UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

DEXIA SA/NV, et al., Plaintiffs, v. BEAR STEARNS & CO., INC, et al., Defendants.	No. 1:12-cv-04761-JSR

PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

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GLOSSARY OF DEFINED TERMS

The following citation forms are used in this memorandum:

- "¶__" refers to Plaintiffs' Local Rule 56.1 Counterstatement of Material Facts.
- "Bear" or "Bear Stearns" means Defendants Bear, Stearns & Co. Inc. (now known as J.P. Morgan Securities LLC), The Bear Stearns Companies, Inc. (now known as The Bear Stearns Companies LLC), Bear Stearns Asset Backed Securities I LLC, EMC Mortgage LLC (f/k/a EMC Mortgage Corporation), and Structured Asset Mortgage Investments II Inc.
- "Certificates" means the 65 RMBS certificates that are the subject of this litigation, as described in the Complaint.
- "Chase" means Chase Home Finance.
- "Collateral Agent" means The Bank of New York Mellon Trust Company, N.A., as collateral agent under the Pledge and Administration Agreement among Dexia SA, DCL, FSAM, Financial Security Assurance, Inc., and The Bank of New York Mellon Trust Company, N.A.
- "Complaint" and "Cmplt. ¶ __" refer to the May 18, 2012 Amended Complaint in this matter.
- "COO" means chief operating officer.
- "Countrywide" means Countrywide Financial Corporation and its affiliates.
- "DCL" means Plaintiff Dexia Credit Local SA.
- "Defendants" means Bear Stearns, JPM, and WaMu.
- "Defs. Ex." means the exhibits to the Declaration of J. Wesley Earnhardt in Support of Defendants' Motion for Summary Judgment, dated January 21, 2013.
- "Dexia" means Plaintiffs DCL, Dexia SA, DHI, and FSAM.
- "Dexia SA" means Plaintiff Dexia SA/NV.
- "DHI" means Plaintiff Dexia Holdings, Inc.
- "DTI" means debt-to-income ratio.
- "EPD" means early payment default.

- "Ex. __" means the exhibits to the Declarations of Timothy A. DeLange, Jonathan M. Peterson, and John D. Hendrickson III in Opposition to Defendants' Motion for Summary Judgment.
- "FSAM" means Plaintiff FSA Asset Management LLC.
- "GIC" means guaranteed investment contract.
- "GIC Affiliates" means Dexia's affiliates (primarily FSA Capital Management Services LLC and FSA Capital Markets Services LLC) that issued GICs.
- "Guaranteed Put Contract" means the ISDA Master Agreement, Schedule and Credit Support Annex among Dexia SA, DCL, and FSAM dated as of June 30, 2009, together with a Confirmation thereunder among Dexia SA, DCL, and FSAM, each captioned "Guaranteed Put Contract."
- "JPM" means Defendants J.P. Morgan Acceptance Corporation I, J.P. Morgan Mortgage Acquisition Corporation, J.P. Morgan Securities LLC (f/k/a JPMorgan Securities Inc.), JPMorgan Chase & Co., and JPMorgan Chase Bank, N.A.
- "Kolchinsky ¶__" refers to the Expert Report for Plaintiffs of Ilya Kolchinsky, dated December 6, 2012 (Defs. Ex. 18).
- "Long Beach" means Long Beach Mortgage Company, a subsidiary of WaMu.
- "Mason ¶__" refers to the Expert Report for Plaintiffs of Joseph R. Mason, Ph.D., dated December 16, 2012 (Defs. Ex. 19).
- "NASD" means the National Association of Securities Dealers.
- "Offerings" means the 51 RMBS offerings in which the Certificates were issued.
- "OTS" means the United States Office of Thrift Supervision.
- "Plaintiffs" means DCL, Dexia SA, DHI, and FSAM.
- "RMBS" means residential mortgage-backed securities.
- "SEC" means the U.S. Securities and Exchange Commission.
- "Seguin ¶__" means the Expert Report for Plaintiffs of Paul J. Seguin, Ph.D., dated December 6, 2012 (Defs. Ex. 14).
- "SIPC" means the Securities Investor Protection Corporation.
- "WaMu" means Defendants WaMu Asset Acceptance Corp., WaMu Capital Corp., and WaMu Mortgage Securities Corp.

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I. INTRODUCTION

Plaintiff FSAM purchased 65 Certificates in reliance on Defendants' representations regarding the quality of the underlying mortgages.[1] FSAM did not receive what it paid for, and paid hundreds of millions of dollars more for the Certificates than they were truly worth at the time of purchase. The evidence shows that Defendants knew that large percentages of the Certificates sold to FSAM contained materially defective loans.

Defendants received detailed due-diligence reports from independent mortgage loan underwriters demonstrating that between 20% and 80% of the loans in samples used for testing the quality of the loans did not meet the underwriting guidelines, including loans with unreasonable (*i.e.*, falsified) income or property valuations, or missing essential documentation, like loan applications, underwriting approvals, mortgage notes, or appraisals. Rather than disclose these known defects to FSAM, Defendants bought and sold the massive quantities of defective loans. In short, Defendants secretly overrode the independent loan underwriters' determinations, creating a final, sanitized version of the due diligence results. Then, knowing the remaining, non-sampled pool suffered from the same, massive critical deficiencies, Defendants nevertheless bought and securitized the remaining loans without informing FSAM of the widespread and significant material defects. Defendants also provided false information about the loan quality, including at times the fraudulently sanitized due diligence reports, to the rating agencies to procure valuable AAA ratings on the Certificates. *See* generally ¶14-190; 226-230.[2]

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[1] Plaintiffs made 67 purchases, two of which were of additional amounts of the same Certificate. Plaintiffs respectfully refer the Court to the Glossary of Defined Terms.

[2] Citations in the form "¶__" are to Plaintiffs' Local Rule 56.1 Counterstatement of Material Facts, submitted herewith, at Paragraphs __-__.

In light of these facts, it is not surprising that Defendants chose not to move for summary judgment as to falsity or scienter.

Trying to avoid accountability for their misconduct, Defendants rehash previously rejected assertions concerning Plaintiffs' standing, reliance, and loss causation. Defendants are still wrong. *First*, Plaintiff DCL plainly has standing. DCL's corporate affiliate, FSAM, transferred the Certificates including all "right, title and interest" to DCL. ¶232-253. As the Second Circuit has held, a transfer of all "right, title and interest" in an asset includes assignment of all related causes of action.[3] Moreover, the intercompany assignment here distinguishes all Defendants' authorities, which seek to ensure that defendants are not subjected to the civil version of double jeopardy.[4] Here, there is no risk of some other party not before the Court suing Defendants on these Certificates.

Defendants' last-ditch assertion that "Delivery" of "all right, title and interest" to the Certificates did not occur because the word "delivery" was not uniformly capitalized is nonsense. The form of transfer document using the lowercase "delivery" was attached to the Guaranteed Put Agreement and its purpose was implementing the assignment agreement. Finally, even if the intercompany agreements were insufficient – and they are not – DCL stands in FSAM's shoes as an equitable subrogee.[5]

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[3] *Banque Arabe et Internationale d'Investissement v. Md. Nat'l Bank*, 57 F.3d 146, 152-53 (2d Cir. 1995) (transfer from subsidiary to corporate parent of all "rights, title and interest . . . . alone is sufficient . . . to transfer all of their rescission and fraud claims").

[4] *See Rosenblum v. Dingfelder*, 111 F.2d 406, 407 (2d Cir. 1940) ("Since the claim is owned and may be sued upon by some one, all a defendant may properly ask is such a party plaintiff as will render the judgment final and *res adjudicata* of the right sued upon.").

[5] *See, e.g., Am. Nat'l Bank & Trust Co. v. Weyerhaeuser Co.*, 692 F.2d 455, 459-66 (7th Cir. 1982) (allowing bank, as subrogee of its asset-management clients that it made whole in connection with mishandled tender offer, to sue tender offeror for wrongful refusal of tender).

Second, Defendants incorrectly assert that FSAM bought billions of dollars of Certificates without relying on a single representation regarding the quality of the underlying loans. As the Complaint alleges (and the record confirms), FSAM relied on Defendants' representations in various marketing materials used to solicit FSAM's purchase of each Certificate. ¶6-13; 191-208. Defendants sent FSAM term sheets providing detailed descriptions of the collateral; computer load files projecting the future cash flows of the loans; and supplemental term sheets with additional descriptions of the collateral and of the applicable loan underwriting guidelines. ¶191-92. Defendants' pre-trade representations also reported that the Certificates would be rated AAA by the credit rating agencies. ¶209-219. [FSAM's principal RMBS analyst, Frank Albus, testified that FSAM had a rigorous investment process and that he personally read every representation about the underlying loans *before FSAM made the purchase decision*. ¶193-197.] Defendants' representatives could only be true if the loans were generally underwritten in accordance with the guidelines. Thus, Defendants' misleading "gotcha" about when FSAM received final prospectus supplements ignores the record.

Third, as to loss causation, Defendants rehash the well-worn "don't blame us, blame the financial crisis" defense, which numerous courts have rejected. As Jamie Dimon told Congress, "new and poorly underwritten mortgage products were a significant contributor that proved costly for consumers, the entire financial system and our economy." ¶224. Dr. Joseph Mason – a renowned macroeconomist and Plaintiffs' expert – similarly opines that Defendants' fraud was part and parcel of the financial crisis and that the crisis therefore cannot be considered an independent intervening influence on the value of the Certificates. ¶220-23. Relying on inapposite cases under the federal securities laws, Defendants nonetheless claim that Plaintiffs must separate the harm resulting from Defendants' fraud from the broader financial crisis. But

under New York law, Plaintiffs merely have to show that Defendants' fraud caused FSAM to pay more for the Certificates than they were worth at the time of purchase, and "it is the job of the factfinder to determine which losses were proximately caused by misrepresentations and which were due to extrinsic forces."[6]

Almost as an afterthought, Defendants summarily seek dismissal – without citation to a single shred of evidence – of the 16 Offerings for which JPM and Bear were the RMBS underwriters but not the sponsors. After discovery, the record not only supports the allegations in the Complaint about Defendants' actions as underwriters – on which the Court relied in rejecting the dismissal motions – but demonstrates that Defendants' purported distinction makes no sense. Defendants' witnesses and experts uniformly admit that there is no distinction between JPM's and Bear's knowledge about the loans in the offerings they only underwrote and those they also sponsored. JPM and Bear conducted the same due diligence, received the same due-diligence reports, and exercised the same abuse of power to override the independent loan underwriters' determination that large volumes of the loans sampled (and thus large portions of the overall pools) were critically defective. ¶74-89; 99-100; 123; 225-31.

II. STATEMENT OF FACTS

A. Defendants Knew Of Critical Defects In Securitized Loans

Defendants profited from the RMBS business through underwriting fees and, in offerings they sponsored, the spread between the amount they paid to acquire loans and the amount they received from the sale to investors in the RMBS trust. ¶1-4. The growth in Defendants' RMBS business was staggering. From 2005 to 2007, Bear, WaMu, and JPM securitized and sold over $162 billion, $103 billion, and $62 billion in loans, respectively. ¶5.

[6] *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 87 A.D.3d 287, 298 (1st Dept. 2011) (quoting *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1174 (C.D. Cal. 2008)).

Critically, an RMBS trust is effectively a "blind trust," meaning that investors like FSAM ***were neither able nor permitted to directly view the mortgage loan files***. ¶6-7. And, if the mortgages in a pool are worse than represented, the Certificates will be worth less and the pool will likely perform worse than expected. ¶8-10. Thus, representations about the characteristics and quality of the underlying loan pool are pivotal to an investor's reliance that the assets in the pool meet their expectations. ¶11-13.

Here, Defendants intentionally designed and implemented policies aimed at maximizing deal volume while concealing the critical defects in the mortgages they securitized. Independent, experienced loan underwriters re-underwrote a 10-30% sample of loans to verify they were underwritten in accordance with the loan sellers' guidelines. The underwriters sent Defendants reports scoring each loan in the sample on the following scale: EV1 (meets guidelines), EV2 (does not meet guidelines but compensating factors justify an exception), or EV3 (does not meet guidelines, materially defective). ¶14-16. These independent assessments of the sample of loans backing the Certificates were devastating. The results revealed to Defendants that large portions of the sampled loans (20% to 80%) had "material" defects, including fraudulent incomes, inflated property appraisals, or missing material documents required by the guidelines to ensure credit quality and compliance. *See, e.g.*, ¶46-94; 115-125; 188-189.

Having been informed that the sample showed so many defective loans that the term sheets and data files providing investors with aggregate pool data could not be accurate, Defendants deliberately concealed the poor quality of the overall loan pools. *First*, Defendants' personnel (often with little to no underwriting experience) overrode the independent underwriters' determinations and reduced the number of EV3s in the sample. ¶40-51; 65-89; 188-89. For example, in connection with its securitization of a pool of loans, JPM's third party

diligence provider determined that 54% was a materially defective EV3. ¶65-69. JPMorgan did not expand its sample set and override the EV3 determinations so that the final due diligence report reflected that only 5.8% of the sample pool were EV3s. ¶71-73. Defendants overrode diligence samples with 54% EV3s to create final reports reflecting 5.8% EV3s. *Second*, ***Defendants ignored the fact the remaining loan pool contained similar material defects***, acquiring the entire pool and selling it to investors like FSAM without disclosure of the true quality of the loans. ¶70, 89. *Third*, when the rating agencies asked for diligence results to calibrate their ratings models, Defendants provided only the final sanitized reports, without disclosing the massive critical deficiencies in the sample and the remaining non-sampled loans. ¶46-51; 209-219.[7]

1. JPM Knowingly Securitized Materially Defective Loans

JPM's due diligence managers created an internal assessment of its large loan sellers for underwriting, documentation, and delivery. These assessments highlighted the failure to meet underwriting guidelines as a common issue for numerous loan sellers, including Chase, Countrywide, Greenpoint, and others. ¶22-29. For example, JPM graded Chase, its own affiliate and the originator of huge volumes of loans at issue here, "poor" in all three categories, and noted Chase's problems with unsupported appraisal values and occupancy status. ¶25. Externally, JPM never disclosed its knowledge of these common issues to FSAM or other investors.

[7] Until late 2007, after FSAM made its last RMBS purchase from Defendants, the rating agencies trusted the loan data provided to them. Once the rating agencies first learned about the scope of underwriting violations in securitized loans, they not only demanded to review "originator/conduit/issuer due diligence reports," but made clear their intention to extrapolate diligence sample results in calibrating their RMBS ratings models. ¶216.

JPM had additional knowledge of pervasive, material defects in the loans it securitized and sold to FSAM. For example, FSAM purchased $22 million in Certificates in JPMAC 2006-CW1. Clayton's independent underwriters told JPM that 24% of the 713 loans in the random sample (out of a 5,758-loan pool) were materially defective and graded "EV3." ¶46-48. When a Moody's analyst asked to see the diligence report, JPM provided Moody's a report showing only 5.33% materially defective loans in the 713-loan sample. ¶50-51.

For the JPMAC 2006-NC1 offering, JPM internally knew that 1,154 of the loans in the trust had been more than 30 days delinquent in the prior twelve months. ¶59. Externally, JPM told FSAM and other investors that only 25 loans in the trust had been delinquent between 30 and 59 days at any point during the prior twelve months. ¶52-63. JPM's corporate designee could provide no explanation for how more than 1,150 loans that had been delinquent within the prior twelve months ended up in the Offering. ¶64.[8]

2. Bear Stearns Knowingly Securitized Materially Defective Loans

Bear's RMBS machine was "a moving company, NOT a storage company." ¶2-3; 95. When poor quality loans stayed on Bear's books, senior managers demanded to know why. ¶126-132; 137. In order to increase the number of loans it could securitize, Bear undermined its own diligence process by creating a "streamlined" review that was effectively no due diligence at all. ¶109-25. This streamlined due diligence did not, for example, check for borrower fraud or assess the reasonableness of the borrower's stated income. ¶112-14. Moreover, not only did Bear instruct its independent due-diligence vendors to code loans that violated the underwriting guidelines as acceptable, Bear knew these due-diligence vendors were missing material issues during their review. ¶133-34. In fact, Bear senior management internally complained about

[8] Other examples of JPM's fraudulent conduct are referenced at ¶65-94.

wasting "way too much money on Bad Due Diligence." *Id.* Nevertheless, for its largest sellers the ***only*** diligence Bear conducted was "post-closing," virtually assuring that thousands of loans never subjected to any credit diligence were securitized. ¶130-32.

Thus, Bear knew it was securitizing and selling materially defective loans to FSAM. For example, FSAM purchased more than $19 million in Certificates in BALTA 2006-7. Watterson-Prime, Bear's independent due-diligence vendor, informed Bear that 76.7% of the loans it reviewed were materially defective. Bear overrode the conclusions of the independent underwriters for more than 100 of these materially defective loans and included them in BALTA 2006-7. ¶119-22. Bear went to great lengths to hide its fraud. Indeed, Bear instructed its employees to purge all but the final due-diligence reports, thus hiding the number of loans Bear had overridden. ¶108.

Unsatisfied with a bonus pool that paid certain executives more than $15 million in annual bonuses, Bear's management utilized EPD claims on loans it had already securitized as a way to further inflate the bonus pool. ¶135-46. From 2006 through April 2007, Bear settled claims on already-securitized loans with an unpaid principal balance of at least $477 million. ¶142-43. In 2006, Bear designated part of its EPD recoveries as "cash to income" – *i.e.*, profits. ¶144-46. Bear's senior management (including recipients of these large bonuses) was incentivized to quickly settle EPD claims so the money could be included in the bonus pool. For example, senior managing director Thomas Marano wrote in November 2006 that if "the impacted" settlement was "not done by [year-end] several peoples comp will be affected." ¶147. Sure enough, in February 2007, senior executives convinced the Management Compensation Committee of the Board to release over $35 million of EPD funds. ¶146. Bear also traded

RMBS investors' EPD claims in exchange for the coveted sole underwriter position and a 25 basis point increase in underwriting fees of another sponsor's RMBS deal. ¶147.

3. WaMu Knowingly Originated And Securitized Fraudulent Loans

In 2005, WaMu adopted a new, "high risk" lending strategy pushing loan sellers to originate billions of dollars in new mortgages. At the same time, WaMu cut back on underwriting and controls. As WaMu's former Senior Credit Risk Officer Mark Hillis explained, this shift "tore the heart out of [the] control environment." ¶148-151. Recognizing that "disclos[ing] the issues with the loans" identified in its quality-review processes meant "tak[ing] a couple point hit in price" upon RMBS securitizations, WaMu's instructed its due-diligence team to override defects at all costs. ¶154.

WaMu adopted its high-risk, low-diligence RMBS strategy despite numerous internal and government audits making clear that WaMu originated and securitized billions of dollars of defective and fraudulent loans. ¶152-59. In November 2005, an internal investigation into certain WaMu Home Loan offices confirmed "a sustained history of ***confirmed fraud findings*** over the past three years" and uncovered an "extensive level of loan fraud," with "***42% of the loans reviewed contain[ing] suspect activity or fraud***." ¶155. Rather than stop the fraud, WaMu awarded to the individuals responsible for originating large volumes of fraudulent loans. ¶156.

In December 2006, Hugh Boyle, WaMu's Chief Risk Officer, informed WaMu's Board of Directors that the rate of unsatisfactory underwriting was higher than 50% for subprime loans. ¶164-65. Boyle informed the Board in January 2007 that a post-funding review revealed that only 43.5% of Long Beach loans and 55.8% of Home Loan loans were satisfactory. ¶166. In mid-2007, an internal audit of Long Beach concluded that the "overall system of risk management and internal controls has deficiencies related to multiple, critical origination and underwriting processes," including a "Repeat Issue" that "[u]nderwriting guidelines . . . are not

always followed [and] [a]ccurate reporting and tracking of exceptions to policy does not exist." ¶159.

Rather than broaden or improve its loan-level diligence process, WaMu strategically weakened its diligence structure in order to maximize its ability to pawn bad loans off onto RMBS investors like FSAM. First, WaMu never told its head of RMBS securitization or its head of due diligence about the rampant fraud and defective loan underwriting in its own mortgage origination business. ¶173-75. Second, WaMu preselected its favored due-diligence vendors based on their willingness to "minimize the number of rejects." ¶176-77. Third, WaMu sought to reduce the number of "EV3" loans identified by its outside diligence vendors by instructing the vendors to universally grade a wide range of historically material underwriting defects as securitizable "EV2" loans. ¶178. Fourth, WaMu deliberately accelerated its diligence and securitization timelines in order to offload the worst-quality loans from its balance sheet before the loans went into early default. ¶179-81.

WaMu knew it was securitizing and selling materially defective loans to FSAM. For example, FSAM purchased more than $30 million in LBMLT 2006-3. Clayton informed WaMu in March 2006 that 86 of the loans in a sample set (23.8% of the total reviewed) were materially defective. WaMu overrode the conclusions of the independent underwriters, waiving 60 of the 86 materially defective loans into the deal. ¶188-89.

B. FSAM Actually And Justifiably Relied On Defendants' Fraudulent Statements And Omissions

1. Defendants' Disclosures Regarding The Collateral Quality And Loan Underwriting Induced Dexia's Purchases

The evidence demonstrates that FSAM received marketing materials, including term sheets, supplemental term sheets, loan cash-flow data, and (in many cases) preliminary prospectus supplements from Defendants before making its investment decision with respect to

each Certificate. ¶6-11; 191-198. These marketing materials (referred to as "free writing prospectuses" under SEC regulations) included the Certificates' expected AAA ratings and data about the underlying loans, including LTV ratios, FICO scores and other numerical and qualitative data, including descriptions of the underwriting standards through which loans were made, all of which FSAM used to perform credit and cash-flow analyses of the Certificates. *Id*.

FSAM's portfolio managers testified that they read and relied upon these materials in performing credit and cash-flow analyses before deciding to purchase the Certificates. ¶193-97. For example, FSAM portfolio manager Frank Albus testified that FSAM relied on all of the information about an Offering that it received from Defendants before making its investment decision:

> As part of the investment process . . . we went through a term sheet, we'd go through the collateral, we'd go through anything that we have. . . .
>
> *****
>
> I think as part of my job, I would have looked at – and if this wasn't clear I should make sure that it's crystal clear – I would have gone through and looked at any available information that I could in order to make an informed investment recommendation and to facilitate the investment process. ¶193.[9]

Here, each of the Defendants' term sheets and marketing materials used to solicit FSAM's purchase of Certificates either expressly represented that the loan pool was properly underwritten, or provided loan-level data that could only be relied upon for use in valuation models if the data accurately represented the RMBS collateral. ¶12. (Appendix A). FSAM portfolio manager Jake Hendrickson testified that "[t]he LTV was always important. . . . The FICO scores were always important. Whether it was owner occupied or investor owned, what the

[9] After the portfolio managers conducted their cash-flow and credit analyses based on all of the data made available to them, they recommended purchase of the Certificates to an authorized officer, who approved the purchases at issue here in reliance on the portfolio managers' analyses and recommendations. ¶198.

percentage of the second liens were, things along those lines. Geographic distributions." ¶194. Indeed, WaMu's own David Beck and JPM's own Robert Miller testified that numerical loan-level data would not be reliable if the loans were not underwritten in accordance with the guidelines. ¶199-204. As Defendants' own due diligence expert explained, the purpose of conducting diligence was to "confirm by visiting the files that [the] description of the mortgage pool as described in the trade document . . . in fact are there," and the files themselves are as represented. ¶205.

In many of the Offerings, the supplemental term sheets or preliminary prospectus supplements provided to FSAM before its investment decision also contained information about the originators' underwriting standards. The marketing materials received by FSAM from Defendants for each Offering and those materials' representations about the quality of the loans are set forth in Appendix A hereto (Ex. 72).

To be sure, nothing disclosed in a final prospectus supplement could materially differ from the pre-trade decision marketing materials. ¶207. Indeed, when a prospectus supplement provided material new or corrective information, FSAM had the right to rescind its prior purchase order. ¶208.

2. Defendants' Production Of Manipulated "Final" Due-Diligence Reports To The Rating Agencies Affected The Certificates' Ratings, Which Were Essential To FSAM's Investment Decisions

FSAM's portfolio managers relied on the Certificates' AAA ratings when deciding to purchase the Certificates. ¶209-10. Significantly, just like investors in the Certificates, the rating agencies had no access to the loan files to verify information provided by Defendants and thus relied entirely on Defendants' descriptions of the collateral. ¶212-14. Unlike RMBS investors, the rating agencies (sometimes but not typically) received the final, sanitized due-diligence results. ¶215. As noted above, however, Defendants knew that they had not extrapolated the

results of the initial, non-sanitized sample results to the entire pool. Defendants did not disclose to the credit rating agencies that the final, sanitized sample was not representative of the quality of the loan pool. ¶215-19. Sending this final report misled rating agencies into believing that the level of defective loans in the pool was much lower than Defendants knew to be true. In sum, the credit ratings relied upon by FSAM (and essential to its ability to buy the Certificates) also resulted from Defendants' fraud.

III. ARGUMENT

A. Summary Judgment Standards

The summary judgment standard is well established. Fed. R. Civ. P. 56(a); *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). The "party seeking summary judgment always bears the initial responsibility of . . . identifying those portions of 'the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any,' which it believes demonstrate the absence of a genuine issue of material fact." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986). Here, Defendants regularly assert that Plaintiffs "have adduced no evidence" supporting their claims without citing any evidentiary support. *See, e.g.*, Def. Br. at 17, 18, 20, 23. Thus, Defendants' motion fails even to carry their initial burden.

B. FSAM Relied On Defendants' Misrepresentations And Omissions

1. FSAM Relied On Defendants' Term Sheets And Marketing Materials

As detailed above, it is beyond dispute that FSAM received, reviewed, and relied upon Defendants' marketing materials, including term sheets, loan cash-flow data, and (in many cases) preliminary prospectus supplements, before making its investment decision with respect to each Certificate. ¶191-211. This evidence easily satisfies the reliance element, which "does not require complex legal analysis and may be satisfied simply by plaintiff's testimony." *Gabriel Capital, L.P. v. NatWest Fin., Inc.*, 177 F. Supp. 2d 169, 174 (S.D.N.Y. 2001) (citing *McMahan*

& Co. v. Wherehouse Entm't, Inc., 859 F. Supp. 743, 753-54 (S.D.N.Y. 1994) (denying summary judgment where plaintiffs testified they relied on misrepresentations), *rev'd on other grounds*, 65 F.3d 1044 (2d Cir. 1995)).[10]

Defendants move on the false (and irrelevant) premise that Plaintiffs did not *allege* that term sheets and other marketing materials they received were false (Def. Br. at 16-17). This is demonstrably wrong. The Complaint alleges the marketing materials' falsity (¶6, 237) and Defendants cite no materials they "believe[] demonstrate the absence of a genuine issue of material fact" in this regard. *Celotex*, 477 U.S. at 323.[11] Thus, this case is on all fours with *Federal Housing Finance Agency v. Deutsche Bank AG*, -- F. Supp. 2d --, No. 11 Civ. 6192(DLC), 2012 WL 5471864 (S.D.N.Y. Nov. 12, 2012), where Judge Cote upheld fraud claims based on the exact same types of RMBS marketing materials at issue here:

> [Plaintiffs] purchased the securities at issue on the basis of term sheets and free writing prospectuses ("Preliminary Materials") that identified the originators of the underlying loans and contained "critical data as to the Securitizations, including with respect to anticipated credit ratings by the credit rating agencies, loan-to-value and combined loan-to-value ratios for the underlying collateral, and owner occupancy statistics."

Id. at *2. Plaintiffs' allegations that the marketing materials contained the same information as the false final prospectus supplements "are therefore sufficient to plead the falsity of overlapping information in the Preliminary Materials as well." *Id.* at *3.[12] Moreover, Defendants' failure to

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[10] This procedural posture distinguishes this case from *Dexia SA/NV v. Deutsche Bank AG*, No. 11 Civ. 5672 (JSR), 2013 WL 98063, slip op., at *15 (S.D.N.Y. Jan. 4, 2013), where this Court dismissed fraud claims under Rule 12(b)(6) without prejudice. Here, Plaintiffs have presented evidence under Rule 56 demonstrating that FSAM received and relied on Defendants' false marketing materials before making its investment decisions.

[11] Defendants' LR 56.1 statement makes no showing that the information they provided to FSAM before it decided to purchase the Certificates was not false and misleading.

[12] Even if the marketing-materials claims were not pled in the Complaint (which they were – see Cmplt. ¶¶6, 237-84), those claims are properly presented in opposition to Defendants' summary judgment motion. "Upon an application for summary judgment, the formal issues presented by

disclose that significant percentages of loans underlying the Certificates violated underwriting guidelines and were graded "materially defective" is an actionable omission under New York law. *See Nasaba Corp. v. Harfred Realty Corp.*, 287 N.Y. 290, 295 (1942) ("Concealment with intent to defraud of facts which one is duty-bound in honesty to disclose is of the same legal effect and significance as affirmative misrepresentations of fact."); *Callahan v. Callahan*, 127 A.D.2d 298, 300 (3d Dep't 1987) ("Nondisclosure is tantamount to an affirmative misrepresentation where a party to a transaction is duty-bound to disclose certain pertinent information."); *Banque Arabe et Internationale d'Investissement v. Md. Nat'l Bank*, 850 F. Supp. 1199, 1222 (S.D.N.Y. 1994) (to prove reliance on an omission "[o]ne need only prove that, had the omitted information been disclosed one would have been aware of it and behaved differently") (citation omitted), *aff'd*, 57 F.3d 146 (2d Cir. 1995). By providing the loan data, Defendants assumed the obligation to speak truthfully about the data and disclose the persistent underwriting violations rendering the data unreliable.

In adopting Regulation AB, the SEC determined that it would be "inappropriate" for marketing materials provided to investors before their trade decision to disclaim liability for the information contained in the marketing materials because a final prospectus would be delivered after the trade decision. Asset Backed Securities, 70 Fed. Reg. 1506-01, 1557 (Jan. 7, 2005). The SEC further specified that pre-trade marketing materials are considered prospectuses and "remain subject to the general anti-fraud provisions of the Securities Act and Exchange Act."

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the pleadings are not controlling and the court must ascertain from an examination of the proof submitted whether a substantial triable issue of facts exists." *Edward B. Marks Music Corp. v. Stasny Music Corp.*, 1 F.R.D. 720, 721 (S.D.N.Y. 1941); *see also Block v. First Blood Assocs.*, 988 F.2d 344, 350 (2d Cir. 1993) (unpled claim presented with evidence on a Rule 56 motion allowed as motion to amend under Rule 15(a), absent prejudice or bad faith); *Clomon v. Jackson*, 988 F.2d 1314, 1323 (2d Cir. 1993) (same).

SEC Release No. 33-8591, Securities Offering Reform at 1558, n. 410.[13] As a result, when a prospectus supplement contains new corrective information, the banks must give investors like FSAM the right to rescind. *See* SEC Rule 159, 17 C.F.R. § 239.159.

Finally, Defendants misplace reliance on *Gabriel Capital*, where certain claims were dismissed because there was no allegation that the plaintiff relied upon a preliminary offering memorandum. *See* 177 F. Supp. 2d at 174. Critically, *Gabriel Capital* denied defendants' motion for summary judgment with respect to misstatements made during road shows plaintiff attended before making its investment decision. *See id.* at 174-75.[14] Here, FSAM actually relied on Defendants' marketing materials before making its investment decisions. ¶191-211.

2. FSAM Relied On The Fraudulent Credit Ratings

Notably, Defendants' Rule 56.1 statement does not assert that Defendants provided accurate and truthful information to the rating agencies. Nor could it. The record is clear that Defendants made false statements and omitted to provide critical information to the rating agencies, including manipulating due-diligence results to secure valuable AAA ratings that Defendants needed to maximize their profits. Defendants did not disclose that the initial due-diligence reports identified numerous materially defective EV3 loans that violated underwriting guidelines, lacked identifiable compensating factors, and should not have been securitized, but were waived into the loan pools as a result of Defendants improperly overriding the determinations of the independent due-diligence underwriters. ¶14-190. Defendants knew that the rating agencies had no access to the loan files and relied on the accuracy of the information

[13] Necessarily, such material is also subject to common-law fraud claims.

[14] Defendants' reliance on *Turtur v. Rothschild Registry Int'l, Inc.*, No. 92 Civ. 8710 (RPP), 1993 WL 338205, at *2, *7 (S.D.N.Y. Aug. 27, 1993); *Sec. Investor Prot. Corp. ("SIPC") v. BDO Seidman*, 95 N.Y.2d 702, 709 (2001); and *Singer Co. v. Stott & Davis Motor Express, Inc.*, 79 A.D.2d 227, 233 (4th Dep't 1981), is also misplaced, because in all of those cases it was undisputed that plaintiffs neither received nor read the misrepresentations before investing.

provided by Defendants. ¶209-219. Indeed, when the rating agencies learned, after the last of Dexia's Certificate purchases, about the link between underwriting-guidelines violations and spiking delinquencies, they insisted on receiving diligence reports and made clear the results would be used to adjust assumptions in the RMBS models. ¶216.

There is a genuine issue of fact whether the Certificates would have been rated AAA but for Defendants' fraud. Plaintiffs' expert Ilya Kolchinsky has opined that "the Defendants' alleged misconduct compromised the integrity of the ratings process – and that the ultimate ratings provided to the Dexia [Certificates] would not have been awarded had the rating agencies been informed of the true nature and quality of the loans supporting those bonds." ¶217-18.

In response, Defendants do not assert that Kolchinsky is wrong. Rather, they state – without identifying a shred of evidentiary support – that Plaintiffs have not shown any specific false data provided by Defendants to the rating agencies in a specific Offering. Def. Br. at 19.[15] Defendants ignore the extensive evidence presented that Defendants systematically provided false data to the agencies and investors alike, not just in any one Offering, but systematically throughout their entire RMBS securitization programs.[16]

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[15] Defendants' assertion that "Kolchinsky merely *assumed* that the rating agencies received false information from the Defendants" (Def. Br. at 21) is incorrect. In fact, Kolchinsky based his opinions on Plaintiffs' allegations ***and*** his review of discovery documents. *See* Decl. of Timothy DeLange dated Feb. 4, 2013, Ex. 169. He stated that "[m]y own review indicates that a number of low quality loans, including loans determined by due diligence providers to fail to meet relevant underwriting guidelines, were often nevertheless securitized into Dexia Deals" (*id.* at 13 n.10), and identified such loans in Appendix 4 to his Report.

[16] *See also MBIA Ins. Corp. v. Royal Bank of Canada*, No. 12238/09, 2010 WL 3294302, at *29 (N.Y. Sup. Ct. Aug. 19, 2010) (sustaining false-ratings claims against investment bank where "Plaintiff alleges that these ratings were false because the Defendants provided false information to the ratings agencies"); *M&T Bank Corp. v. Gemstone CDO VII, Ltd.*, No. 7064/08, 2009 WL 921381, at *11 (N.Y. Sup. Ct. Apr. 7, 2009) (sustaining false-ratings fraudulent-concealment claim against investment bank where plaintiff alleged that the bank "had knowledge of the false information provided to the rating agencies").

Defendants' case are inopposite. *SIPC v. BDO* does not help here. The court held that "SIPC cannot claim reliance on alleged misrepresentations of which it was unaware even by implication." 95 N.Y.2d at 710. The court recognized, however, "the general and unremarkable principle that liability for fraud can be imposed through communication by a third party," citing *Tindle v. Birkett*, 171 N.Y. 520 (1902), where – just as in this case – "plaintiff received defendant's misrepresentations in the form of a positive credit report upon which it relied." 95 N.Y.2d at 710. Defendants' assertion that the ratings themselves are inactionable statements of opinion (Def. Br. at 19 n.14) fails because Plaintiffs have presented evidence that Defendants knowingly gamed the agencies to elicit the ratings based on false information. *See Dexia Holdings, Inc. v. Countrywide Fin. Corp.*, No. 2:11-cv-07165-MRP, 2012 WL 1798997, at *5-6 (C.D. Cal. Feb. 17, 2012) (applying New York law); *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164, 1183-88 (C.D. Cal. 2011) (same). The statement in *Abu Dhabi Commercial Bank v. Morgan Stanley & Co., Inc.*, No. 08 Civ. 7508(SAS), 2012 WL 3584278, at *8) that ratings are not attributable to investment banks that publish them in offering documents does not apply under New York law. *See, e.g., Stichting Pensioenfonds ABP v. Credit Suisse Group AG*, 2012 WL 6929336, at *9 (N.Y. Sup. Ct. Nov. 30, 2012) (if plaintiff can prove underwriter did not believe in accuracy of credit ratings when they were given, because they relied on data underwriter provided and knew to be false, then underwriter "cannot hide behind disclosures and claims of opinion").

Defendants' argument that "Plaintiffs have adduced no evidence . . . that any particular purchase decision by Plaintiffs would have changed based on [a different] rating" (Def. Br. at 20) is also wrong. The record shows that FSAM relied on the credit ratings and would not have purchased the Certificates if they had not been rated AAA. ¶209-10. Thus, Plaintiffs have

demonstrated precisely that they "would not have acted without the defendant's misrepresentation" of the ratings. Def. Br. at 20 (citing *Nam Tai Elecs., Inc. v. UBS Paine Webber Inc.*, 46 A.D.3d 486, 488 (1st Dep't 2007)).[17]

3. FSAM's Reliance Was Reasonable And Justified

Defendants' assertion that FSAM's reliance was unreasonable because Plaintiffs are sophisticated institutions (Def. Br. at 15) is unavailing. "New York authority follows a two-tier standard in assessing the duty of the party claiming fraud, according to whether the misrepresentations relate to matters peculiarly within the other party's knowledge. If so, the wronged party may rely on them without further investigation." *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171, 181 (2d Cir. 2007) (citing *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 80–81 (2d Cir. 1980)).[18] Here, it is undisputed that the information necessary to

[17] *Laub v. Faessel*, 297 A.D.2d 28, 29, 31 (1st Dep't 2002), is off point. There, plaintiff sued an investment advisor for misrepresenting his "training, expertise and experience," not "the financial condition of any of the companies whose stock he recommended," and therefore failed to demonstrate that the misrepresentations caused any losses.

[18] Defendants reliance on *Crigger v. Fahnestock & Co.*, 443 F.3d 230, 233 (2d Cir. 2006), is wrong. There, plaintiff multimillionaires invested with someone who promised them "an assured income stream of six to seven percent *a month.*" The very sentence Defendants quote from *Crigger* states that reliance may be unjustified where "sophisticated businessmen . . . enjoy access to critical information but fail to take advantage of that access . . . ." Def. Br. at 15 (quoting 443 F.3d at 235). Here, Dexia had no such access. *Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189 (2d Cir. 2003), is equally inapt. There, plaintiff agreed to buy stock of defendant, which represented orally that its principal asset was a $14 million investment, and made extensive written representations about other aspects of its business, but made no written representation about the $14 million investment, which was later revealed to be only $4 million. *See id.* at 192-93. On those facts, the court held that plaintiff was "on notice" of the undocumented fact and should have demanded "the available documentation." *Id.* at 195. Here, Plaintiffs were not "on notice" of Defendants' misrepresentations, and the relevant documents were not "available." Similarly, in *Global Minerals & Metals Corp. v. Holme*, 35 A.D.3d 93, 100-01 (1st Dep't 2006), plaintiff itself expressed doubts about defendant's representations before signing the contract it later challenged as fraudulent. Likewise in *Steed Fin. LDC v. Nomura Sec. Int'l, Inc.*, No. 00 Civ. 8058(NRB), 2004 WL 2072536, at *6 (S.D.N.Y. Sept. 14, 2004), plaintiff had its own "agent to perform pre-purchase due diligence and re-underwrite every mortgage in the D5 Trust on its behalf." And in *Rodas v. Manitaras*, 159 A.D.2d 341, 342

determine the truth about Defendants' misrepresentations – the underlying loan files showing volumes of fraudulent and defective loans – was exclusively in Defendants' possession and unavailable to FSAM. ¶6-11. Indeed, when bidding on whole loan pools (i.e., before having access to individual loan files), JPMorgan's subprime trading desk relied on the accuracy of the data in the loan tape and that they were written in accordance with underwriting guidelines. ¶199-205.

Defendants' assertion that risk factors in the final prospectus supplements for the Offerings defeat Plaintiffs' claims (Def. Br. at 21-23) is equally unavailing. Defendants have not shown, and cannot show, any disclosure in any offering materials that the due-diligence process was designed to conceal the loan-pool defects or that large swaths of the loans underlying the Certificates violated underwriting standards and were not accurately reflected on the loan tapes. Disclosures such as "[e]xceptions to stated underwriting guidelines may be made" (Def. Br. at 22) did not warn investors that Defendants systemically overrode EV3 (materially defective) scores in the samples and refused to extrapolate findings about material defects to the non-sampled parts of the loan pools. Disclosures that credit ratings might be downgraded and that property values might decrease in the future (*see id.*) did not warn investors that the AAA ratings were based on Defendants' false information or that the represented LTV and DTI ratios were unreliable. *See Fed. Housing Fin. Agency v. JPMorgan Chase & Co.*, -- F. Supp. 2d --, No. 11 Civ. 6188(DLC), 2012 WL 5395646, at *17 (S.D.N.Y. Nov. 5, 2012) ("disclosures regarding the

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(1st Dep't 1990), plaintiffs buying a restaurant "specifically requested examination of the records of the business and were refused," such that "they were aware that the income of the business was a material fact in which they had received no documentation."

riskiness of the securitizations cannot absolve the defendants of their duty to avoid making fraudulent representations regarding the character of the underlying assets").[19]

C. Dexia Has Presented Sufficient Evidence Of Loss Causation

1. New York's Common-Law Fraud Standard, Not Federal Securities Law, Controls The Evidence Needed To Show Loss Causation

Under New York law, damages and causation are established "when a misrepresentation is made that induces a party to take action and that party suffers damage as a result." *Syncora Guarantee Inc. v. Countrywide Home Loans, Inc.*, 36 Misc.3d 328, at 9 (N.Y. Sup. Ct. 2012); *see also Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 187 (2d Cir. 2001) (denying summary judgment where plaintiff could show "disparity between the transaction price and the true 'investment quality' of the securities at the time of the transaction."). Here, loss causation is assessed as of the time of purchase because the measure of common-law fraud damages is "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 v. Allegheny*, 500 F.3d at 183 (citations omitted). The relevant inquiry is whether Defendants' fraud caused the Certificates to be worth less than Defendants' represented at the time of purchase.

Focusing on New York's causation law is critical for two reasons. *First*, Defendants completely ignore – and thus are deemed to have waived – any argument for judgment regarding

[19] *Republic Bank & Trust Co. v. Bear Stearns & Co.*, 683 F.3d 239, 254 (6th Cir. 2012), is inapplicable because plaintiff there challenged defendants' representations about credit enhancement and timely interest and principal payments, but the offering documents expressly disclosed that credit enhancement might be inadequate and payments might not be made. *Orlando v. Kukielka*, 40 A.D.3d 829, 831-32 (2d Dep't 2007), is inapposite because plaintiff there actually audited the alleged misrepresentations but ignored its own audit results.

Plaintiffs' claim for fraudulent inducement. *See* Complaint, Counts 4-6. To the extent Plaintiffs establish a right to rescissory damages, Defendants' loss-causation arguments do not apply.[20]

Second, the vast majority of Defendants' cases were decided under the federal securities laws, which apply different loss-causation standards. In *Merrill Lynch v. Allegheny*, the Second Circuit reversed the district court for applying *Dura*'s loss-causation principles to a New York fraud claim. In particular, while the "overpayment" theory of causation has been nullified under federal securities law, that same theory is mandated under New York law:

> In *Dura* the Supreme Court explained that a mere disparity between the purchase price plaintiffs paid for their shares of common stock and the shares' true value at the time of purchase is insufficient to prove loss causation. *Dura*'s bar on recovery based on overpayment alone represents an easily explained departure from common law guidelines on computing damages.

Merrill Lynch v. Allegheny, 500 F.3d at 183 (citation omitted).[21]

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[20] Rescissory damages are a viable remedy for fraudulent inducement. *See Reznor v. J. Artist Mgmt., Inc.*, 365 F. Supp. 2d 565, 576 (S.D.N.Y. 2005); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Wise Metals Grp., LLC*, 19 A.D.3d 273, 275 (1st Dep't 2005). Rescission is appropriate when "the breach is found to be material and willful, or if not willful, so substantial and fundamental as to strongly tend to defeat the object of the parties in making the contract." *T.E.A.M. Entm't, Inc. v. Douglas*, 361 F. Supp. 2d 362, 368 (S.D.N.Y. 2005). Where, as here, rescission is impracticable, rescissory damages are a well-established alternative remedy. *See Assured Guar. Mun. Corp. v. UBS Real Estate Sec. Inc.*, No. 12 Civ. 1579(HB), 2012 WL 5927379, at *3 (S.D.N.Y. Nov. 21, 2012); *Syncora*, 36 Misc.3d at 344; *MBIA Ins. Corp. v. Countrywide Home Loans, Inc.*, 34 Misc.3d 895, 907 (N.Y. Sup. Ct. 2012). Rescissory damages are "designed to be the economic equivalent of rescission in a circumstance in which rescission is warranted, but not practicable." *St. Clair Shores Gen. Emps. Ret. Sys. v. Eibeler*, 745 F. Supp. 2d 303, 315 (S.D.N.Y. 2010).

[21] Defendants' cited cases were decided under § 10(b), rather than New York common law, or otherwise are distinguishable. *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161 (2d Cir. 2005); *In re Omnicom Grp., Inc. Sec. Litig.*, 541 F. Supp. 2d 546 (S.D.N.Y. 2008); and *Carpe v. Aquila, Inc.*, No. 02-0388-CV-W-FJG, 2005 WL 1138833 (W.D. Mo. Mar. 23, 2005), are federal securities cases applying *Dura*. In *Sciallo v. Tyco Int'l Ltd.*, No. 03 Civ. 7770(KBF), 2012 WL 2861340 (S.D.N.Y. July 9, 2012); and *Gordon Partners v. Blumenthal*, No. 02 Civ. 7377(LAK), 2007 WL 1438753 (S.D.N.Y. May 16, 2007), plaintiffs submitted no evidence of loss causation. In *Kosovich v. Metro Homes, LLC*, No. 09 Civ. 6992(JSR), 2009 WL 5171737 (S.D.N.Y. Dec. 30, 2009), plaintiffs failed to plead that defendants' misrepresentations caused plaintiffs' losses. In *Shanahan v. Vallat*, No. 03 Civ. 3496 (PAC), 2008 WL 4525452 (S.D.N.Y. Oct. 3, 2008),

Moreover, this case involves RMBS, not common stock or corporate bonds at issue in typical securities cases. Unlike stocks and bonds, RMBS are structured securities whose value rests on the quality of the collateral creating the cash flows. Thus, Defendants' reliance on cases like *Omnicom* and *Lentell*, both of which involve securities whose pricing is expected to fluctuate with a wide range of outside market influences, rather than RMBS whose value is tied really closely to the performance of underlying trust assets is misplaced.

2. Defendants' Disaggregation Theory Has Been Repeatedly Rejected

In seeking judgment based on loss causation, Defendants trot out the big Wall Street banks' favorite mantra: "the financial crisis caused your losses, not my fraud." Defendants cannot, however, ignore that their fraud is at the root of the financial crisis and downturn. As Judge Scheindlin held in *Abu Dhabi*, "[t]o prevail on summary judgment . . . it is insufficient for defendants to offer evidence that plaintiffs' losses were caused by the liquidity crisis; rather, defendants must demonstrate that a jury could not reasonably infer from the available evidence that *some* portion of plaintiffs' losses were caused by defendants' fraud." 2012 WL 3584278, at *19. As shown below, there is a triable issue of fact whether Defendants' misrepresentations regarding the quality of RMBS loan collateral caused Plaintiffs' damages.

Courts in this district have repeatedly rejected Defendants' theory that RMBS investors cannot prove loss causation just because Defendants' fraud coincided with the financial crisis. Loss causation is inherently fact-based and "[t]o hold that plaintiffs failed to plead loss causation solely because the credit crisis occurred contemporaneously with [defendants' fraud] would place too much weight on one single fact." *Abu Dhabi*, 2012 WL 3584278, at *19 (finding that fact issues precluded summary judgment on loss causation in common-law fraud action); *In re*

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plaintiffs provide only "speculation" that defendants' misstatements caused their losses.

Sadia, S.A. Sec. Litig., 269 F.R.D. 298, 317 (S.D.N.Y. 2010) ("For the third time in as many months, the Court finds itself presented with the defense: 'don't blame me, blame the financial crisis.' For the same reasons I rejected this argument in prior cases, I reject it once again.").[22]

In all events, Plaintiffs have more than sufficiently provided a basis for a reasonable jury to find that Defendants' fraud caused Plaintiffs' losses. Plaintiffs have offered two experts on damages, Paul J. Seguin, Ph.D. and Joseph R. Mason, Ph.D. Dr. Seguin determined Plaintiffs' rescissory damages, and Dr. Mason opined on compensatory damages and loss causation. Based on a detailed statistical model, Dr. Mason concluded that "underwriting quality had a statistically significant impact on [mortgage loan payment] delinquencies" and that those delinquencies "exacerbated the decline in home prices and other macroeconomic factors" commonly referred to as the financial or credit crisis. ¶221. Dr. Mason further concluded that "the key cause of the decline in home prices and the increase in unemployment is, in all probability, the decline in underwriting quality, including the failure to adhere to underwriting standards." ¶222. Dr. Mason also refutes Defendants' faulty assertion that Plaintiffs must separate the market downturn from Defendants' fraud to apportion their losses:

> [S]ince widespread underwriting defects, including by the Defendants in this case, are at the root of the financial crisis and economic downturn, there is no known generally-accepted economic method that can distinguish investor losses caused by the underwriting defects alleged here from those arising from the subsequent financial crisis and economic downturn, nor would I argue that such a distinction is appropriate. Again, therefore it is my opinion that declines in home prices and the ensuing recession cannot be considered independent

[22] *See also Emergent Capital*, 343 F.3d at 197 (whether a general market drop caused plaintiffs' losses is a matter of proof for trial); *King Cnty., Wash. v. IKB Deutsche Industriebank AG*, 708 F. Supp. 2d 334, 343 (S.D.N.Y. 2010) (neither *Lentell* nor *Dura* burdens "plaintiffs with pleading that *no other possible* event could have caused plaintiffs' losses"); *Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d at 1174 ("It will be the fact-finder's job to determine which losses were proximately caused by [defendants' fraud] and which are due to extrinsic or sufficiently linked forces."); *In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 513 (S.D.N.Y. 2009) (same trial).

> intervening influences on the value of the certificates at issue in this case that mitigate damages.

¶223. In sum, a jury should decide whether Plaintiffs have shown loss causation.

D. Defendants' Central Role In The Fraudulent Sale Of All Of The Certificates

Defendants seek judgment on the 16 Offerings in which Bear or JPM served as RMBS underwriter but not as sponsor. The sole basis for Defendants' motion is this Court's ruling in *Dexia v. Deutsche Bank, supra*, that the complaint in that case only alleged a "limited and attenuated role" for Deutsche Bank when it only underwrote RMBS. Slip op. at *21. In that case, the Court focused on the absence of allegations that Deutsche Bank re-underwrote the loans underlying the RMBS, and that, other than playing a traditional securities-underwriting role, the defendant had no involvement "with these loans or Offerings in any way." *Id.*

Defendants' assertion here fails because the record shows that the role JPM and Bear played when underwriting the Certificates was anything but "limited and attenuated." To the contrary, JPM's and Bear's loan-level diligence and structuring control for these 16 Offerings (including systematic overrides of due diligence filings that loans were materially defective) mirrored the involvement they had as sponsors of the other Offerings. ¶226-31. A reasonable jury would likely draw no distinction between Defendants' culpability based on their role as RMBS underwriter only, versus RMBS underwriter and sponsor.

The role that JPM and Bear played in underwriting the Certificates differed from traditional notions of an equity or debt securities underwriter. In the RMBS context, both Bear and JPM admit that they conducted the very same loan-level diligence as when they acquired and securitized mortgages. ¶99-100; 226-229. For example, the head of JPM's due diligence, Joel Readance, testified that when JPM acted solely as underwriter and not sponsor, it still conducted the same due diligence, decided which diligence vendor to retain, received diligence reports from

the vendors, and controlled the process of "clearing" exceptions. Further, the sponsor was not involved in the diligence and there was no difference between when JPM was only underwriter and when it was both underwriter and sponsor. ¶227.[23] Defendants' own diligence expert opined that when Bear and JPM served solely as underwriter and did not own the underlying mortgages, they conducted the same diligence on the collateral as when they owned the mortgages. ¶229. As to structuring in underwriter-only deals, RMBS sponsors typically hired JPM and Bear as underwriter specifically because JPM and Bear not only sold the securities, but employed their expertise in "creating the waterfall and creating the structure of the RMBS itself." ¶231. Thus, a reasonable jury could find that the Defendants' involvement was not too "limited" or "attenuated" to support a fraud claim.

E. Plaintiffs Have Established Their Standing

This Court has twice previously rejected Defendants' challenge to the Dexia entities' standing. Defendants raise no new arguments or facts to alter this conclusion. Defendants concede – as they must – that FSAM purchased each Certificate. Thus, FSAM was a victim of the fraud and unquestionably has standing. The only issue is whether FSAM assigned these valid claims to its affiliate, DCL.[24] As before, the Guaranteed Put Contract transferred to DCL "all right, title and interest" in all but one Certificate,[25] in exchange for DCL's payment of 100% of

[23] Indeed, Seth Fenton, JPM's 30(b)(6) witness, when asked whether JPM's diligence was as "rigorous" when JPM served solely as underwriter as when it was also sponsor, testified that "[t]he review process was generally the same regardless if we were buying loans [and was] based upon the counterparty and what [level of diligence] they had negotiated in the trade." ¶228.

[24] An assignee has standing to sue based on the assignor's injuries. As a result of the assignment, the assignee is asserting its own legal rights (not the rights of a third person). *See Sprint Commc'ns Co. v. APCC Servs., Inc.*, 554 U.S. 269, 285 (2008).

[25] Defendants concede that FSAM has standing with respect to the one Certificate (BSABS 2006 EC2 A4) that FSAM never transferred to DCL. *See* Def. Br. at 4 n.3.

the unpaid principal amount of the Certificates (plus accrued but unpaid interest). As before, Defendants' challenge to the assignment fails on the facts and the law.

1. Facts Pertinent To Standing

At all times, Plaintiffs Dexia SA, DCL and DHI were the direct or indirect corporate parents of FSAM. FSAM invested the proceeds obtained from the sale of GICs to third-party investors. FSAM invested most of the funds it received from the GIC proceeds in purportedly safe, AAA-rated RMBS (including the Certificates). ¶233. As set forth above, however, Defendants concealed the true quality of the RMBS from both the credit rating agencies (to procure AAA ratings) and FSAM (to sell the Certificates and transfer the risk). Because it paid significantly more for the Certificates than they were truly worth, FSAM's RMBS portfolio placed considerable financial pressure on the entire Dexia corporate family. ¶234. In response, Dexia took various steps to stabilize itself, including corporate asset sales. ¶235-36.

As part of selling one of its businesses, Dexia was required to guarantee that FSAM would have enough money to cover the GIC repayment obligations. ¶238. Dexia SA and DCL therefore guaranteed substantially all of the RMBS in FSAM's portfolio (including all but one of the Certificates) pursuant to various agreements, including the June 2009 Guaranteed Put Contract. ¶238.

The Guaranteed Put Contract provided that FSAM was required to cause its Collateral Agent to "Deliver" the relevant RMBS to DCL, and DCL was required to pay FSAM 100% of the RMBS' outstanding principal amount (plus accrued interest). *Id*. The guarantee stated:

> "Deliver" means to deliver, novate, transfer, assign or sell, as appropriate, in the manner customary for the settlement of the applicable Put Settlement Assets (which shall include executing all necessary documentation and taking any other necessary actions), in order to convey **all right, title and interest** in the Put Settlement Assets to Dexia or DCL, as applicable, free and clear of any and all liens, charges, claims and encumbrances . . . .

¶239 (emphasis added); *see also id.* at 16 ("On the Call Settlement Date, the Collateral Agent will Deliver to DCL or Dexia, as applicable, the relevant Call Settlement Assets against payment of the Call Settlement Amount . . . ."). [26] All but one of the Certificates were ultimately either put to, or called by. DCL and delivered to DCL under the Guaranteed Put Contract. DCL then resold the Certificates to third parties at an enormous loss. ¶245.

Although unnecessary because the assignment is unambiguous, FSAM testified that "it was the parties' intent to provide for the assignment to Dexia SA or DCL (as applicable) of 'all right, title and interest' in the relevant RMBS, including all contract, tort or other legal or equitable remedies or claims that FSAM had in connection with such RMBS." Peterson Decl. ¶18. Frank Dattalo, a director in DCL's portfolio manager group, confirmed that "[m]y understanding of the put contract is Dexia would take possession of all rights and titles under the bonds through that put contract, so we would be purchasing the bonds from FSAM in essence stepping into their shoes." ¶247. In an August 2009 email, Dattalo stated that DCL should take delivery of a Certificate that had been written down to zero because "that will provide us the ability to receive any recoveries in the future without having the money tied up by [FSAM]." ¶248. He testified that this meant that "any sort of settlement, whether principal, or interest recoveries or legal action would be in the possession and fall to [DCL] as owner of the underlying bond." ¶249.

2. FSAM Validly Assigned Its Fraud Claims *Via* The Guaranteed Put Contract

[26] In response to a Put Exercise Notice, DCL had the option of making a "Deferred Settlement Election." In this scenario (which DCL frequently exercised before the summer of 2011), instead of paying 100% of the outstanding unpaid par value and accrued interest on an RMBS and taking delivery of the RMBS, (1) DCL would pay FSAM the principal or interest shortfall or writedown amounts as they occurred, and (2) FSAM's Collateral Agent would retain custody of the relevant RMBS pending future calls or puts.

The language of the Guaranteed Put Contract, conveying "all right, title and interest" in the Certificates, effects an assignment of related legal claims. *See Banque Arabe*, 57 F.3d at 152-53 (language transferring all "rights, title and interest" in a transaction "alone is sufficient to demonstrate [the assignee's] intent to transfer all of their rescission and fraud claims"). In *Banque Arabe*, the district court held that the plaintiff/parent corporation bank lacked standing to pursue fraud claims initially belonging to its subsidiary because the written assignment of assets to the bank did not directly reference the claims. *See id*. at 152. The Second Circuit reversed, holding that the contractual language assigning "all rights, title and interest" standing alone, unambiguously assigned the fraud claims to the bank. *Id*. at 152. *Banque Arabe* confirms that FSAM's assignment of "all right, title and interest" in the Certificates to DCL is unambiguous and assigned *both* the Certificates and the associated fraud claims to DCL.[27]

It is thus not surprising that this Court has twice *rejected* the very standing argument that Defendants rehash for a third time here. *See Dexia SA/NV v. Deutsche Bank AG*, No. 11-cv-5672 (JSR), Order at *2 (S.D.N.Y. Feb. 7, 2012) (ECF No. 49) (where Defendants submitted the Guaranteed Put Contract for review, Court *rejected* argument that the guarantee's assignment of "all right, interest and title" language was insufficient as a matter of law to assign related tort claims to DCL); *Dexia SA/NV v. Bear, Stearns & Co., et al.*, No. 12-cv-4761 (JSR), Order at 1-2

[27] *See also Pro Bono Invs., Inc. v. Gerry*, No. 03-cv-4347 (JGK), 2008 WL 4755760, at *17-18 (S.D.N.Y. Oct. 29, 2008) ("*Banque Arabe* thus reflects that the default rule in New York for broadly worded assignments that do not contain limiting language or purport to transfer only contract rights, is that such assignments include causes of action, although they may not refer to them explicitly"); *Int'l Design Concepts LLC v. Saks Inc.*, 486 F. Supp. 2d 229, 237 (S.D.N.Y. 2007) (assignment of assets is sufficient to assign associated legal claims); *N. Fork Bank v. Cohen & Krassner*, 44 A.D.3d 375, 375 (1st Dep't 2007) (assignment by lender, which was "victim of the alleged fraud," of "all of [lender's] right, title and interest in and to" mortgage also assigned lender's related fraud claims against law firm that issued fraudulent opinion letter in connection with mortgage, citing *Banque Arabe*). These decisions are also "consistent with the general trend in New York toward adopting principles of free assignability of claims, including those of fraud." *Banque Arabe*, 57 F.3d at 153 (citation omitted).

(S.D.N.Y. Sept. 28, 2012) (ECF No. 27) (rejecting identical arguments as part of summary order denying Defendants' motion to dismiss).[28]

Moreover, the policy concerns regarding the effectiveness of an assignment of fraud claims focus on protecting a defendant from civil double jeopardy. Such concerns do not exist when – as here – an intra-corporate assignment is made and both assignor and assignee are parties to the litigation. *See Rosenblum*, 111 F.2d at 407 ("Since the claim is owned and may be sued upon by someone, all a defendant may properly ask is such a party plaintiff as will render the judgment final and *res adjudicata* of the right sued upon."); *Barry v. Duffin*, 290 Mass. 398, 402 (Mass. 1935) ("It is of no concern to the debtor whether proceedings are brought in the name of the assignor, or, where permitted, in the name of the assignee, so long as the debtor is in no danger of double liability.") (internal citations omitted). Defendants' attack on the assignment here should be rejected as the empty formalism it is.[29]

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[28] Indeed, Defendants' theory would lead to absurd results. Defendants concede that (a) FSAM had standing to pursue the instant claims as to all of the Certificates until it was "made whole" by DCL and (b) FSAM was free to assign the claims to DCL. Why, in the context of a transaction within the same corporate family, would a subsidiary and its parents transfer assets among them in a manner that would result in *neither* entity having the ability to pursue pre-existing legal claims against third parties? *See, e.g., Cole v. Macklowe*, 90 A.D.3d 595, 596 (1st Dep't 2012) (it is "well settled" that "a contract should not be interpreted to produce an absurd result, one that is commercially unreasonable, or one that is contrary to the intent of the parties"). Tellingly, none of Defendants' cases involve assignments between affiliates within the *same* corporate family.

[29] In any event, FSAM has ratified the assignment of its claim to its affiliates by participating in this action as a plaintiff. In *Abu Dhabi Commercial Bank v. Morgan Stanley & Co.*, -- F. Supp. 2d --, 2012 WL 5438954, at *6 (S.D.N.Y. Nov. 7, 2012), (the court upheld an assignor's post-suit ratification of assignment of notes-related claims to the plaintiff under Fed. R. Civ. P. 17(a), rejecting the argument that the assignor could not ratify the assignment because the assignee's purchase of the notes at par destroyed the assignor's standing as "an assertion that there is no real party in interest, and that [assignor]'s claims have evaporated. Such an outcome is untenable." *See also Lambrinos v. Exxon Mobil Corp.*, 349 Fed. App'x 613, 614 (2d Cir. 2009) (sustaining post-suit assignment under Rule 17), (Plaintiff's appellate brief in Lambrinos confirms that the assignment approved by the Second Circuit was post-suit. *See* 2008 WL 7934915, at *6). Although unnecessary, FSAM can also provide an express ratification of the assignment.

Defendants also assert that "Delivery" of the relevant RMBS assets never occurred, and that no assignment therefore took place because the Call Exercise Notices did not capitalize the "d" in "delivery." Def. Br. at 8-10. *Id.* at 8-9. The absurdity of this contention is evidenced by the undisputed fact that the Call Exercise Notices were attached as an Exhibit to the Guaranteed Put Contract, which unambiguously provided that "Delivery" of the Certificates included all rights, title and interest.

Moreover, the Guaranteed Put Contract governing these transfers within the same corporate family plainly did not require the execution of any particular documentation to effect "Delivery." Delivery took place.[30] Finally, Defendants assert that FSAM has no injury with respect to 63 of the 65 Certificates because it received principal and interest distributions, plus payments equal to 100% of the outstanding principal balance when they were put or called. Defendants are wrong for several reasons.

First, as discussed above, the evidence shows that Defendants' fraud damaged Plaintiffs under New York common law by inducing FSAM to substantially ***overpay*** for the Certificates. Thus, the receipt of distributions of principal and interest does not mean FSAM was not damaged (or "injured") by the fraud.[31]

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[30] Defendants' assertion that the Collateral Agent – the third party that had custody of FSAM's assets and that DCL had to pay before it would release any of FSAM's RMBS to DCL – never had the authority or ability to "Deliver" the Certificates is also wrong. In fact, the underlying agreements all contemplated that the Collateral Agent *would* "Deliver" the relevant assets to DCL upon receipt of the required payment in response to a Put or Call Exercise Notice. Until now, no party has ever disputed that the Certificates were "Delivered" to DCL.

[31] In analyzing damages under the Securities Act of 1933, which (like New York common law fraud damages) are generally measured as the difference between the amount paid and the securities' value, courts have rejected this very same argument. *See, e.g., Pub. Emps' Ret. Sys. of Miss. v. Merrill Lynch & Co.*, 277 F.R.D. 97, 108 (S.D.N.Y. 2011) ("As recent precedent confirms, Defendants' argument that Plaintiffs must show that they failed to receive principal or interest payments . . . constitutes 'too cramped a reading of damages.'") (citing *Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d at 1169–70); *N.J. Carpenters Health Fund v. DLJ Mortg.*

Second, FSAM's receipt of payment under the Guaranteed Put Contract did not extinguish its "injury-in-fact" because the Defendants' fraud (and the damage to the Plaintiffs) ***was complete at the time FSAM purchased the Certificates***. *See Hotaling v. A.B. Leach & Co.*, 247 N.Y. 84, 87-88 (1928) ("The seller's fraud is ordinarily complete and its effect exhausted at the time of the sale and transfer."); *Allstate Ins. Co. v. Countrywide Fin. Corp.*, 824 F. Supp. 2d 1164, 1188 (C.D. Cal. 2011) (fraud damages under New York common law are "measured as of the date of sale"); *Cnty. of Oakland v. City of Detroit*, 866 F.2d 839, 845-46 (6th Cir. 1989) ("the plaintiff who has subsequently passed on the overcharge to his customers is no more deprived of standing to sue than is the claimant whose loss happens to be covered by insurance") (citing Justice Holmes in *S. Pac. Co. v. Darnell-Taenzer Lumber Co.*, 245 U.S. 531, 534 (1918)).

Third, FSAM's "injury-in-fact" existed at the time of the assignment. *See Stewardship Credit Arbitrage Fund LLC v. Charles Zucker Culture Pearl Corp.*, No. 600634/2010, 2011 WL 1744217, at *4 (N.Y. Sup. Ct. May 4, 2011) (despite fact that assignor was fully paid by plaintiffs/assignees, fraud claims were properly assigned because damage ***still existed*** at time of assignments). Indeed, full payment in connection with an assignment simply does not extinguish "injury-in-fact" for a standing determination. *See N. Fork Bank*, 44 A.D.3d at 376 (assignee of lender-assignor's mortgages could maintain fraud claim against defendant even though assignor was paid full value for assignment). *See also* Fed. R. Civ. P. 25(c) ("[i]f an interest is transferred, the action may be continued by . . . the original party unless the court, on motion, orders the transferee to be substituted in the action or joined with the original party.").

3. DCL Has Standing as FSAM's Equitable Subrogee

Capital, Inc., No. 08 Civ. 5653 (PAC), 2010 WL 1473288, at *4-6 (S.D.N.Y. Mar. 29, 2010) (plaintiff pled cognizable injury by alleging that RMBS lost market value, even though plaintiff did not allege nonpayment of principal or interest due); *Genesee Cnty. Emps.' Ret. Sys. v. Thornburg Mortg. Sec. Trust 2006-3*, 825 F. Supp. 2d 1082, 1147-51 (D.N.M. 2011) (same).

In any event, if the assignment is invalid – and it clearly is not – DCL has standing as FSAM's equitable subrogee. Under New York law, "subrogation . . . include[s] every instance in which one party pays a debt for which another is primarily answerable and which in equity and good conscience should have been discharged by the latter so long as the payment was made either under compulsion or for the protection of some interest of the party making the payment and in discharge of an existing liability." *Hamlet at Willow Creek Dev. Co. v. Ne. Land Dev. Co.*, 64 A.D.3d 85, 105-06 (2d Dep't 2009); *see also* 23 N.Y. Jur. 2d Contribution, Etc. § 165.

Here, it is undisputed that DCL (1) guaranteed FSAM against losses on the Certificates to allow the sale of corporate assets (thus enabling Dexia to raise needed capital), and (2) paid FSAM par value for the Certificates in accordance with the guarantee notwithstanding Defendants' liability to FSAM. As a guarantor, DCL is the archetype of a party entitled to equitable subrogation. *See Banco Nacional de Mexico, S.A. v. Ecoban Fin. Ltd.*, 276 A.D.2d 284, 284 (1st Dep't 2000); *Am. Nat'l Bank & Trust Co. v. Weyerhaeuser Co.*, 692 F.2d at 459-66 (upholding bank's standing as subrogee of its asset-management client for claims that issuer wrongly rejected bank's submission of client's shares into tender offer, after which bank paid client the tender-offer price (which was higher than the current market price)).

New York courts traditionally apply the doctrine of equitable subrogation broadly and do not limit it to guarantors. *See Pittsburgh-Westmoreland Coal Co. v. Kerr*, 220 N.Y. 137, 143-44 (1917) ("The remedy of subrogation is no longer limited to sureties and *quasi* sureties, but includes so wide a range of subjects that it has been called the mode which equity adopts to compel the ultimate payment of a debt by one who in justice, equity, and good conscience ought to pay it.") (emphasis in original, citations omitted); *Gerseta Corp. v. Equitable Trust Co. of N.Y.*, 241 N.Y. 418, 425-26 (1926) (equitable subrogation applies wherever a party pays another

party's liability to protect its own interest, and the equities are such that the originally liable party should not be relieved of liability).[32]

Today, New York courts continue to find equitable subrogation under the principles set forth in *Pittsburgh-Westmoreland* and *Gerseta*. *See Willow Creek*, 64 A.D. 3d at 105-06 (citing *Gerseta*). New York courts also routinely apply equitable subrogation to tort claims. *See, e.g.*, *Allstate Ins. Co. v. Stein*, 1 N.Y.3d 416, 422 (2004); *Fed. Ins. Co. v. Arthur Andersen & Co.*, 75 N.Y.2d 366, 371 (1990) (plaintiff "would have a right of subrogation against [the tortfeasor] . . . even if there were no explicit subrogation clause in the insurance policy").[33]

Here, Dexia's intra-company transfers of the Certificates and related payments from DCL to FSAM were done to protect the Dexia corporate family's interests by ensuring that FSAM could cover its obligations on the GIC contracts. In sum, under well-established New York law, DCL has standing as FSAM's equitable subrogee.[34]

IV. CONCLUSION

For the above reasons, Defendants' motion for summary judgment should be denied.

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[32] In *Gerseta*, a trading company used bank financing to acquire silk, sold the silk to Gerseta, and then became insolvent. When the bank sued Gerseta to recover the cost of the silk, Gerseta paid cash to settle the bank's case and then sued the trading company. *See* 241 N.Y. at 425-26.

[33] The Guaranteed Put Contract also provided that, in connection with all payments that DCL made to FSAM under any Deferred Settlement Elections, DCL would be "subrogated to the rights of [FSAM] to receive reimbursement from the Issuer of the relevant [RMBS] for the relevant Interest Shortfall, Principal Shortfall or Writedown Amount." Ex. 54 at 17-18. This clause confers additional standing on DCL as FSAM's contractual subrogee. Although Defendants may attempt to argue that DCL's contractual subrogation rights are less than its equitable subrogation rights, DCL's equitable and contractual subrogation rights are distinct and independent. *See Fasso v. Doer*, 12 N.Y.3d 80, 86-87 & n.4 (2009); *see also Fed. Ins.*, 75 N.Y.2d at 371 (plaintiff could proceed under both contractual subrogation and independent equitable subrogation).

[34] Similarly, under another set of intercompany agreements, Dexia SA and DHI also have standing as DCL's subrogees to the extent that they subsequently reimbursed DCL for certain amounts that DCL paid to FSAM under the Guaranteed Put Contract. ¶253.

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