HSH Nordbank AG v Goldman Sachs Group, Inc.
2013 NY Slip Op 33015(U)
November 26, 2013
Sup Ct, New York County
Docket Number: 652991/12
Judge: Melvin L. Schweitzer
Cases posted with a "30000" identifier, i.e., 2013 NY Slip Op 30001(U), are republished from various state and local government websites. These include the New York State Unified Court System's E-Courts Service, and the Bronx County Clerk's office.
This opinion is uncorrected and not selected for official publication.

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

PRESENT: MELVIN L. SCHWEITZER PART 45
Justice

HSH NORDBANK AG, et al

INDEX NO. 652991/12

MOTION DATE

- v -

MOTION SEQ. NO. 001

THE GOLDMAN SACHS GROUP, INC., et al

MOTION CAL. NO.

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

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

Cross-Motion: ☐ Yes ☐ No

Upon the foregoing papers, it is ordered that this motion by defendant to dismiss the Complaint is DENIED, in part, and GRANTED, in part, per the attached Decision and Order.

A Preliminary Conference is scheduled for 1-7-14 at 11:30 AM at 60 Centre St. Room 218

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

Dated: November 26, 2013

MELVIN L. SCHWEITZER J.S.C.

Check one: ☐ FINAL DISPOSITION ☑ NON-FINAL DISPOSITION

Check if appropriate: ☐ DO NOT POST ☐ REFERENCE

☐ SUBMIT ORDER/JUDG. ☐ SETTLE ORDER /JUDG.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK : PART 45

HSH NORDBANK AG, et al.,	:	
Plaintiffs,	:	Index No. 652991/12
-against-	:	DECISION AND ORDER
THE GOLDMAN SACHS GROUP, INC., et al.,	:	Motion Sequence No. 001
Defendants.	:	

MELVIN L. SCHWEITZER, J.:

In this action, HSH Nordbank AG, HSH Nordbank AG, Luxembourg Branch, HSH Nordbank AG, New York Branch, HSH Nordbank Securities S.A., and Carrera Capital Finance Limited (collectively Nordbank) assert various claims against The Goldman Sachs Group, Inc., Goldman Sachs Real Estate Funding Corp., GS Mortgage Securities Corp., Goldman Sachs Mortgage Company, Goldman, Sachs & Co., and Goldman Sachs International (collectively Goldman Sachs) in connection with the sale of residential mortgage-backed securities. Nordbank alleges that Goldman Sachs violated the laws of New York and is liable for fraud, fraudulent concealment, negligent misrepresentation, and aiding and abetting fraud. In the alternative, Nordbank alleges that the sale of the securities should be rescinded on the grounds of mutual mistake. Goldman Sachs has moved to dismiss the complaint pursuant to CPLR 3016 (b), 3211 (a) (1), 3211 (a) (5) and 3211 (a) (7).

Background

The following facts are drawn from the complaint, and are taken as true with all reasonable inferences drawn in favor of Nordbank for the purposes of this motion to dismiss.

[* 3]

HSH Nordbank AG is a financial institution incorporated in Germany with offices around the world, including in New York. Between 2005 and 2006, Nordbank purchased securities, known as Certificates, in six different residential mortgage-backed securities (RMBS) offerings. The Certificates were the outcome of a complex securitization process. Before it made each purchase, Nordbank received information from Goldman Sachs about the Certificates and the securitization process in registration statements, prospectuses, prospectus supplements, free writing prospectuses, term sheets, and various other materials (the Offering Materials).

The Goldman Sachs Group, Inc. is the ultimate parent company of the various Goldman Sachs entities and the seller of the Certificates. Goldman Sachs participated in all aspects of the securitization process, including acting as the depositor, sponsor and lead underwriter on all but one of the offerings.[1] Goldman Sachs also prepared the Offering Materials, which included various metrics and representations regarding the quality and nature of the various pools of loans that collateralized the Certificates. The gravamen of the complaint is that Goldman Sachs knew that these metrics and representations were false, but did not alert Nordbank.

Nordbank alleges that Goldman Sachs knew that loan originators had systematically abandoned underwriting guidelines described in the Offering Materials. It alleges that Goldman Sachs knowingly reported false credit ratings, owner-occupancy percentages, appraisal amounts, and loan-to-value ratios. It alleges that although Goldman Sachs represented otherwise in the Offering Materials, Goldman Sachs never intended to properly effectuate transfer of the underlying notes and mortgages that collateralized the Certificates.

---

[1] Nordbank asserts its fraud claims with respect to only the following five offerings: GSAMP 2005-HE4; GSAMP 2006-HE2; GSAMP 2006-HE3; GSAMP 2006-NC1; and GSAMP 2006-NC2.

Discussion

Goldman Sachs moves to dismiss the claims as time-barred under German law. Goldman Sachs additionally argues that Nordbank has not adequately pleaded justifiable reliance, scienter, or loss causation, or any actionable material misrepresentations. Goldman Sachs further asserts that Nordbank has failed to state a claim for mutual mistake or for negligent misrepresentation. The motion is granted as to the claim for negligent misrepresentation as well as to the fraud claims for statements regarding credit ratings and assignment and transfer, but is otherwise denied.

On a motion to dismiss for failure to state a cause of action, the court accepts all factual allegations pleaded in plaintiff's complaint as true, and gives plaintiff the benefit of every favorable inference. CPLR 3211 (a) (7); *Sheila C. v Povich*, 11 AD3d 120 (1st Dept 2004). The court must determine whether "from the [complaint's] four corners[,] 'factual allegations are discerned which taken together manifest any cause of action cognizable at law." *Gorelik v Mount Sinai Hosp. Ctr.*, 19 AD3d 319 (1st Dept 2005) (quoting *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977)). Vague and conclusory allegations are not sufficient to sustain a cause of action. *Fowler v American Lawyer Media, Inc.*, 306 AD2d 113 (1st Dept 2003).

On a motion to dismiss on the ground that defenses are founded upon documentary evidence, the evidence must be unambiguous, authentic and undeniable. CPLR 3211 (a) (1); *Fontanetta v Doe*, 73 AD3d 78 (2d Dept 2010). "To succeed on a [CPLR 3211 (a) (1)] motion . . . a defendant must show that the documentary evidence upon which the motion is predicated resolves all factual issues as a matter of law and definitively disposes of the plaintiff's claim." *Ozdemir v Caithness Corp.*, 285 AD2d 961, 963 (3d Dept 2001), *leave to appeal denied* 97 NY2d 605. In other words, "documentary evidence [must] utterly refute plaintiff's factual

allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of New York*, 98 NY2d 314, 326 (2002).

I. Statute of Limitations

As an initial matter, Goldman Sachs argues that Nordbank's claims are barred by the applicable three-year German statute of limitations. Limitations-based arguments in RMBS fraud actions have not generally been accepted at the motion to dismiss phase. *See e.g. Capital Ventures Intern. v J.P. Morgan Mortgage Acquisition Corp.*, 2013 WL 535320, at *7 (D Mass 2013); *In re Countrywide Fin Corp Mortgage-Backed Secs.*, 2012 WL 1322884, at *4 (CD Cal 2012]); *Allstate Ins Co v Morgan Stanley*, No. 651840/2011, 2013 WL 2369953, at *9 (NY Sup Ct 2013). As Judge Pfaelzer aptly explained in Allstate:

> Defendants have cited a number of articles from 2007 that either make or hint at this same connection. As in Allstate it is possible, perhaps probable, that Defendants will ultimately demonstrate that a reasonable investor was on inquiry notice by August 31, 2007. However, 2007 was a turbulent time during which the causes, consequences, and interrelated natures of the housing downturn and subprime crisis were still being worked out. The Court cannot, based solely on the FAC and judicially noticeable documents, conclude that by August 31, 2007 a reasonably diligent investor should have linked increased defaults and delinquencies in the loan pools underlying the Certificates with both a failure to follow the underwriting and appraisal guidelines specified in the Offering Documents and the possibility that the tranches purchased by MassMutual would suffer losses. That is the link that a reasonable investor would have needed to make in order to know that something material was amiss with the Offering Documents for the particular tranches that are at issue in this case. Accordingly, the Court DENIES Defendants' motions to dismiss based on the statute of limitations.

Allstate v Morgan Stanley, 2013 WL 2369953, at *8 (quoting *In re Countrywide Fin Corp Mortgage-Backed Secs*, 2012 WL 1322884, at *4). Judge Pfaelzer also noted that in a fraud case involving a scienter element, plaintiffs would have a difficult task in obtaining sufficient notice

of the facts underlying their claims. *In re Countrywide Fin Corp Mortgage-Backed Secs*, 2012 WL 1322884, at *4

Under section 195 of the German Civil Code, the limitation period for contract-based claims and claims for fraud is three years and exists primarily to protect the defendant from "unjustified, unknown, or unexpected claims." According to Uwe Schneider, a professor of German corporate and securities law:

> The limitations period commences at the end of the first calendar year by which time both (a) the claim arose and (b) the claimant obtains knowledge of the circumstances giving rise to the claim and the identity of the defendant, or would have obtained such knowledge if he or she had not shown gross negligence.

Based on a tolling agreement both parties executed in 2011, Goldman Sachs argues the claims are time-barred if Nordbank had knowledge of the circumstances giving rise to the claims by December 31, 2007.

As evidence that Nordbank had such knowledge, Goldman Sachs has provided the court with a number of press reports, lawsuits and other information that was available to the public in 2007. Goldman Sachs claims this information "demonstrate[s] that Nordbank knew, or was grossly negligent in not knowing, of its claims by the end of 2007." Nordbank responds that information available in 2007 did not put Nordbank on notice that "Goldman Sachs knowingly failed to exclude bad loans from the securitizations at issue, or that Goldman Sachs intentionally or recklessly misdescribed the loans in the Offering Materials."

The court is unable to determine whether Nordbank had sufficient notice of its claims in 2007 at this stage of the proceedings. Goldman Sachs largely relies on news reports from the fall of 2007 that indicate that German banks and investors were "already considering whether to turn to the U.S. courts to seek restitution." Information of this nature does not establish as a

matter of law that Nordbank was grossly negligent in not learning of its claims against Goldman Sachs before the end of 2007. The court agrees with Nordbank's argument that this language is essentially speculative, and does not indicate that Nordbank could have deduced facts sufficient to support its claims for fraud with respect to the sale of specific Certificates at issue in this lawsuit.

While Nordbank may have had notice in 2007 that loan originators were not following their underwriting guidelines, there is nothing to suggest that Nordbank knew or should have known that the Offering Materials for each of the Certificates it had purchased contained false statements, and critically, that Goldman Sachs knew about them. *See Allstate*, 2013 WL 2369953, at *9 ("The collapse of the various loan originators . . . would not necessarily apprise plaintiffs that Morgan Stanley was complicit in their wrongdoing").

In any case, Goldman Sachs will be given the opportunity to fully develop a factual record that will more clearly indicate whether Nordbank in fact had sufficient notice under German law that it had viable claims against Goldman Sachs in 2007.

II. Fraudulent Misrepresentation

The elements of a claim of fraud under New York law are "(1) a material misrepresentation of a fact, (2) knowledge of its falsity, (3) an intent to induce reliance, (4) justifiable reliance by the plaintiff, and (5) damage." *Eurycleia Partners, LP v Seward & Kissel, LLP*, 12 NY3d 553, 559 (2009). Under CPLR 3016(b), these elements must be stated in detail. As discussed below, Nordbank has adequately alleged each element of its fraud claim with respect to certain alleged misrepresentations, but not as to all of the alleged misrepresentations.[2]

[2] Nordbank's fraud claims includes each of the securities listed in Table 1 of the complaint, except the FBR Securitization Trust (FBRSI) 2005-2.

1. Misrepresentations

The complaint alleges the Offering Materials contained a number of false or misleading statements. Nordbank accuses Goldman Sachs of falsely representing that the mortgages backing the securities complied with the originators underwriting standards and conformed to certain metrics including appraisal values, loan-to-value ratios and owner occupancy rates. Nordbank also alleges that Goldman Sachs knowingly made false representations concerning the accuracy of the Certificate's credit ratings, as well as the schedule on which the mortgages would be assigned and transferred to the respective issuers of the securities. Goldman Sachs moves to dismiss the complaint on the grounds that none of the various alleged misrepresentations are actionable.

Compliance with Underwriting Guidelines

With respect to allegations that it falsely represented that the mortgages in the pools collateralizing the Certificates were underwritten in compliance with originators' own guidelines, Goldman Sachs argues that the representations were in fact not false. Goldman Sachs asserts that the Offering Materials indicated that standards were only followed "generally" and that they further disclosed that originators could depart from guidelines based on certain exceptions.

Allegations of widespread abandonment of underwriting guidelines have been found sufficient to sustain a claim for fraudulent misrepresentation even where the pre-deal representations included general disclaimers that exceptions could occur in the presence of certain compensating factors. *See e.g. In re IndyMac Mortgage-Backed Sec Litig*, 718 F Supp 2d 495, 509 (SDNY 2010) ("The crux of plaintiffs' claims, however, is that IndyMac Bank ignored even those watered-down underwriting standards, including the standards for granting

exceptions . . . . disclosures regarding the risks stemming from the allegedly abandoned standards do not adequately warn of the risk the standards will be ignored."); *Stichting Pensioenfonds ABP v Credit Suisse Group AG*, 2012 WL 6929336, at *8 (NY Sup Ct Nov. 30, 2012).[3] Accordingly, Nordbank's allegations of widespread abandonment of underwriting guidelines are sufficient to withstand a motion to dismiss.

Appraisal Values, Loan-to-Value Ratios, and Owner-Occupancy Rates

The alleged misrepresentations regarding appraisal values, loan-to-value ratios and owner-occupancy rates also stand. Nordbank's own investigation and loan-level analysis[4] yielded materially different information than what was represented in the Offering Materials. The Offering Materials represented that none of the mortgages for each security had combined loan-to-value (CLTV) ratios above 100%. Mortgages with CLTV ratios higher than 100% have been referred to as "underwater" and are far more likely to default. Nordbank alleges that between 10.08% and 28.81% of the loans it sampled in its investigation had CLTV ratios over 100%. Owner-occupancy statistics are also of critical importance in evaluating the risk of

---

[3] *See also New Jersey Carpenters Vacation Fund v Royal Bank of Scotland Grp, PLC*, 720 F Supp 2d 254, 270 (SDNY 2010) ("Disclosures that described lenient, but nonetheless existing guidelines about risky loan collateral, would not lead a reasonable investor to conclude that the mortgage originators could entirely disregard or ignore those loan guidelines."); *Tsereteli v Residential Asset Securitization Trust 2006-A8*, 692 F Supp 2d 387, 392 (SDNY 2010) (allegations of "widespread abandonment of underwriting guidelines at IndyMac Bank during the period of time at issue and that the percentage of 'defaulting' loans rose dramatically shortly after the Certificates were issued . . . create a sufficient nexus between the alleged underwriting standard abandonment and the loans underlying the Certificates"); *Allstate v Morgan Stanley*, 2013 WL 2369953, at *13 ("defendants have merely identified boilerplate disclaimers and disclosures in the relevant offering documents that did not disclose the risk of a systematic disregard for underwriting standards" (internal quotations omitted)).

[4] Goldman Sachs's attempt to undermine Nordbank's forensic investigation is premature at this stage. *See Capital Ventures Int'l v UBS Sec LLC*, CIV.A. 11-11937-DJC, 2012 WL 4469101 (D. Mass. Sept. 28, 2012); *Bank Hapoalim BM v Bank of Am Corp*, 12-CV-4316-MRP MANX, 2012 WL 6814194 (C.D. Cal. Dec. 21, 2012) ("the Court must assume that the AVM accurately reflects the ultimate sales prices of the homes."). Whether the methodology used by Nordbank to show that loan-to-value ratios were inaccurate and to show that borrowers did not in fact live in the homes that were designated owner-occupied is an evidentiary issue and a question of fact. *See Allstate Ins Co v Ace Sec Corp*, 2013 WL 4505139, at *13.

securitization of residential mortgages as occupied houses are significantly less likely to default. Nordbank's investigation revealed that between 12.2% and 17.9% of the mortgages backing the Certificates had owner-occupancy circumstances that were allegedly misstated in the Offering Materials.

The statements regarding appraisal values and loan-to-value ratios and owner-occupancy rates are only actionable if Goldman Sachs did not believe the representations to be accurate at the time they were made. The court finds that Nordbank has sufficiently alleged that Goldman Sachs had knowledge that originators were deliberately inflating appraisal values to artificially obtain understated CLTV ratios that corresponded with lower risk. As evidence of Goldman Sachs's knowledge, Nordbank alleges that Goldman Sachs negotiated discounts for defective loans based on information it received before and during the preparation of the Offering Materials. The information was allegedly provided to Goldman Sachs by a diligence provider that had scrutinized many aspects of the underwriting process, including loan-to-value ratios and owner-occupancy rates.[5]

Because Nordbank alleges that Goldman Sachs made these representations with knowledge of their falsity, the complaint sufficiently describes actionable misrepresentations regarding appraisal values, loan-to-value ratios, and owner-occupancy rates. *See e.g. MBIA Ins Corp v Countrywide Home Loans, Inc*, 87 A.D.3d 287, 294 (1st Dept 2011); *In re Bear Stearns Mortg Pass-Through Certificates Litig*, 851 F Supp 2d 746, 769 (SDNY 2012); *Bank Hapoalim BM v Bank of Am Corp*, 2012 WL 6814194, at *6; *Capital Ventures v JP Morgan*, 2013 WL

[5] *See* Part II, sec. 2, *infra* ("Scienter").

535320, at *5 *Allstate v Ace Sec Corp*, 2013 WL 4505139, at *13 (misrepresentations regarding the appraisal process, owner-occupancy rates and loan-to-value ratios were adequately alleged).

Assignment and Transfer of the Notes and Mortgages

The alleged misrepresentations regarding the assignment and transfer of the notes and mortgages are not pleaded with sufficient particularity to survive the motion to dismiss. Because the representation to transfer the notes and mortgages was obviously a statement of future intent, a claim for fraud must be premised on the fact that Goldman Sachs knew at the time it issued the Certificates that proper transfer would not be effectuated. Fatally, the allegations regarding Goldman Sachs's knowledge in this regard are wholly insufficient.

Nordbank alleges that Goldman Sachs knowingly engaged in a continuing and deliberate practice of not effectuating transfers of notes and mortgages to the issuers of the Certificates. But Nordbank only offers conclusory allegations that Goldman Sachs had such a practice and that Goldman had a present but undisclosed intention to continue that practice. The complaint fails to supply any factual allegations indicating that Goldman Sachs engaged in any such deliberate practice. *Cf. W & S Life Ins Co v Countrywide Fin Corp*, No. 11-CV-7166-MRP (C.D. Cal. June 29, 2012) (Investors' remedy for alleged violations of the purchase and sale agreement is to sue the trusts for breach of contract and breach of fiduciary duties.).

The allegations regarding the transfer and assignment representations fail to satisfy the requirements of CPLR 3016(b). Accordingly, the court grants the motion to dismiss with respect to the statements regarding assignment and transfer.

Credit Ratings

Similarly, Nordbank's allegations concerning representations about the accuracy of the credit ratings are not pleaded with sufficient particularity. Nordbank alleges that Goldman Sachs

knew at the time the representations were made that the ratings were not accurate because it had essentially fed inaccurate data into the ratings system. Nordbank does not identify the inaccurate data that was allegedly provided to the rating agencies, much less how and when such information was provided. Without particular factual allegations that Goldman Sachs provided false or incomplete information to the credit agencies such that it knew the ratings were inaccurate, Nordbank cannot state a claim for fraudulent misrepresentation. *Compare In re Nat'l Century Investment Litig.*, 2008 WL 2872279 (S.D. Ohio July 22, 2008) *with M&T Bank Corp v Gemstone CDO VII*, Ltd, 68 A.D.3d 1747, 1749 (4th Dept 2009) (sustaining claim for fraudulent nondisclosure where complaint identified specific relevant information that was withheld from ratings agencies); *Stichting*, 2012 WL 6929336, at *9 (same).

2. Nordbank has Adequately Pleaded Scienter.

Goldman Sachs disputes the adequacy of Nordbank's allegations of scienter. To state a claim for fraud, a plaintiff must allege some "rational basis for inferring that the alleged misrepresentations were knowingly made." *Houbigant, Inc v Deloitte & Touche LLP*, 303 AD2d 92, 93 (1st Dept 2003). These allegations must meet the heightened pleading standard of CPLR 3016(b), but this "requirement should not be confused with unassailable proof of fraud." *Pludeman v N Leasing Sys Inc*, 10 NY3d 486, 492 (2008). This is a more lenient test than the Second Circuit's "strong inference of fraud" test, and requires only that the complaint include "facts from which it is possible to infer defendant's knowledge of the falsity of its statements." *Houbigant*, 303 AD2d at 99; *Stichting*, 2012 WL 6929336, *9.

"In a case involving RMBS', 'the allegations of the mortgage loans material and pervasive non-compliance with the Seller's underwriting Guide and the mortgage loan representations are sufficient non-compliance from which Defendant's scienter can be inferred.'" *Allstate v Morgan*

Stanley, 2013 WL 2369953, at *10 (quoting *MBIA Ins Co v Morgan Stanley*, 2011 WL 2118336, at *4-5 (NY Sup Ct May 26, 2011)). The complaint alleges widespread abandonment of underwriting guidelines by a number of loan originators, including MILA, Inc., Fremont Investment and Loan, New Century Financial Corporation, Meritage Mortgage Corporation, Aames Investment Corporation, ResMAE.

To further establish that Goldman Sachs knowingly misrepresented that loan originators complied with underwriting standards, the complaint includes allegations regarding Goldman Sachs's use of a third-party due diligence provider to review the quality of underlying loans. Nordbank alleges that this diligence provider furnished Goldman Sachs with "detailed reports" regarding the quality of the underlying mortgages "prior to and during the preparation of the Offering Materials." In 2007, the diligence provider informed Goldman Sachs that a significant portion of the soon-to-be-securitized loans did not meet underwriting standards.[6] Nordbank alleges that the due diligence provider provided Goldman Sachs with knowledge that CLTV ratios, owner-occupancy rates, and appraisal values represented in the Offering Materials for each of the securities were false. But instead of informing its investors of these deficiencies or asking the originators to repurchase the loans, Nordbank alleges that Goldman Sachs instead negotiated discounts of the purchase price and waived these loans into the pool.

---

[6] Goldman Sachs's argument that this exact due diligence report cannot support an inference that it acted with fraudulent intent has already been explicitly rejected by one court. *See Fed Hous Fin Agency v JPMorgan Chase & Co*, 902 F Supp 2d 476, 492 n15 (SDNY 2012). Although Goldman Sachs may not have had access to the report itself when they marketed the Certificates, the report did serve as evidence of information that was communicated to Goldman Sachs "on a rolling basis between the first quarter of 2006 and the second quarter of 2007." *Id.* Similarly, Nordbank alleges that Goldman Sachs received information from its due diligence provider during this period. Accordingly, the court adopts the sound reasoning of *FHFA v JPMorgan* and finds that the due diligence report in question may in fact serve to support Nordbank's allegations of fraudulent intent with respect to the Certificates purchased during and after the first quarter of 2006.

These allegations allow a reasonable inference that Goldman Sachs acted with fraudulent intent when it represented that loan originators complied with underwriting guidelines. Goldman Sachs not only allegedly had access to information indicating a "wholesale abandonment of underwriting standards," *see Plumbers Union Local No 12 Pension Fund v Nomura Asset Acceptance Corp*, 632 F3d 762, 773 (1st Cir 2011), but it also had both the motive and a clear opportunity to realize greater profits by negotiating discounts for loans that did not meet underwriting standards. *See also Stichting*, 2012 WL 929336, at *10 (finding reasonable inference of scienter based on, *inter alia*, defendant's demand for extra compensation from originators for poor quality loans); *Phoenix Light SF Ltd v Ace Secs Corp.*, 2013 WL 1788007, at *2 (NY Sup Ct Apr 24, 2013) (denying motion to dismiss fraud claims where defendant negotiated a lower purchase price because underlying loans did not comply with stated underwriting guidelines).

Nordbank alleges that the relationship between Goldman Sachs and the loan originators was such that Goldman knew or should have known that the representations in the Offering Materials regarding the quality of the pooled mortgages were false. Courts have found that scienter can be adequately pleaded by alleging that the issuer of securities was also a loan originator with "knowledge of the true characteristics and credit quality of the mortgage loans." *Fed Hous Fin Agency ("FHFA") v JP Morgan*, 902 F Supp 2d at 492; *see also Stichting*, 2012 WL 929336, at *10.

Here, although Goldman Sachs was not technically a loan originator, Goldman's role as a warehouse lender strongly suggests it had access to information regarding the "true characteristics and credit quality of the mortgage loans." *FHFA v JP Morgan*, 902 F Supp 2d at 492. For example, Goldman Sachs served as a major warehouse lender for MILA, Inc., an

originator of residential loans that were ultimately securitized by Goldman Sachs and sold to Nordbank. Goldman Sachs's close relationship with originators like MILA, Inc. put Goldman Sachs in the unique position to observe originators' lax lending practices before the mortgages were pooled and securitized.

Goldman Sachs's role as a warehouse lender would have provided a strong incentive to quickly securitize fraudulent loans and not reveal their dismal quality. If the originators that Goldman Sachs financed had ever defaulted, Goldman Sachs would presumably be saddled with the bad loans that secured the warehouse loans. By securitizing the loans and selling the resulting securities as fast as possible, Goldman Sachs could instead unload the risk that the loans would default while they were still on its books. *See China Dev Indus Bank v Morgan Stanley & Co*, 86 AD2d 435, 436 (1st Dept 2011) ("The element of scienter can be reasonably inferred from the facts alleged including e-mails, which support a motive by Morgan, at the time of the subject transaction, to quickly dispose of troubled collateral (i.e., predominantly residential mortgage-backed securities) which it owned at the time." (citation omitted)). Accordingly, Goldman Sachs's role as a warehouse lender reasonably supports an inference of scienter.

Finally, the complaint alleges that two separate Congressional investigations concluded that at the time it was marketing two of the securities presently at issue, Goldman Sachs had knowledge that the underlying loans did not meet the underwriting guidelines included in the Offering Materials.[7] The United States Senate's Permanent Subcommittee on Investigations (the

[7] Plaintiff is entitled to rely on government investigations in support of its allegations and all reasonable inferences drawn therefrom. *See e.g. NJ Carpenters Health Fund v Residential Capital, LLC*, 2010 WL 1257528, at *6 (allegations based on FTC and West Virginia Attorney General Investigations sufficient to create a "reasonable inference" that originator completely disregarded mortgage underwriting guidelines).

"PSI Report") found that "Goldman was aware of the poor quality of at least some of Fremont's loans," and that "Goldman initiated a detailed review of its Fremont loan inventory . . . and found that on average about 50% of about 200 files" did not meet loan quality standards. Nordbank also alleges that a different government investigation report revealed that "Goldman Sachs employees routinely used terms such as 'monstrosities,' 'dogs,' 'junk' and other such disparaging descriptors when discussing their own mortgage-backed products internally."

Taken together, these allegations state with sufficient particularity that Goldman Sachs intended to deceive Nordbank by falsely indicating that the residential loans met underwriting guidelines. Based on information allegedly gleaned from its third-party due diligence provider and its role as a warehouse lender, Goldman Sachs had both knowledge of and a motive to disregard the loan originators' substantial noncompliance with underwriting guidelines. Goldman Sachs's alleged knowledge concerning the abandonment of underwriting guidelines is further supported by the fact that Goldman actually benefitted from securitizing substandard loans by negotiating a lower purchase price. Finally, the allegations regarding the results of the various government investigations serve as further support of Goldman Sachs's fraudulent intent.

At this stage, the court must reject Goldman Sachs's argument that Nordbank's scienter allegations "defy economic reason." Goldman Sachs contends that because it exposed itself to greater financial risk by purchasing the same securities, Nordbank's scienter theory is economically irrational and must be rejected as a matter of law. Not only is this is a factual dispute inappropriate for resolution at this stage, *see FHFA v Morgan Stanley*, 2012 WL 5868300, at *2 (SDNY 2012), but the court is skeptical of this line of reasoning. *See Phoenix Light*, 2013 WL 1788007, at *6 ("for a bank to contend that it did not act with scienter with

respect to touting the safety of RMBS because the bank stood to sustain a net loss if the RMBS were bad investments[] defies the reality of the situation").

3. Nordbank has Adequately Pleaded Justifiable Reliance.

Goldman Sachs next argues that the claims for fraud fail because Nordbank has not pleaded that it justifiably relied on the alleged misstatements in the Offering Materials. "New York law imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by investigating the details of the transaction." *Global Minerals & Metals Corp v Holme*, 35 AD3d 93, 100 (1st Dept 2006). But if the allegedly misrepresented facts are "peculiarly within the misrepresenting party's knowledge," reliance will be justified. *Dallas Aerospace, Inc v CIS Air Corp*, 352 F3d 775, 785 (2d Cir 2003). As the Court of Appeals explained:

> "[I]f the facts represented are not matters peculiarly within the party's knowledge, and the other party has the means available to him of knowing, by the exercise of ordinary intelligence, the truth or the real quality of the subject of the representation he must make use of those means, or he will not be heard to complain that he was induced to enter into the transaction by misrepresentations."

DDJ Mgmt, LLC v Rhone Grp LLC, 15 NY3d 147, 154 (2010).

The issue of justifiable reliance generally implicates questions of fact which are not to be resolved at this early stage in the proceedings. *See e.g. DDJ Mgmt*, 15 NY3d at 156 ("If plaintiffs can prove the allegations in the complaint, whether they were justified in relying on the warranties they received is a question to be resolved by the trier of fact."); *Knight Secs, LP v Fiduciary Trust Co*, 5 AD2d 172, 173 (1st Dept 2004) ("on a motion to dismiss for failure to state a cause of action, a plaintiff . . . need only plead that he relied on misrepresentations made by the defendant . . . since the reasonableness of his reliance [generally] implicates factual issues whose resolution would be inappropriate at this early stage."); *MBIA Ins Corp v Countrywide*,

2013 WL 1845588, at *5 (NY Sup Ct Apr 29, 2013) ("[W]hether MBIA's due diligence review was sufficient and whether MBIA's review made adequate use of the means available to it, at bottom, are disputed issues of fact.").

Goldman Sachs argues that Nordbank failed to conduct even a "minimal pre-purchase investigation." Goldman Sachs further argues that to adequately plead justifiable reliance, the complaint must allege that Nordbank evaluated the quality of the underlying loans. Finally, Goldman Sachs argues that Nordbank should have requested access to the underlying loan files, or alternatively, should have requested access to Goldman Sachs' own diligence reports.

As long as it otherwise conducted a reasonable investigation, Nordbank was under no duty to request the underlying loan files. *See CIFG v Goldman Sachs*, 106 AD2d 437, 437 (1st Dept 2013). Goldman Sachs' efforts to distinguish *CIFG* are unavailing. Although Nordbank did not commission a pre-purchase third party due diligence report as CIFG did, it did engage in other methods of investigation that may render its reliance on the alleged misstatements justifiable. Determining whether the totality of Nordbank's efforts was reasonable is a question of fact. *Id.*

Similarly, the court cannot determine as a matter of law that Nordbank failed to conduct a reasonable investigation by failing to request access to Goldman Sachs's own due diligence reports. The underwriter of securities adds value by efficiently pricing the offering after assisting the issuer in marshaling facts required for disclosure in a prospectus. It engages in a due diligence process aimed at ensuring the correctness of disclosed facts. Traditionally, the underwriter's internal notes, memoranda, and other file material are closely guarded work product, no more available for review by securities purchasers than the work papers of auditors who opined on the issuer's financial statements. The court is highly skeptical that a request here

to view these internal materials would have been fruitful. Goldman Sachs's point that failure to make this request negatively impacts justifiable reliance borders on meritless. Whether Nordbank knew before the transaction that Goldman Sachs had such information, whether Nordbank should have asked for the information, and whether Goldman Sachs would have provided the information upon request are all questions of fact inappropriate for resolution at this stage.

In arguing that reliance was not justifiable, Goldman Sachs points to a recent case in which the First Department affirmed the dismissal of a different RMBS complaint also filed by Nordbank. *See HSH Nordbank v UBS*, 95 AD2d 185, 195 (1st Dept 2012). Importantly, Nordbank's fraud claims against UBS were predicated on publicly-available information. *Id.* ("[H]ere, the true nature of the risk being assumed could have been ascertained from reviewing market data or other publicly available information"). In the present case, however, Nordbank alleges that it relied on Goldman Sachs' characterization of the underlying loans because it did not have the ability to obtain samples of these loans. Simply put, the information was not publicly-available. *See id.* at 208 n15 (citing cases where denial of a motion to dismiss was warranted because "the matter allegedly misrepresented—whether the mortgage loans backing the securities that the plaintiff insured were made in compliance with applicable standards—was a matter peculiarly within the knowledge of the defendants").[8]

---

[8] Because the Offering Materials stated, "[y]ou should rely on the information incorporated by reference or provided in this prospectus or any prospectus supplement," the cases cited by Goldman Sachs in which the plaintiff failed to obtain contractual warranties are inapposite. *See e.g. ACA Fin Guar Corp v Goldman, Sachs & Co*, 106 AD2d 494, 494 (1st Dept 2013) ("plaintiff fails to plead that it exercised due diligence by inquiring about the nonpublic information regarding the hedge fund with which it was in contact prior to issuing the financial guaranty, or that it inserted the appropriate prophylactic provision to ensure against the possibility of misrepresentation"); *DDJ Mgmt*, 15 NY3d at 154 ("Where a plaintiff has gone to the trouble to insist on a written representation that certain facts are true, it will often be justified in accepting that representation rather than making its own inquiry.")

Viewing the allegations in the light most favorable to Nordbank, the complaint adequately alleges justifiable reliance. Nordbank alleges that it conducted due diligence by evaluating the structure of each Certificate according to criteria based on appraisal values, CLTV ratios and owner occupancy rates. Based on representations made by Goldman Sachs concerning the quality of the underlying loans, Nordbank applied "rigorous investment criteria" in determining which Certificates to purchase. Nordbank further alleges that it "conducted due diligence with respect to the efficiency and cost of foreclosures by various services." Taken together, these allegations serve to defeat Goldman Sachs' motion to dismiss on the grounds that Nordbank failed to conduct an adequate pre-purchase investigation.

4. Nordbank has Adequately Pleaded Loss Causation

As the final element of its claim of fraud, Nordbank must plead "that the misrepresentations directly caused the loss about which plaintiff complains." *Laub v Faessel*, 297 AD2d 28, 31 (1st Dept 2002); *see also Citibank, NA v K-H Corp*, 968 F2d 1489, 1495 (2d Cir 1992). Goldman Sachs asserts that Nordbank cannot establish that the decline in the value of the securities was proximately caused by their alleged misrepresentations. Courts have consistently rejected this argument as premature. *See e.g. MBIA Ins Corp v Countrywide Home Loans, Inc*, 87 AD2d 287, 294 (1st Dept 2011) ("It cannot be said on this pre-answer motion to dismiss, that [plaintiffs'] losses were caused, as a matter of law, by the 2007 housing and credit crises."); *MBIA Ins Co v Morgan Stanley*, 2011 WL 2118336, at *5 (NY Sup Ct May 26, 2011) ("whether MBIA's losses were caused by Morgan Stanley's representations or the economic down[turn] is a question of fact for trial."); *Allstate v Morgan Stanley*, 2013 WL 2369953, at *12 (same). "Untangling the effect of the alleged misrepresentations from the effects of the broader financial crisis will present a complicated issue of fact . . . . better saved for a more complete

factual record." *Dexia Holdings, Inc v Countrywide Fin Corp*, 2012 WL 1798997, at *6 (CD Cal Feb 17, 2012). Where the plaintiff pleads some causation between the defendant's misstatements and the loss, and the defendant claims some other mechanism of causation such as a market downturn, causation "is a matter of proof at trial and not to be decided on a . . . motion to dismiss." *Emergent Capital Inv Mgmt, LLC v Stonepath Group, Inc*, 343 F3d 189, 197 (2d Cir 2003).

Nordbank alleges that it has suffered losses totaling more than $1.5 billion as a result of the alleged misrepresentations regarding the loans' conformity with originators' underwriting guidelines. Specifically, Nordbank alleges that it has been unable to transfer notes and mortgages that have declined in value because of the poor quality of the underlying loans. The representations at issue allegedly resulted in higher rates of default, an impaired ability to obtain forecloses, and ultimately, a lower cash flow to Certificate-holders like Nordbank. Because Nordbank has sufficiently alleged a chain of causation leading from the alleged abandonment of underwriting standards to a decline in the market value of the Certificates, the complaint cannot be dismissed for failure to allege lost causation.

III. Negligent Misrepresentation

To state a claim for negligent misrepresentation in connection with a commercial transaction, a plaintiff must plead that the defendant "possess[ed] unique or specialize expertise, or [was] in a special position of confidence and trust with the injured party." *Greenberg, Trager & Herbst, LLP v HSBC Bank USA*, 17 NY3d 565, 578 (2011). A cause of action for negligent misrepresentation can only stand in the presence of a special relationship of trust or confidence, which creates a duty for one party to impart correct information to another. *United Safety of America, Inc v Consolidated Edison Co of New York, Inc*, 213 AD2d 283, 285-86 (1st Dept

1995). An arm's length relationship is not of a confidential or fiduciary nature and thus does not support a cause of action for negligent misrepresentation. *MBIA v Countrywide*, 87 AD2d 287, 296 (1st Dept 2011); *River Glen Assocs, Ltd v Merrill Lynch Credit Corp*, 295 AD2d 274, 275 (1st Dept 2002).

Superior knowledge of the particulars of its own business practices is insufficient to sustain a cause of action for negligent misrepresentation. *MBIA v Countrywide*, 87 AD3d at 297. "The knowledge of the information in the loan files is not specialized knowledge because the details of those loan files constitute the particulars of [its own] business." *MBIA Ins Co v GMAC Mortgage LLC*, 914 NYS2d 604, 611 (Sup Ct 2010)

Goldman Sachs's exclusive access to the underlying loan files does not constitute the type of unique or specialized knowledge necessary to state such a claim. *See e.g. Allstate v Morgan Stanley*, 2013 WL 2369953, at *16; *CIFG Assur N Am, Inc v Bank of Am, NA*, No 654028/12, 2013 WL 5459468 (NY Sup Ct Sept 23, 2013); *Stichting*, 2012 WL 6929336, at *13; *MBIA Ins Corp v Residential Funding Co*, No. 603552/08, 2009 WL 5178337, at *6 (NY Sup Ct Dec 22, 2009). Because there is no other allegation that suggests that Nordbank's purchase of the Certificates was anything other than an "ordinary arm's length business transaction," the claim for negligent misrepresentation must be dismissed.

IV. Mutual Mistake

In alternative to its fraud-based claims, Nordbank alleges a claim for rescission based upon mutual mistake with respect to the subject matter of the purchase and sale transaction. Nordbank argues that if Goldman Sachs did not know that the notes and mortgages would be properly transferred, then there was no "meeting of the minds."

To bring a claim for rescission based on mutual mistake, it must be alleged that "the parties have reached an oral agreement and, unknown to either, the signed writing does not express that agreement." *Chimart Assoc v Paul*, 66 NY2d 570, 573 (1986). A claim for mutual mistake must be pleaded with particularity pursuant to CPLR 3016(b). *Simkin v Blank*, 19 NY3d 46, 52 (2012). A claim for rescission based on mutual mistake can be pleaded in the alternative to a fraud theory in an RMBS suit. *See M&T Bank Corp v Gemstone CDO VII, Ltd*, 881 NYS2d 364 (Sup Ct Erie Cnty 2009), *affd as mod.*, 68 AD2d 1747 (4th Dept 2009)

Goldman Sachs argues that the claim for mutual mistake fails because the Offering Materials themselves contemplated contractual remedies in the case loans were not properly transferred. While it is correct that there can be no claim for mutual mistake where the parties made an express provision regarding a contingency, only the Offering Materials for the FBRSI 2005-2 security expressly discusses the potential "breach . . . by the Seller in the Transfer and Servicing Agreement that materially and adversely affects the Indenture Trustee's or the Noteholders' interest." *Id.* With respect to the other securities, the disclaimers in the Offering Materials concerning "missing," "defective" and "unrelated" documents are insufficient to show that the parties' agreement contemplated improper transfer.

Goldman Sachs also argues that the alleged mistake cannot merely relate to the value of the Certificates. That is a correct statement of the law in New York. *Highmount Olympic Fund, LLC v Pipe Equity Partners, LLC*, 93 AD3d 444 (1st Dept 2012). However, Nordbank alleges that the failure to transfer the notes and mortgages resulted in their purchase of what was essentially unsecured subprime debt. *Fed Home Loan Bank of Chicago v Banc of Am Funding Corp*, No. 10CH45033, 2012 WL 4364410 (Ill Cir Ct Cook Cnty Sept 19, 2012) ("Defendants' claim that the Offering Documents never said the notes would be validly transferred insinuates

that Defendants wish the court to believe that investors bought securities knowing that the underlying assets could not be enforced"). Nordbank's clear position is that the parties were mistaken as to the subject matter of the exchange. For instance, Nordbank argues that failed transfers affected the ability to initiate foreclosure proceedings, an essential part of a mortgage-backed security.[9]

This goes to the heart of the bargain as to the nature of the property being sold. The facts here are analogous to those in *Sherwood v Walker*, 66 Mich 568 (1887), which has instructed generations of first year law students. There, the seller and purchaser of a cow believed her to be sterile in setting the sales price. Before delivery, it was determined she was fertile and worth ten times the sales price. The court ruled the transaction voidable, saying "Yet the mistake was not the mere quality of the animal, but went to the very nature of the thing. A barren cow is substantially a different creature than a breeding one. There is as much difference between them . . . as there is between an ox and a cow." *Sherwood*, 66 Mich at 577.

Two noted commentators, citing 7 Corbin § 28.35 (Perillo) and Palmer, Mistake and Unjust Enrichment, § 926 n. 4 write:

> "One explanation for the decision is that in any contract parties take certain risks, but do not take risks of the existence of facts materially affecting their bargain which both shared as a common pre-supposition. In deciding which facts are vital and basic to their bargain one must search the facts for unexpected, unbargained-for gain on the one hand and unexpected, unbargained-for loss on the other. . . . Here the buyer sought to retain a gain that was produced, not by a subsequent change in circumstances, nor by the favorable resolution of known uncertainties when the contract was made, but by the presence of facts quite

---

[9] Nordbank points to an academic study suggesting that loan originators are more reluctant to initiate foreclosure proceedings where proper loan transfer procedures were not followed because the trusts would not be able to establish ownership of the delinquent mortgage loans. *See* Opp. (citing Linda Allen, Stavros Peristiani & Yi Tang, *Bank Delays in Resolution of Delinquent Mortgages: The Problem of Limbo Loans* (June 2013)).

different from those on which the parties based their bargain." Calamari and Perillo on Contracts at 363, 364 (5th Edition 2003).

The court is not persuaded by Goldman Sachs's argument that the transfer of notes and mortgages was not the subject of the parties' exchange.

The claim that the Certificates should be rescinded based on an alternate theory of mutual mistake is sustained. *See M&T Bank*, 881 NYS2d 364, *affd as mod.*, 68 AD2d 1747. Nordbank will be entitled to prove that both parties were sufficiently mistaken about the transfer and assignment provisions to warrant rescission.

ORDERED that the motion to dismiss the third cause of action for negligent misrepresentation is granted; and it is further

ORDERED that the motion to dismiss the first, second, and fourth causes of action with respect to the statements regarding credit ratings and the transfer of the notes and mortgages is granted; and it is further

ORDERED that the motion to dismiss the first, second, and fourth causes of action with respect to the statements regarding loan-to-value ratios, owner-occupancy rates, appraisal values and underwriting guidelines is denied; and it is further

ORDERED that the motion to dismiss the fifth cause of action for rescission based upon mutual mistake is denied.

Dated: November 26, 2013

ENTER:

J.S.C.

MELVIN L. SCHWEITZER