Countrywide nonetheless contends (Br. 47) that MBIA's receipt of these premiums precludes its ability to seek rescissory damages.

Countrywide's argument fails because it conflates *rescission* and *rescissory damages*. To be sure, in the context of rescission, the plaintiff's acceptance of benefits under the contract can bar the plaintiff from seeking rescission. *See, e.g.*, *Bible v. John Hancock Mut. Life Ins. Co.*, 256 N.Y. 458, 462 (1931) (cited at Countrywide Br. 47). But, as discussed above, rescission (which here would be sought against the RMBS certificateholders) is impractical for several reasons, and MBIA is therefore seeking rescissory damages against Countrywide. In the context of rescissory damages, there is no prohibition on the plaintiff accepting premiums or payments so long as those amounts are reduced from the damages recovery. In other words, because rescissory damages (unlike rescission) leaves the policies in place, and MBIA has adhered to its obligations under those policies by making $1.4 billion in payments as of August 2009, it would make no sense to excise the portion of the policies that allowed MBIA to receive (minimal) premiums.

Mooney, one of the automobile-insurance cases discussed above, illustrates the point. There, the insurer, after discovering that the insured had misrepresented his driving record, received and cashed the insured's check for the premium. *See* 172 A.D.2d at 146. The insurer later sent the insured a refund check, which the

insured never cashed. *Id.* at 147. Accordingly, the premium remained in the insurer's account throughout the litigation in which the insurer asserted a fraud claim seeking rescissory damages. The court nonetheless recognized such relief as viable. *Id.* at 149. Similarly, in the context of insurance on a securitization, *Syncora* did not view the insurer's receipt of premiums as precluding a request for rescissory damages; rather, the court explained that awarding "claim payments less premiums" would be within "the Court's equitable powers." *See* 2012 WL 2326068, at *10; *see also, e.g.*, *Alanco Tech., Inc. v. Carolina Cas. Ins. Co.*, No. CV-04-789, 2006 WL 1371633, at *2-3 (D. Ariz. May 17, 2006) (waiver of rescission did not preclude rescissory damages).

Although a lone New York trial court has held that an insurer's acceptance of premiums precludes rescissory damages, *see Assured Guar. Mun. Corp. v. DLJ Mortg. Capital, Inc.*, No. 6528737/2011, 2012 WL 5192752, at *6 (Sup. Ct. N.Y. Cty. Oct. 11, 2012), that decision is erroneous for several reasons. *First*, it relied exclusively on cases involving claims for rescission, which are inapposite in a case, as here, where rescission is impractical and rescissory damages are therefore appropriate. *Second*, and relatedly, it ignored *Mooney* and *Syncora* (or the IAS Court's holding below), which held that rescissory damages are appropriate notwithstanding the insured's receipt of premiums from the insured. *Third*, it failed to consider, as the IAS Court below and *Syncora* recognized, that the insurer

will receive no windfall from rescissory damages because any premiums received must be deducted from the damages amount.[14]

2. MBIA Need Not Show That It Lacks An Adequate Remedy At Law, But In Any Event Has Done So

Countrywide (Br. 50-53) and movant-for-*amicus-curiae*-status the Securities Industry and Financial Markets Association ("SIFMA") (Br. 24-25) are equally unpersuasive in contending that rescissory damages are unavailable because MBIA has an adequate remedy at law. As an initial matter, Countrywide waived the argument by failing to present it below. *See, e.g.*, *Sosa v. Cumberland Swan, Inc.*, 210 A.D.2d 156, 157 (1st Dep't 1994) (appellant "failed to raise this issue before the IAS court, and is therefore precluded from raising it on appeal").[15]

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[14] *MBIA Ins. Co. v. Merrill Lynch & Co.*, 81 A.D.3d 419, 420 (1st Dep't 2011) (cited at Countrywide Br. 50), did not involve a request for rescissory damages (only for rescission), and this Court therefore understandably did not focus on the distinctions between these two forms of relief.

[15] SIFMA's proposed *amicus* brief should be rejected (or at least heavily discounted) because SIFMA is a partisan for Countrywide rather than an organization advocating for the public interest. As explained in more detail in the Affirmation Of Philippe Z. Selendy In Opposition To The Motion Of SIFMA's Motion For Leave To File An *Amicus Curiae* Brief (filed Nov. 28, 2012), SIFMA's partisanship is evident from the fact that its decision-making members are banks that are involved as defendants in actions (including actions brought by MBIA) like this one; indeed, MBIA is a member but its interests were plainly disregarded in SIFMA's brief. Moreover, SIFMA's attorneys represent a defendant (Credit Suisse) in one such action, and portions of their proposed *amicus* brief are essentially cut-and-pasted from a brief they filed on behalf of that defendant. SIFMA's reply in support of its motion (filed Dec. 6, 2012) completely

In any event, the argument is unpersuasive. *First*, N.Y. Ins. L. §§ 3105 and 3106, in providing that rescission (or rescissory damages, *see, e.g.*, *Seneca*, 2002 WL 1067828, at *5) follows from a showing of harm on day one of the policy, obviate any need by the insurer to show that other remedies are inadequate.[16] *Second*, even if MBIA were required to make that showing, it has done so. Requiring MBIA to show a causal connection between the misrepresentation and the subsequent loss would deny MBIA its well-recognized right as an insurer to weigh the risks of an insurance policy *before* issuing it, and would also create the perverse incentives for applicants that the insurance-law causation rule is designed to forestall.

The only other remedy to which Countrywide points (Br. 50-53) is the contractual provision that requires Countrywide to "repurchase" from the securitizations' loan pools a loan as to which Countrywide made a misrepresentation that materially affects MBIA's interest (*i.e.*, its risk) in the loan. But the repurchase remedy is merely "a low-powered sanction for bad mortgages

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fails to respond to the latter point, and responds to the former only by saying that SIFMA's board has a few other members besides defendants in RMBS suits.

[16] To be sure, *Syncora* held that the insurer was required to make this showing and failed to do so at the summary-judgment stage. But that holding turned on a specific indemnification provision in the contract, absent from the Transaction Documents here, that might have provided a remedy akin to rescissory damages, making it unnecessary to provide rescissory damages based on general equitable principles. 2012 WL 2326068, at *10.

that slip through the cracks. It is a narrow remedy (‘onesies’ and ‘twosies’) that is appropriate for individualized breaches …. This is not what is alleged here. Here, [MBIA] alleges massive misleading and disruption of any meaningful change by distorting the truth.” *Syncora Guar. Inc. v. EMC Mortg. Corp.*, No. 09 Civ. 3106, 2011 WL 1135007, at *6 n.4 (S.D.N.Y. Mar. 25, 2011). The appropriate remedy as a matter of well-settled law and fairness is to award rescissory damages that will place MBIA in the position it would have occupied had it not issued the policies.

3. Rescissory Damages Are Not Precluded By The Sole-Remedy Provisions In The Transaction Documents

Countrywide never argued before the IAS Court’s Order was issued that the sole-remedy provisions in the Transaction Documents preclude rescissory damages. Accordingly, this argument too is waived. *See, e.g.*, *Sosa*, 210 A.D.2d at 157.

In any event, Countrywide’s argument again lacks merit. MBIA’s claim for breach of warranty is grounded on breaches of representations, warranties, and covenants contained in at least eight provisions of the Insurance Agreements, including Section 2.01(j), which warranted that the information provided by Countrywide was not “untrue or misleading in any material adverse respect when made.” *E.g.*, R.802. Countrywide’s argument, however, rests on only a single, separate warranty, Section 2.01(l). To be sure, that one warranty restricts MBIA’s remedy to the repurchase remedy expressly specified in the Transaction

Documents, stating: "The remedy for any breach *of this paragraph* with respect to representations or warranties relating to a Mortgage Loan shall be limited to the remedies specified in the related Transaction Documents." *E.g.*, R.802-03 (emphasis added). But the emphasized language makes clear that this remedy restriction applies only to a breach of Section 2.01(l), not to other paragraphs such as Section 2.01(j).

Section 5.02(a) confirms this interpretation, providing that, in the event that any of Countrywide's loan-level representations is materially false (and hence in breach of the warranty in Section 2.01(j)), MBIA's remedies will *not* be limited to the repurchase remedy unless the affected loan has already been repurchased. Instead, MBIA is permitted to "take whatever action at law or in equity as may appear necessary or desirable in its judgment to … enforce performance and observance of any obligation, agreement or covenant of … the Sponsor [*i.e.*, Countrywide] … under the Transaction Documents." *E.g.*, R. 835. Because MBIA's claims seeking rescissory damages seek to enforce Countrywide's representations and covenants under the Transaction Documents, these remedies are expressly preserved by Section 5.02.

This interpretation is also consistent with the parties' intent concerning the function of the repurchase remedy. As discussed above, *Syncora* explained that parties to a similar insurance transaction did not intend that a repurchase remedy

designed for isolated instances of misrepresented loans would provide an appropriate remedy in a case of massive, widespread misrepresentations like those Countrywide made here.[17]

CROSS-APPEAL

MBIA's cross-appeal seeks reversal of the portion of the IAS Court's Order that, while finding that MBIA had "posited a strong argument," R.92, denied partial summary judgment to MBIA (and deferred to trial) the issue whether only loans that have failed to perform are eligible for the repurchase remedy. That issue impacts MBIA's separate claim for breach of the repurchase provision, not MBIA's claims for misrepresentation or breach of warranty discussed in the main appeal.

The IAS Court erred because, as numerous courts have held in similar cases, the relevant contractual provision plainly requires only that Countrywide have breached a warranty that materially and adversely affects MBIA's "interest" (*i.e.*, risk) in the loan. For similar reasons to those discussed on the main appeal, risk is

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[17] Even if Countrywide's interpretation of the Transaction Documents were correct, its sole-remedy argument would fail for additional reasons. *First*, as to six of the securitizations, the Transaction Documents expressly carve MBIA out from the class of persons limited by the Section 2.01(l) paragraph upon which Countrywide relies. *Second*, and more broadly, if MBIA establishes its fraudulent inducement claim, the entire Insurance Agreements, including any remedy limitations, will be void *ab initio*. *See Olympia Mortg. Corp. v. Lloyd's of London*, 2009 N.Y. Slip Op. 32623U, 2009 N.Y. Misc. LEXIS 5027, at *15-16 (N.Y. Sup. Ct. Kings Cty. Oct. 29, 2009).

measured on day one of the policy and does not require a showing that the loan actually defaulted during the life of the policy.

STATEMENT OF QUESTION INVOLVED ON CROSS-APPEAL

On its claim for breach of Countrywide's repurchase obligations, is MBIA entitled to partial summary judgment that it need establish only that a loan breached a representation or warranty in a way that materially affects MBIA's interest (*i.e.*, risk) in the loan, and need not further show that the non-compliant loan had failed to perform?

Answer of the IAS Court: The IAS Court, while correctly finding that MBIA had "posited a strong argument" on this issue, incorrectly answered "no" to whether MBIA was entitled to partial summary judgment.

STATEMENT OF FACTS ON CROSS-APPEAL

A. The Repurchase Remedy

The Transaction Documents provide MBIA with the right to demand that Countrywide repurchase, or replace with compliant loans, those mortgage loans for which Countrywide has breached a loan-level warranty in a way that materially affects MBIA's interest in the loan. Specifically, Section 2.04(b) of the Sales and Servicing Agreement ("SSA") for the securitization known as "Revolving Home Equity Loan Asset Backed Notes, Series 2006-E,"[18] provides:

> If the substance of any representation or warranty in this Section made to the best of the Sponsor's knowledge or as to which the Sponsor has no knowledge is inaccurate and the inaccuracy *materially and adversely affects the interest* of the Trust, the Noteholders, or the *Credit Enhancer [i.e., MBIA] in the related Mortgage Loan* then … the inaccuracy shall be a breach of the applicable representation or warranty.

R.938 (emphasis added). Section 2.04(d) then provides that "[t]he cure for any breach of a representation and warranty relating to the characteristics of the Mortgage Loans ... shall be a repurchase of or a substitution for … the Mortgage Loans." R.939.

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[18] This securitization is the only one for which MBIA introduced Transaction Documents in the branch of its motion regarding Countrywide's repurchase obligation. MBIA does not dispute the IAS Court's conclusion, R.92-93, that this branch of the motion could potentially be granted only as to this securitization. However, such a grant would provide guidance regarding the other securitizations, whose Transaction Documents have similar language.

B. The IAS Court's Order

MBIA moved for partial summary judgment that, on its claim for breach of Countrywide's repurchase obligation under the relevant contract, MBIA need establish only that a loan breached a representation or warranty in a way that materially affects MBIA's interests, and MBIA need not further show that the non-compliant loan was non-performing or that the non-performance was caused by Countrywide's breaches of representations and warranties.

The IAS Court denied this branch of MBIA's motion. While recognizing that MBIA had "posited a strong argument," R.92, the court found partial summary judgment inappropriate because it viewed the applicable provisions of the contract as "subject to varying interpretations regarding 'interest' and [e]ffect on interest …." R.93. MBIA timely filed a notice of cross-appeal on February 6, 2012. R.65.

ARGUMENT

A LOAN NEED NOT BE IN DEFAULT TO QUALIFY FOR THE REPURCHASE REMEDY

The plain language of the provision quoted above makes the repurchase obligation turn only upon whether the breach of warranty materially and adversely affects MBIA's "interest" (*i.e.*, risk) in the loan. For reasons similar to those discussed in the main appeal Argument I, *supra*, risk in the insurance-law context is measured on day one of the policy and thus is not concerned with post-policy

events such as whether (or why) the loan failed to perform. To depart from that well-settled insurance-law notion, the parties would have had to state explicitly that the loan must fail to perform to be eligible for repurchase. They did not do so.

Syncora adopted exactly this reasoning in granting partial summary judgment to the insurer on this issue. The court explained that N.Y. Ins. L. § 3106 and its underlying policy informs interpretation of a contractual repurchase provision: "[Section] 3106(b) recognizes the insurance law principle that an insurer relies on receiving complete and accurate information when deciding whether to issue a policy and how to price risk, and that a material breach of a representation or warranty can adversely affect an insurer's interests as a matter of law." 2012 WL 2326068, at *9. Because the *Syncora* insurer, like MBIA here, "relied on EMC's representations and warranties in deciding whether to insure the Transaction and how to price that risk … [a] breach of these warranties … would have adversely affected [the insurer's] interests as an insurer." *Id.* at *5. The court additionally reasoned that "the parties' written agreements do not provide that breaches of representations or warranties must cause any … loan to default, before the Note Insurer can enforce its remedies under the repurchase provision. Had the parties intended this requirement, they could have included such language." *Id.*

Syncora was recently followed by another federal decision involving a repurchase provision that applied when a breach "materially and adversely affects

the interest of the … Note Insurer in the related Mortgage Loan." *Assured*, 2012 WL 4373327, at *4. The court held that this provision "did not require the plaintiff to show that the breaches caused the loans to default," *id.*, and that "the causation that must here be shown is that the alleged breaches caused plaintiff to suffer an increased risk of loss," *id.* at *5. The court explained that, giving "adverse" its ordinary meaning of "opposed to one's interests," "a breach of contract that materially increased Assured's risk of loss would be adverse, because it was opposed to the insurer's interests." *Id.* at *4.[19]

To the extent any doubt remains, it is resolved by another provision that expressly contemplates repurchase of loans that are still performing, stating that, "with respect to any Mortgage Loan *that is not in default or as to which default is not imminent*, no repurchase or substitution pursuant to [the repurchase obligation] shall be made unless" the party making such repurchase or substitution provides the Trustee" with an opinion of counsel concerning the tax implications of such repurchase or substitution. *E.g.*, R.944 (emphasis added). By its plain terms, this provision makes clear that the repurchase provision may apply to a loan that has not yet defaulted.

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[19] *See also*, *e.g.*, *Morgan Guar. Tr. Co. of N.Y. v. Bay View Franchise Mortg. Acceptance Co.*, No. 00 Civ. 8613, 2002 WL 818082, at *15 (S.D.N.Y. Apr. 30, 2002) (enforcing repurchase remedy due to material breach of warranties without discussing whether the loan had gone into default).

CONCLUSION

The IAS Court's Order should be affirmed insofar as it granted partial summary judgment to MBIA that, if it proves it claims for fraud and/or breach of warranty, it will be entitled to recover rescissory damages from Countrywide. The Order should be reversed only insofar as it denied partial summary judgment to MBIA that the repurchase provision does not require that a loan have defaulted to qualify for repurchase.

DATED: New York, New York
December 7, 2012

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SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION, FIRST DEPARTMENT

MBIA INSURANCE CORPORATION, Plaintiff-Respondent-Cross-Appellant, -against- COUNTRYWIDE HOME LOANS, INC., COUNTRYWIDE SECURITIES CORP., COUNTRYWIDE FINANCIAL CORP., COUNTRYWIDE HOME LOANS SERVICING, L.P., and BANK OF AMERICA CORP., Defendants-Appellants-Cross-Respondents.	Index No. 602825/08 IAS Part 3 Hon. Eileen Bransten **PRE-ARGUMENT STATEMENT**

Plaintiff-Respondent-Cross Appellant MBIA Insurance Corporation ("MBIA") submits the following Pre-Argument Statement under Rule 600.17 of the Rules of this Court:

1. The title of the action is accurately set forth in the caption above.

2. The original parties to this action are:

   a. Plaintiff: MBIA.

   b. Defendants: Countrywide Home Loans, Inc. ("CHL"), Countrywide Securities Corp., Countrywide Financial Corp. and Countrywide Home Loans Servicing, L.P. (collectively, "Countrywide"), and Bank of America Corp. ("BAC").

3. The name, address and telephone number of counsel for Plaintiff-Respondent-Cross Appellant MBIA is:

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5. This appeal is taken from the Order of the Supreme Court, New York County, I.A.S. Part 3 (per Justice Eileen Bransten) (the "IAS Court") dated January 3, 2012, and duly entered with the Clerk of the Court on January 3, 2012, granting in part and denying in part MBIA's Motion for Partial Summary Judgment and Motion to Strike Defenses (Mot. Seq. No. 37) (the "Order"). A true and correct copy of the Order is attached hereto as Exhibit A.

6. This action arises out of Countrywide's fraudulent inducement of MBIA to provide financial guaranty insurance on 15 securitizations of home mortgage loans (the "Securitizations"), and Countrywide's breaches of representations and warranties relating to the underlying mortgage loans (the "Mortgage Loans").[1] MBIA alleges that Countrywide fraudulently induced it to provide financial guaranty insurance on the Securitizations by misrepresenting its loan origination, underwriting, and servicing practices, as well as the true risk profiles of the loans included in the pools of Mortgage Loans underlying the Securitizations.

[1] Nine of the Securitizations involve home equity lines of credit ("HELOCs") and six involve closed-end second liens ("CESs").

MBIA also alleges that Countrywide breached certain representations and warranties in the agreements relating to the Securitizations (the "Insurance Agreements"), including that the Mortgage Loans were originated in accordance with Countrywide's underwriting guidelines, that they adhered to federal, state, and local law, and that Countrywide had accurately represented the characteristics of the Mortgage Loans in schedules referenced in the Insurance Agreements. MBIA further alleges that Countrywide breached its obligations under the Insurance Agreements to repurchase certain loans that did not comply with these representations and warranties.

As a direct result of Countrywide's actions, MBIA has already paid out nearly $3 billion on the financial guaranty policies and is exposed to claims in excess of hundreds of millions of dollars more.

On May 25, 2011, MBIA filed a Motion for Partial Summary Judgment and Motion to Strike Defenses (Mot. Seq. No. 37), seeking a declaration that: (1) on MBIA's claim for fraud against Countrywide, MBIA need establish only that Countrywide's misrepresentations induced MBIA to issue insurance policies on terms to which it would not otherwise have agreed, and MBIA need not further show a causal link between Countrywide's misrepresentations and MBIA's claims payments made under the insurance policies; (2) on MBIA's claim for breach of the Insurance Agreements against CHL, MBIA similarly need establish only that CHL's warranty breaches increased the risk profile of the insurance, and MBIA need not further show a causal link between those breaches and MBIA's claims payments made under the insurance policies; and (3) on MBIA's claim for breach of CHL's repurchase obligations under the Insurance Agreements, MBIA need establish only that a loan breached a representation or warranty in a way that materially affects MBIA's interests, and MBIA need not further show that

the non-compliant loan was non-performing or that the non-performance was caused by Countrywide's breaches of representations and warranties.

7. By its Order dated January 3, 2012, the IAS Court ruled that (1) MBIA's motion for partial summary judgment was granted to the extent that MBIA must establish for its claim of fraud that the Countrywide Defendants' misrepresentations induced MBIA to issue insurance policies which it might otherwise have not issued, or would have issued on different terms, and that MBIA is not required to establish a direct causal link between the Countrywide Defendants' misrepresentations and MBIA's claims payments made pursuant to the insurance policies at issue; (2) MBIA's motion for partial summary judgment was granted to the extent that MBIA must establish for its claim for breach of the Insurance Agreements against CHL that CHL's breach of warranties in the issued insurance policies' transaction documents increased the risk profile of the issued insurance policies, and MBIA is not required to establish a direct causal connection between proven warranty breaches by CHL and MBIA's claims payments made pursuant to the insurance policies at issue; and (3) MBIA's motion for partial summary judgment was granted to the extent that MBIA may seek rescissory damages upon proving all elements of its claims for fraud and breach of representation and/or warranty. The IAS Court recognized that "[i]t is without basis in case law to require MBIA to provide a causal link between the alleged misrepresentations and payments made pursuant to the policies. The elements of the claims are well-established and make no such holding; it is well-settled that it is upon the misrepresentation that induces action resulting in damages that fraud or breach occurs." (Order at 18.)

The IAS Court denied MBIA's motion for partial summary judgment as to its claim for breach of the repurchase obligation. The IAS Court denied MBIA's motion for partial summary judgment that its claim for breach of CHL's repurchase obligation under the Insurance

Agreements is not limited to non-performing loans, and does not require MBIA to demonstrate that CHL's alleged breach of representations and warranties caused the non-performance of loans. Although the IAS Court recognized that MBIA "posited a strong argument" (Order at 23), it found that summary judgment was not appropriate because MBIA's contention was "wholly based upon the Revolving Home Equity Loan Asset Backed Notes, Series 2006-E, and that securitization's Sale and Servicing Agreement," and "the applicable provisions of the SSA and PSA [Pooling and Servicing Agreement] are subject to varying interpretations regarding 'interest' and affect [sic] on interest . . ." (Order at 24).

The IAS Court also denied MBIA's motion to strike Countrywide's and BAC's Fourteenth and Fifteenth Affirmative Defenses, in which Countrywide asserts that it was not the cause of any alleged injury, loss or damages suffered by MBIA (Fourteenth) and that MBIA's claims are barred, in whole or in part, by superseding or intervening causes of any alleged damages, and that any damages which MBIA did suffer resulted directly from causes other than Countrywide's alleged acts or omissions (Fifteenth).

8. On January 25, 2012, BAC filed a Notice of Appeal against the IAS Court's Order to the extent that it granted the relief sought by MBIA. MBIA has filed herewith a Notice of Cross-Appeal against the Order to the extent that it denied the relief sought by MBIA.

MBIA respectfully submits that the IAS Court erred in denying MBIA's motion for partial summary judgment with respect to the repurchase remedy provision in the Insurance Agreements. Despite acknowledging that MBIA "has posited a strong argument," the IAS Court held that additional evidence was necessary to confirm MBIA's position on the meaning of the provision. This holding contravenes the clear and unambiguous language of the repurchase

provision in the Insurance Agreements and the prevailing case law interpreting similar repurchase provisions.

By its plain terms, the repurchase remedy provision provides that "[t]he cure for any breach of a representation and warranty relating to the characteristics of the Mortgage Loans . . . shall be a repurchase of or a substitution for . . . the Mortgage Loans . . ."[2] This provision does *not* state that the Mortgage Loans must be in default or that the breach have caused such default. In fact, neither "default" nor "cause" appears anywhere in the provision. If the parties had intended that repurchase would be required only if a Mortgage Loan had defaulted, they would have explicitly said so in the contracts.

Moreover, the Transaction Documents relating to several of the HELOC Securitizations contain a further term which states that "with respect to any Mortgage Loan that is *not in default* or as to which default is not imminent, no repurchase . . . shall be made *unless*" certain conditions are satisfied (emphasis added). By its plain terms, this provision makes clear that the repurchase provision may apply to a loan which is not in default, and thus that default—much less causation with respect to such default—is not a condition of a repurchase claim.

In addition, courts addressing similar contracts have rejected attempts to impose extra-contractual conditions on a plaintiff's repurchase remedy. *See, e.g.*, *Resolution Trust Co. v. Key Fin. Serv.*, 280 F.3d 12, 17 n.11 (1st Cir. 2001) (under New York law, evidence of injury to plaintiff was irrelevant to plaintiff's ability to invoke repurchase remedy); *Morgan Guar. Tr. Co. of N.Y. v. Bay View Franchise Mortg. Acceptance Co.*, No. 00 Civ. 8613, 2002 WL 818082, at *15 (S.D.N.Y. Apr. 30, 2002) (enforcing repurchase remedy due to material breach of warranties without even discussing whether the loan had gone into default); *Orrix Capital Mkts., LLC v.*

[2] Similar language appears in each of the Insurance Agreements.

Love Funding Corp., No. 04 Civ. 9890, 2005 WL 2582177, at *7 (S.D.N.Y. Oct. 11, 2005) (same). As one federal court recently explained:

> Evidence regarding the post-securitization meltdown is relevant only if Plaintiff asserts material and adverse effects occurred after the securitization closing date. So long as Plaintiff asserts material and adverse effects as of the closing date, evidence regarding the post-securitization market conditions is inadmissible.

Wells Fargo Bank, N.A. v. LaSalle Bank N.A., No. Civ-08-1125-C, 2011 WL 1303949, at *8 (W.D. Okla. Apr. 1, 2011). So too here, MBIA asserts that Countrywide's misrepresentations regarding the loans underlying the Securitizations breached Countrywide's repurchase obligations as of the closing date, and that, upon this showing, Countrywide must repurchase such loans.

The following related actions are pending before the IAS Court (Bransten, J.):

a. *Syncora Guarantee Inc. v. Countrywide Home Loans, Inc., et al.*, Index No. 650042/09. The *Syncora* case has been designated as related to this action by the IAS Court. On January 3, 2012, the IAS Court also granted in part and denied in part Syncora's substantially similar motion for partial summary judgment. Syncora has noticed an appeal and Defendants-Appellants-Cross Respondents have cross-noticed an appeal from the IAS Court's Order on Syncora's substantially similar motion.

b. *Financial Guaranty Insurance Company v. Countrywide Home Loans, Inc., et al.,*, Index No. 650736/09. The *FGIC* case has also been designated as related to this action by the IAS Court.

c. *Ambac Assurance Corp., et al. v. Countrywide Home Loans, Inc., et al.*, Index No. 651612/2010. The *Ambac* case has also been designated as related to this action by the IAS Court.

Two appeals are currently pending in this action:

a. A consolidated appeal taken by Countrywide from the Orders of the IAS Court denying Countrywide's Motion to Compel Disclosure Concerning Plaintiffs' Remediation Efforts (Mot. Seq. No. 17), granting MBIA's Motion to Compel (Mot. Seq. No. 31) and denying Countrywide's Cross-Motion for a Protective Order (Mot. Seq. No. 31). Exhibit B is a copy of the Notice of Appeal and Pre-Argument Statement for the appeal on Motion Sequence Number 17. Exhibit C is a copy of the Notice of Appeal and Pre-Argument Statement for the appeal on Motion Sequence Numbers 29 and 31.

b. A notice of appeal, dated November 3, 2011 and attached hereto as Exhibit D, taken by BAC from the IAS Court's Order denying BAC's motion to sever and consolidate successor liability claims.

Dated: February 6, 2012
New York, New York

Respectfully submitted,

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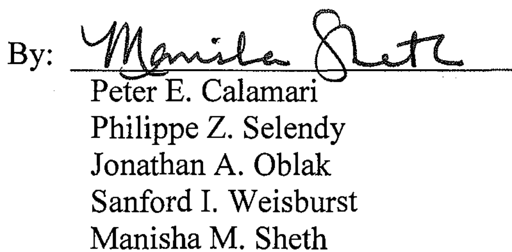
By: 

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