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

PRESENT: JUSTICE SHIRLEY WERNER KORNREICH PART 54

Index Number : 600070/2010

AMBAC ASSURANCE CORPORATION

vs

DLJ MORTGAGE CAPITAL, INC.

Sequence Number : 007

DISMISS ACTION

INDEX NO. _____

MOTION DATE 10/12/10

MOTION SEQ. NO. _____

MOTION CAL. NO. _____

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

	E-Filed PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	42-45
Answering Affidavits — Exhibits	49-52
Replying Affidavits	53-54

Cross-Motion: ☐ Yes ☒ No

Upon the foregoing papers, it is ordered that this motion

MOTION IS DECIDED IN ACCORDANCE WITH ACCOMPANYING MEMORANDUM DECISION AND ORDER.

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

Dated: 4/5/11

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 54

----------X

AMBAC ASSURANCE CORPORATION and THE SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION ,

Index No. 600070/2010

Plaintiffs,

DECISION & ORDER

-against-

DLJ MORTGAGE CAPITAL, INC. and CREDIT SUISSE SECURITIES (USA), LLC,

Defendants.

----------X

SHIRLEY WERNER KORNREICH, J.:

This action arises out of insurance issued by plaintiff Ambac Assurance Corporation (Ambac) to guarantee payments for principal and interest due to the HEMT 2007-1 Trust (Trust). The Trust assets consist of residential mortgage-backed securities secured by second mortgage liens. The amended complaint seeks damages for losses suffered by Ambac, allegedly as a result of fraudulent misrepresentations and breaches of contractual representations and warranties that led it to issue the policy, as well as damages for other breaches of contract.

The complaint contains the following causes of action: fraudulent inducement (1st); breach of contract (2nd, 3rd & 5th); violation of the implied covenant of good faith and fair dealing (4th); indemnification (6th); and reimbursement of litigation costs (7th). Defendants, DLJ Mortgage Capital, Inc. (DLJ), and Credit Suisse Securities (USA), LLC (Credit Suisse), move to: 1) dismiss the amended complaint (AC) for failure to state a cause of action, except for the 3rd cause of action for breach of contractual warranties; 2) dismiss The Segregated Account of Ambac Assurance Corporation (the Account), as a party plaintiff for lack of capacity to sue; 3)

strike plaintiffs' demand for punitive and consequential damages; and 4) strike the jury demand. Mot Seq 007.

Facts

In this motion to dismiss the complaint, the following facts are gleaned from the allegations in the amended complaint, plaintiffs' affirmations and the submitted documents.

On March 9, 2007, Ambac issued a certificate guaranty insurance policy (Policy). Affirmation of Darren Teshima, dated 7/8/10 (Teshima Aff), Ex D. The Policy insured payment to the Trustee of the Trust, non-party U.S. Bank National Association (US Bank), of the principal and interest due under a $175,000,000 securitization of 2,563 adjustable-rate, primarily second-lien home equity lines of credit, which were pooled in the Trust (Loans). *Id.* Ambac agreed "unconditionally and irrevocably" to pay all unpaid amounts due to the Trustee for the benefit of certain note and certificate holders. *Id.*, p. 1.

Defendant DLJ, a Credit Suisse affiliate, had purchased the Loans from originating lenders, pooled them and sold them to the Trust. The Trust sold the certificates and notes to investors. Defendant Credit Suisse, the underwriter of the transaction, sought the Policy to guarantee payment of principal and interest on certain senior classes of the securities in the Trust, specifically the Class A-1 Notes and the Class G Certificates.

Alleged Pre-Contractual Representations

Before Ambac issued the Policy, on February 7, 2007, Credit Suisse provided it with a Loan Schedule, referred to by the parties as the "loan tape." AC, ¶28, fn 4. The transaction closed a month later on March 9, 2007. *Id.* The loan tape contained data from the originating lenders about the borrowers' ability to repay the Loans and the value of the property as collateral.

Id. Id. The loan tape listed the borrowers' credit score, their debt-to-income ratio (DTI), the combined loan-to-value ratio (CLTV, i.e. ratio between the combined first and second mortgage liens and the appraised property value at the time of origination) and occupancy type (primary or secondary residence). Also supplied to Ambac were a March 1, 2007 prospectus (Prospectus); and a March 8, 2007 prospectus supplement (ProSupp).

The Prospectus & ProSupp

The Prospectus painted a less than rosy picture of the potential value of the Trust investment and the health of the residential real estate market. It disclosed that:

> In recent months, delinquencies and losses with respect to residential mortgage loans generally have increased and may continue to increase, particularly in the subprime sector. In addition, in recent months residential property values in many states have declined or remained stable, after extended periods during which those values appreciated. A continued decline or a lack of increase in those values may result in additional increases in delinquencies and losses on residential mortgage loans generally, especially with respect to second homes and investor properties, and with respect to any residential mortgage loans where the aggregate loan amounts (including any subordinate loans) are close to or greater than the related property values.

Teshima Aff, Ex C, Prospectus, p. 8.

The Prospectus warned that: 1) investors could not be assured that real property values would continue to appreciate; 2) if property values declined, then delinquencies, foreclosures and losses could be higher than those the industry currently was experiencing; and 3) that certain Loans were originated with underwriting guidelines less stringent than those of Fannie Mae and Freddie MAC. *Id.* at 53 and 54. Specifically, the Prospectus stated that no income would be required to be "stated (or verified)" in connection with a Loan application by certain borrowers with acceptable payment histories and that some of the Loans were originated under

"alternative," "reduced documentation," "stated income/stated assets" or "no income/no asset" programs. *Id.*, p. 49. The Prospectus revealed the nature of such programs, i.e., that in a "reduced documentation" program, an originator does not verify the mortgager's stated income or assets; in a "stated income/stated assets program," an originator does not verify the stated income or assets on a mortgagor's Loan application, but a "reasonableness test" is applied; and in a "no income/no assets" (NINA) program, the mortgagor does not state his income or assets on the Loan application and the originator does not verify them. *Id.*, p. 50. The Prospectus alerted investors that the underwriting of such Loans "may be based primarily or entirely on the estimated value of the mortgaged property and the LTV ratio at origination, as well as on the payment history and credit score." *Id.*

The ProSupp stated that the Loans consisted of adjustable rate, primarily second lien home equity revolving credit lines, that 29% of the Loans had a CLTV of 95-100%, that the Loans had a maximum CLTV of 100%, and that the Loans had a weighted average CLTV of 86.10%. Teshima Aff, Ex C, ProSupp, S-7 and S-24. The ProSupp promised that in the event of a material breach of a representation or warranty by DLJ with respect to a Loan, or in the event that a required document was missing from a Loan file, DLJ would follow a repurchase protocol set forth in a Loan Purchase Agreement, which is described in greater detail below. *Id.*

The ProSupp makes certain representations regarding the underwriting guidelines applied to the Loans. The ProSupp states that, except for the Loans acquired by the originating bank Secured Funding Corporation (Secured Funding), DLJ employed standards to qualify originating banks, DLJ designated underwriting guidelines, and DLJ insured that the originators' underwriting guidelines were not materially different from its designated guidelines and were

consistently applied. *Id.*

The ProSupp also disclosed that many of the mortgagors may have had imperfect credit histories ranging from minor delinquencies to bankruptcy and relatively high ratios of monthly mortgage payments to income or monthly credit payments to income. *Id.*, S-11 and S-24. It warned that as a result: 1) the Loans "may experience rates of delinquency, foreclosure and bankruptcy that are higher, and that may be substantially higher, than those experienced by mortgage loans underwritten in accordance with higher standards;" 2) changes in the value of the mortgaged properties may have a greater effect on delinquency, foreclosure and loss rates; and 3) there could be no assurance that the mortgaged properties' value would remain at the value of the date of origination. *Id.*

Further Pre-Closing Representations

Ambac alleges that prior to the closing, Credit Suisse made representations that it had conducted due diligence on a majority of the Loans and on 100% of Loans originated by the originator Secured Funding. AC, ¶¶ 31-33. Credit Suisse supplied sample results of its due diligence on 21 loans it proposed for inclusion in the Trust. *Id.* In addition, Ambac alleges that prior to closing, it asked Credit Suisse for the underwriting guidelines that "governed" the Loans. AC ¶29. In response, Credit Suisse supplied a document entitled "Credit Suisse Underwriting Guidelines Version 2.1 (August 2006)" (CS Guidelines). Finally, Credit Suisse allegedly represented that an earlier, similar transaction, HEMT 2006-2 (Prior Securitization), was doing well, when in fact it was replete with loans to borrowers who did not have the ability to repay. AC, ¶34. Ambac allegedly relied on the limited data Credit Suisse supplied relating to the Prior Securitization, as a "predictor for the performance of the contemplated Transaction." *Id.*

The Insurance and Indemnity Agreement (I&I)

The I&I is dated March 9, 2007, the day the Policy was issued. Teshima Aff, Ex E. The Parties to the I&I are Ambac, the Trust, defendant DLJ, and three non-parties, Credit Suisse First Boston Mortgages Acceptance Corp. (CS First Boston), PNC Bank, N.A. and US Bank. *Id.* DLJ agreed in the I&I that Ambac was an express third-party beneficiary of the Company Documents and incorporated their representations, warranties and covenants into the I&I. *Id.*, §2.05(j), p. 20. "Company Documents" is defined as including the I&I and a March 9, 2007 Loan Purchase Agreement (LPA), which is described below. *Id.*, §1.01, p. 2.

DLJ represented and warranted in the I&I that:

> No information supplied by the Seller [DLJ] contained in the Company Documents [the I&I and the LPA] to which it is a party nor other material information relating to the operations of the Seller ... furnished to the Insurer [Ambac] ... by the Seller contains any statement of a material fact which was untrue or misleading in any material respect when made.

Teshima Aff, Ex E, §2.04(j), p. 15.

In addition, DLJ represented and warranted in the I&I that:

> *No information supplied by the Seller [DLJ] contained in the Company Documents to which it is a party nor other material information relating to the operations of the Seller ... as amended, supplemented or superseded*, furnished to the Insurer [Ambac] in writing or in electronic format by the Seller contains any statement of material fact which was untrue or misleading in any material respect when made.
>
> *The Company Information in the Offering Documents* [the Prospectus) and the ProSupp][1] do not contain any untrue statement of a material fact and do not omit

---

[1]"Offering Documents" is defined in the I&I to include the Prospectus and ProSupp. *Id.*, §1.01, p. 3. "Company Information" means "all information with respect to the Offering Documents other than the Insurer Information and the Underwriter Information. *Id.*, p. 2. The I&I says that "Underwriter Information" is defined in the Indemnification Agreement. *Id.*, p. 5. The "Indemnification Agreement" is defined as a March 9, 2007 agreement between Ambac and

to state a material fact necessary to make the statements made therein, in light of the circumstances under which they were made, misleading ...

The representations and warranties of the Seller [DLJ] contained in the Company Documents to which it is a party are true and correct in all material respects and the Seller hereby makes each such representation and warranty to and for the benefit of the Insurer as if the same were set forth herein.

Id., §2.04(j), (k) & (l), pp. 15-16 [emphasis supplied]. The amended complaint alleges that "Company Information" includes DLJ's operations, including its lending practices, underwriting guidelines and due diligence. AC, ¶49.

The "Company Documents" warranted by DLJ in the LPA, include warranties of the accuracy of the Loan Schedule (or loan tape), a loan level warranty. Ambac refers to the other representations and warranties in the I&I as transaction level warranties.

With respect to remedies, the I&I provides as follows:

(a) Upon the occurrence of an Event of Default, the Insurer may take whatever action at law or in equity as may appear necessary or desirable in its judgment to collect the amounts, if any, then due under this Insurance Agreement or the Indenture or to enforce performance and observance of any obligation, agreement or covenant of the ... Servicer or the Seller under the Company Documents.

(b) Unless otherwise expressly provided, no remedy herein conferred or reserved is intended to be exclusive of any other available remedy, but each remedy shall be cumulative and shall be in addition to other remedies given under this Insurance Agreement, the Indenture, the other Company Documents or existing at law or in equity.

In addition to its other remedies, DLJ agreed in the I&I to indemnify Ambac for:

any untrue statement or alleged untrue statement of material fact contained in any Offering Document or any omission or alleged omission to state therein a material fact required or stated therein or necessary to make the statements therein, in light of the circumstances under which they were made, not misleading....[excluding

---

Credit Suisse. *Id.*, p. 3. It is unclear whether the Indemnification Agreement is the I&I, part of the I&I, or some other agreement not in the record.

the Insurer Information in the Offering documents].

Id., §3.04(a)(v), pp. 32-33.

"Event of Default" is defined to include breach of any representation or warranty by DLJ under the I&I or the Company Documents, unless cured within the specified time period. The indemnification includes litigation costs and reasonable fees and expenses of attorneys, consultants and auditors. *Id.* Teshima Aff, Ex E, §5.02, p. 42. Ambac waived its right to a jury trial in respect of any claim arising, directly or indirectly, from the Company Documents (the I&I and the LPA) or the transactions contemplated thereunder. Teshima Aff, Ex E, I&I, §6.09, p. 50.

The I&I also contained provisions that DLJ would:

> ... keep or cause to be kept in reasonable detail books and records of account of its assets and business, including books and records relating to the Transaction; and
>
> furnish or cause to be furnished to the Insurer ... promptly on request, such other data as the Insurer may reasonably request....

Teshima Aff, Ex E, I&I, §2.05(c) and (c)(v)(B), pp. 16 & 18 (Document Clause). Ambac alleges that the Document Clause required DLJ to maintain copies of the originating banks' underwriting guidelines and furnish them upon Ambac's request.

The Loan Purchase Agreement (LPA)

On March 9, 2007, the same day the I&I was executed, DLJ, CS First Boston, US Bank and the Trust entered into the LPA. Teshima Aff, Ex F. Ambac is an express third-party beneficiary of the LPA. *Id.*, §9. As previously noted, the I&I incorporates the representations and warranties made by DLJ in the LPA.

The Initial Loans to be transferred by DLJ to CS First Boston were listed on a Loan Schedule (the "loan tape") annexed as Exhibit A to the LPA. *Id.*, First Whereas Clause. DLJ

made the following loan-level warranties in the LPA:

> the *Loan "complies with all terms, conditions and requirements of the related originator's underwriting standards* in effect at the time of origination;" and
>
> the information on the *Loan Schedule was complete, true and correct in all material respects* as of the related Cut-off Date.

Id., §2(b) and Ex B, p. B-1, subsections (d) and (e) [emphasis supplied].

With respect to remedies, DLJ also represented and warranted that if it discovered or received notice from Ambac or the Trust (or other parties to the LPA) of a breach of a representation or warranty as to any Loan, it would cure the breach, substitute a conforming loan or repurchase the Loan from the Trust (Repurchase Protocol). *Id.*, §2(d).

Plaintiffs allege that the Loans were not written according to the CS Guidelines that Ambac was given prior to the closing. Defendants, however, point out that DLJ represented and warranted in the LPA [Teshima Aff, Ex F, Ex B thereto, §(d)] that each loan complied with ***the originators underwriting guidelines***, and they argue that Ambac could not reasonably rely on CS Guidelines it received from Credit Suisse in February 2007. Defendants Moving Memorandum of Law, p. 7, fn. 7.

But, the "Company Information" in the "Offering Documents" (Prospectus and ProSupp) was warranted in the I&I. It included information about the DLJ's underwriting standards and their relationship to the originating banks' underwriting standards. The ProSupp states that DLJ acquired 48.88% of the Loans, 29.30% of the Loans were originated by Secured Funding, and that no other originator originated or acquired more than 10% of the Loans. Teshima Aff, Ex C, ProSupp, p. S-34. The ProSupp says that with respect to the 48.88% of the Loans acquired by DLJ, the Loans were acquired from originating banks that DLJ had determined met its "qualified

correspondent requirements." *Id.* The ProSupp represented that the standards for mortgage loans purchased in accordance with qualified correspondent loan requirements included that the mortgage loans were "originated in accordance with underwriting guidelines designated by the sponsor [DLJ] ('Designated Guidelines') or guidelines that do not materially vary from such Designated Guidelines;" that the Designated Guidelines were designated by DLJ on a consistent basis for use by originators in originating mortgage loans for DLJ; that DLJ employed certain quality assurance procedures designed to ensure that the qualified correspondents properly applied the underwriting criteria designated by DLJ; and that the Designated Guidelines were substantially similar to the guidelines described in the Prospectus under "Trust Funds -- Underwriting Standards." *Id.* The ProSupp does not make the same representations with respect to Loans originated by Secured Funding. "Trust Funds -- Underwriting Standards" in the Prospectus contains the information that no income would be required to be stated or verified in connection with a Loan application by certain borrowers with acceptable payment histories and that some of the Loans were originated under "alternative," "reduced documentation," "stated income/stated assets" or "no income/no asset" programs. Prospectus, Teshima Aff, Ex C, pp. 49-50 & 53.

Ambac's Requests for Underwriting Guidelines

As previously noted, Ambac alleges that it asked Credit Suisse for the relevant guidelines and received the CS Guidelines on February 14, 2007, prior to the closing. AC, ¶29; *see also*, Affirmation of Peter Tomlison, dated July 29, 2010 (Tomlison Aff), Ex 1. The CS Guidelines state that "alternative," "reduced documentation," "stated income/stated assets" or "no income/no asset" programs are acceptable. Tomlison Aff, Ex 1, pp. 23-29. The CS Guidelines also state

that for a "no income verification" or a "stated income/stated assets" loan the "[i]ncome must be reasonable for the position." *Id.*, pp. 27-28. For loan origination programs called "no ratio" (where DTI ratio is not calculated), "no income/no asset," or "no documentation" (where borrower's income, assets, and employment are not disclosed and DTI is not calculated), the CS Guidelines state that "[t]he transaction must be prudent for the borrower." *Id.*, pp. 28-29.

On December 11, 2007, Ambac asked Credit Suisse to confirm that Ambac had the correct guidelines, and Credit Suisse resent the CS Guidelines. AC, ¶62. Credit Suisse knew that Ambac had requested the guidelines because it intended to re-underwrite the defaulted Loans to determine whether they conformed to DLJ's representations and warranties. *Id.* On April 25, 2008, Ambac asked DLJ for the applicable underwriting guidelines. *Id.*, ¶63. In its June 17, 2008 response, DLJ provided the CS Guidelines, knowing the Ambac wanted to invoke DLJ's purchase obligations pursuant to the Repurchase Protocol. *Id.* Ambac alleges that it reasonably believed that the CS Guidelines were the minimum underwriting standard used by all of the loan originators who supplied the Loans to the Trust, including Secured Funding.

However, when Ambac tried to have particular Loans replaced or repurchased pursuant to the Repurchase Protocol, Credit Suisse denied that the CS Guidelines were the applicable originating guidelines for almost 60% of the Loans at issue. AC, ¶¶74-79. Credit Suisse stated that "the passage of time and the extraordinary market dislocation" made it difficult to locate the applicable underwriting guidelines. *Id.* Subsequently, Credit Suisse made disclosures of additional guidelines. AC, ¶ 77. Credit Suisse produced two matrices (tables) instead of

underwriting guidelines for the Loans originated by Secured Funding. AC, ¶ 78.[2]

Alleged Damages

The AC alleges that by December 2007, there was an inordinately high default rate on the Loans and that by April 2010 Ambac had paid $46 million in claims due to defaults in over 33% of the Loans. AC, ¶¶ 62 and 71. Ambac alleges that it then sampled 774 of the Loans that had certain characteristics and 390 randomly selected Loans and alleges that 80% of them breached the defendants' representations and warranties. AC, ¶66.

By letters dated October 24, November 10 and November 18, 2008, Ambac gave DLJ formal notice of breaches and demanded compliance with the Repurchase Protocol. AC, ¶75. Ambac alleges it was further damaged because Credit Suisse failed to maintain the underwriting documentation necessary for Ambac to exercise its rights pursuant to the Repurchase Protocol. *Id.* Ambac seeks lost opportunity costs for the $46,000,0000 in claims it has paid and the reserves it had to maintain for anticipated claims. *Id.*, ¶83.

Discussion

In deciding a motion to dismiss pursuant to CPLR 3211(a)(7), the court must afford the pleadings a liberal construction, accept the allegations of the complaint as true and give the plaintiff the benefit of every favorable inference. *EBCI, Inc. v Goldman Sachs & Co.*, 5 NY3d 11 (2005). However, "allegations consisting of bare legal conclusions as well as factual claims either inherently or flatly contradicted by the documentary evidence are not entitled to such consideration." *Stuart Lipsky, P.C. v Price*, 215 AD2d 102 (1st Dept 1995).

---

[2]During the course of disclosure proceedings, defendants' attorneys told the court that in 2010, they were not sure they could identify the applicable underwriting guidelines used by originating banks in connection with all of the Loans in the Trust.

Fraudulent Inducement (First Cause of Action)

The elements of a claim for fraudulent inducement are: 1) a false representation of material fact, 2) known by the utterer to be untrue, 3) made with the intention of inducing reliance and forbearance from further inquiry, 4) that is justifiably relied upon, and 5) resulting damages. *Schumaker v Mather*, 133 NY 590, 595 (1892). Here, Ambac claims that defendants falsely represented, prior to contracting, that the Loans complied with the CS Guidelines and had been subject to Credit Suisse's own due diligence and that Ambac justifiably relied upon these representations to its detriment.

Defendants, on the other hand, argue that Ambac, a sophisticated business entity, has not stated a fraudulent inducement claim because, as a matter of law, Ambac could not have justifiably relied on defendants' representations. They argue that: 1) Ambac admittedly performed no due diligence; 2) Ambac was provided with the same detailed information about the Loans that defendants had; and 3) defendants had no unique knowledge that Ambac did not have. They also argue that the fraud claim is duplicative of the breach of contract claim in the second cause of action for breach of the warranties in the I&I and LPA.

The amended complaint does admit that Ambac did not do its own due diligence. AC, ¶32. Plaintiffs allege that instead of doing due diligence, Ambac relied on representations made by Credit Suisse prior to closing and express representations and warranties made by DLJ in the I&I and LPA. *Id.*, ¶26.

Defendants have not demonstrated that Ambac had all of the same information about the Loans that defendants had. While Ambac had the loan tape, it bargained for representations and warranties that the Loans conformed to the originators' underwriting guidelines and that some of

the originators used underwriting guidelines designated by Credit Suisse, or that the originators' guidelines did not vary materially from the CS Guidelines. It now appears that Ambac did not have, and may never have get, the originators' underwriting guidelines to which the defendants represented and warranted the Loans conformed. However, Ambac did have all of the information that defendants had with respect to their allegation that they were fraudulently induced by defendants' precontractual representations that the CS Guidelines were the minimum guidelines applicable to the Loans originated by Secured Funding. AC, ¶39. Although, there is no statement in the ProSupp that the Loans originated by Secured Funding conformed to CS Guidelines, Ambac admits that it had the CS Guidelines and the loan tape prior to closing. AC, ¶¶ 28, fn 4 & 29, fn 6. Therefore, it had all of the information defendants had with respect to whether the Secured Funding Loans conformed to the CS Guidelines.

Applying the law to the facts of this case, with respect to justifiable reliance, defendants' argument that, as a matter of law, Ambac was not justified in relying on defendants' contractual warranties, instead of doing its own due diligence, is foreclosed by the Court of Appeals decision in *DDJ Mgmt, LLC v Rhone Group, LLC*, 15 NY3d 147, 154 -156 (2010). *DDJ* holds that it is a question of fact whether a sophisticated party reasonably relies on facts contained in a bargained for contractual representation.

Nonetheless, to the extent that Ambac alleges that it was fraudulently induced to contract by representations contained in contractual warranties, the court agrees with defendants that the claim is duplicative of the breach of contract claim and must be dismissed. To sustain a claim for fraudulently inducing a party to contract, the plaintiff must allege a representation that is collateral to the contract, not simply a breach of a contractual warranty, and damages not

recoverable in an action for breach of contract. *RGH Liquidating Trust v Deloitte & Touche LLP*, 47 AD3d 516 (1st Dept 2008), *app den* 11 NY3d 804 (2008)(fraudulent inducement duplicative because it alleged no misrepresentations collateral or extraneous to agreements); *Hawthorne Group, LLC v RRE Ventures*, 7 AD3d 320, 323 (1st Dept 2004) (alleged misrepresentation should be one of then-present fact, extraneous to contract and involve duty separate from or in addition to that imposed by contract); *Varo v Alvis PLC*, 261 AD2d 262 (1st Dept 1999)(duplicative because misrepresentations not collateral to contract); *JE Morgan Knitting Mills, Inc. v Reeves Bros., Inc.*, 243 AD2d 422 (1st Dept 1997)(fraudulent inducement duplicative because based on same facts as contract claim, not collateral to contract and all damages recoverable for breach of contract); *Krantz v Chateau Stores of Can., Ltd.*, 256 AD2d 186 (1st Dept 1998)(fraud claim dismissed as duplicative of breach of contract claim); *cf, GoSmile, Inc. v Levine*, 2010 NY Slip Op 9408; 915 NYS2d 521; 2010 NY App. Div LEXIS 9485 (1st Dept 2010)(nor)(fraud claim sustained because "many 'additional' facts" in addition to warranty misrepresented); *RAG Am. Coal Co. v Cyprus Amax Minerals Co.*, 299 AD2d 259 (1st Dept 2002)(fraud claim sustained because it relied on representations not contained in contractual warranty).

DDJ is not controlling on the issue of duplication because, as the lower court opinion makes clear, there was no breach of contract claim in *DDJ*. 19 Misc3d 1124A (Sup Ct NY Co 2008). In addition, *First Bank of Americas v Motor Car Funding, Inc.*, 257 AD2d 287, 292 (1st Dept 1999), which is cited by plaintiffs, also is distinguishable from this case because the alleged misrepresentations there differed from the contractual warranty. The agreement in *First Bank* gave the plaintiff a right to purchase certain loans over a period of time in the future. In the

contract, the defendant warranted that the loans would conform to certain underwriting guidelines. The alleged false representations concerned collateral for the loans that were made by the defendants after the contract was signed, as the defendants sold the loans to the plaintiff.

Here, to the extent that plaintiffs claim that they were fraudulently induced because the Loans did not conform to the originators' underwriting guidelines or that the Loans purchased from originating banks, other than Secured Funding, did not conform to CS Guidelines, their claims are duplicative of their second cause of action for breach of contractual representations and warranties in the I&I and LPA. The I&I contained representations as to the accuracy of the information about DLJ's operations in the ProSupp, which includes that, except for Secured Funding, the qualified originating banks' guidelines had to conform to the CS Guidelines. Thus, Ambac's claim that it was defrauded because the CS Guidelines were not the minimum guidelines applicable to the Loans not originated by Secured Funding is indistinguishable from the I&I representation allegedly breached. Similarly, the LPA represented that the Loans would conform to the originators' underwriting guidelines. To the extent that Ambac claims it was fraudulently induced because the Loans did not conform to the originators' guidelines, the claim duplicates its breach of contract claim.

The damages sought by Ambac are recoverable in a breach of contract action, particularly as the court is sustaining plaintiffs' claim for breach of the covenant of good faith and fair dealing, for which punitive damages may be available, and its claims for indemnification and reimbursement of litigation costs. *See discussion below*. Additionally, an unelaborated request for punitive damages is not enough to make the damages recoverable for fraud different from contract damages. *Krantz v Chateau Stores of Can., Ltd.*, 256 AD2d 186 (1st Dept 1998). Here,

plaintiffs' damages not recoverable under the contracts are unspecified "equitable damages," a bare-bones, conclusory request insufficient to undermine the holding that the fraud claim is duplicative of the breach of contract claim. *Id.*

Turning to the allegedly fraudulent representation that the Loans originated by Secured Funding did not conform to the CS Guidelines, which is not contained in a bargained-for contractual warranty, the court holds it is not actionable because the facts were not peculiarly in defendants' knowledge and Ambac had the means of discovering them through ordinary diligence. *DDJ, supra*, 15 NY3d at 153-154, citing *Schumaker v Mather*, 133 NY 590, 596 (1892)("'if 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.'"); *Lampert v Mahoney, Cohen & Co.*, 218 AD2d 580, 582 (1st Dept 1995); and *Rodas v Manitaras*, 159 AD2d 341 (1st Dept 1990)(fraud dismissed despite refusal of plaintiff's request for inspection of financial records).

Thus,

> where ... a party has been put on notice of the existence of material facts which have not been documented and he nevertheless proceeds with a transaction without securing the available documentation or inserting appropriate language in the agreement for his protection, he may truly be said to have willingly assumed the business risk that the facts may not be as represented.

Id.; *see also*, *Global Mins. & Metals Corp. v Holme,* 35 AD3d 93 (1st Dept 2006), *app den*, 8 NY3d 804 (2007)(New York law imposes affirmative duty on sophisticated investors to protect themselves from misrepresentations made during business acquisitions by obtaining prophylactic

contractual warranty or investigating details of transaction); *Rigney v McCabe*, 43 AD3d 896 (2d Dept 2007)(representation of fact known to plaintiff not actionable as fraud). Moreover, where a sophisticated party has hints of falsity, its duty of inquiry is heightened and if it fails to investigate or insert protective language in the contract, it willingly assumes the risk that the facts are not as represented. *Global Mins. & Metals Corp.*, *supra* at 100.

This case is stronger than *Rodas* because the amended complaint admits that Ambac had all of the same information that defendants had with respect to Secured Funding, i.e., the CS Guidelines and the loan tape with the Secured Funding Loan data, whereas in *Rodas*, the plaintiff's request for records was refused. Here, defendants made no contractual representation that the Secured Funding Loans conformed to the CS Guidelines. Ambac could have compared the CS Guidelines to Secured Funding data contained in the loan tape or obtained a contractual representation that the Secured Funding Loans complied with the CS Guidelines. Its reasons for not doing so are that it was pressed for time and it was market practice to rely on the sponsor's due diligence. AC, ¶32. Even if that were so, Ambac, a sophisticated insurer, still could have bargained for a contractual representation, as it did with the Loans originated by banks other than Secured Funding. Instead, it accepted the LPA's contractual representation that the Secured Funding Loans complied with the originator's guidelines, i.e. the Secured Funding guidelines. Thus, it assumed the risk that the Secured Funding guidelines were less stringent than the CS Guidelines. *Rodas*, *supra; cf*, *DDJ*, 15 NY3d, *supra* at 154-155.

In addition, the amended complaint admits that Ambac was alert to possible problems with Secured Funding as an originator, which heightened its obligation of diligent inquiry. *Global Mins. & Metals Corp*, *supra.* The amended complaint alleges that Ambac would not

approve Secured Funding as a lender unless the CS Guidelines applied to it. AC, ¶ 29.

Finally, the amended complaint demonstrates that Ambac had the ability to review the Loans for compliance with the CS Guidelines from the data it had. The amended complaint alleges that after Ambac suffered losses, it hired a consultant to review the Loans for compliance with the CS Guidelines. AC, ¶¶ 10, 66. The fact that Ambac did due diligence after the alleged breach that it did not do before the closing shows that Ambac had the ability to discover the facts. Having failed to protect itself by available means, Ambac cannot now claim it was fraudulently induced.

The remaining allegedly fraudulent, precontractual representations are not actionable. The representation that Credit Suisse did due diligence on most of the Loans and 100% of the Secured Funding Loans is not actionable because, even if the court were to infer that the statement encompassed a material representation that the result of the due diligence was that Secured Funding's Loans met the CS Guidelines, Ambac still had the means to protect itself by investigation or contractual language. The allegation that the Prior Securitization was performing well, which Ambac allegedly relied upon as a prediction of the Trust's performance, is not fraud. Puffery, opinions of value or future expectations do not support a cause of action for fraud. *Sidamonidze v Kay*, 304 AD2d 415 (1st Dept 2003); *Longo v Butler Equities II, L.P.*, 278 AD2d 97 (1st Dept 2000).

In sum, plaintiffs' first cause of action for fraud is dismissed. The alleged fraud in the inducement either duplicates the cause of action for breach of contractual representations and warranties in the second cause of action or cannot be maintained because Ambac, a sophisticated business entity, failed to investigate facts contained in documents admittedly in its possession or

obtain a contractual representation or warranty that the Loans originated by Secured Funding complied with the CS Guidelines. Instead, Ambac settled for a representation that the Secured Funding Loans met the Secured Funding guidelines. The precontractual representations are not actionable for the same reason or because they amounted to opinions of value or future expectations.

Breach of the Covenant of Good Faith & Fair Dealing (Fourth Cause of Action)

Defendants argue that the fourth cause of action for breach of the covenant of good faith and fair dealing must be dismissed because it duplicates the breach of contract claims. Every contract implies a promise that neither party will do anything that has the effect of destroying or injuring the right of the other party to receive the fruits of the contract. *Dalton v Educational Testing Service*, 87 NY2d 384, 389 (1995). Causes of action for breach of contract and breach of the covenant of good faith and fair dealing may stand together where the defendant engages in conduct that injures or frustrates the other party's right to receive the fruits of the contractual bargain. *Frydman v Credit Suisse First Boston Corp.*, 272 AD2d 236 (1st Dept 2000). Here, plaintiffs have stated a separate claim for breach of the implied covenant of good faith and fair dealing based upon allegations that defendants frustrated use of the Repurchase Protocol by first providing the CS Guidelines, then disavowing their applicability and still later stating that the originators' guidelines may not be able to be found. Further, the I&I Document Clause arguably required DLJ to maintain copies of the underwriting guidelines applicable to the Loans and furnish them upon Ambac's request.

Breach of Contract, Indemnification & Reimbursement of Litigation Costs (Second, & Fourth through Seventh Causes of Action)

The motion to dismiss the contract claims for lack of specificity, i.e., the failure to identify thousands of loan-level breaches, is denied. Under CPLR 3013, a party bringing an action for breach of contract need only provide notice of the transactions or occurrences underlying the claim. Particularity in a contract action, is not required. *Shilkoff, Inc. v 885 Third Ave. Corp.*, 299 AD2d 253, 254 (1st Dept 2002). Plaintiffs have alleged the existence of valid agreements (the I&I and the LPA); that defendants breached particular provisions of those agreements; that Ambac has conducted a review that has revealed breaches in many of the Loans reviewed; and that Ambac has been harmed by, *inter alia*, payment of more than $46 million in claims.

The pleadings give sufficient notice of the claim at this juncture. In the second cause of action, plaintiffs allege breach of the I&I due to breaches of representations and warranties in the I&I and the LPA. In the fifth cause of action, plaintiffs allege breaches of the I&I through frustration of the Repurchase Protocol and representations and warranties. Plaintiffs allege that the pervasive and systemic nature of the breaches collectively give rise to the claims for material breach of the I&I as a whole, not just the representations and warranties.

Defendants seek dismissal of the indemnification and reimbursement claims because they depend on the viability of the claim for breach of the I&I. Defendants' Moving Memo, p. 22. As the court has sustained the breach of contract claims, the indemnification and reimbursement claims stand. In addition, the I&I specifically provides indemnification as a remedy for breach of warranty, as well as reimbursement of costs and fees of attorneys and other professionals in the

event of misrepresentations in the Prospectus and ProSupp. I&I, Teshima Aff, Ex E, §§ 3.04(a)(v), pp. 32-33 & 5.02, p. 42.

Consequential & Punitive Damages

The consequential damages claimed by Ambac are lost opportunities due to payment of claims and maintenance of reserves. Damages for lost profits are denied if the contract itself does not provide for their recovery "*and no factual issue is otherwise raised*" as to whether the parties intended that they would be able to recover damages due to lost profits. *Brody Truck Rental, Inc. v Country Wide Ins. Co.*, 277 AD2d 125, 125-126 (1st Dept 2000)[emphasis supplied]; *see Hold Bros. v Hartford Ins. Co.*, 357 FSupp2d 651, 657 (SDNY 2005) (interpreting *Brody* to hold that express provision permitting damages for lost profits is not prerequisite for obtaining such damages). Damages in an action for breach of contract are intended to restore the injured party to the position he would have been in had the contract been fully performed. *Brushton-Moira Cent. School Dist. v Fred H. Thomas Associates*, P.C., 91 NY2d 256, 262 (1998). Lost profits are recoverable under this general rule, but only if: 1) it is certain that the loss was caused by the breach; 2) the amount of loss is established with reasonable certainty; and 3) the particular damages were fairly within the contemplation of the parties at the time of entering the agreement. *Kenford Co., Inc. v Erie County*, 67 NY2d 257, 262 (1986). In determining the contemplation of the parties at the time of entering the agreement, the nature, purpose, and circumstances of the contract known by the parties should be considered. *Bi-Economy Market, Inc. v Harleysville Ins. Co. of N.Y.*, 10 NY3d 187, 193 (2008).

The claim for consequential damages here is stricken. The I&I says that Ambac may invoke any remedy available at law or equity "to collect the amounts, if any, then due under this

Insurance Agreement or the Indenture or to enforce performance and observance of any obligation, agreement or covenant of the ... Seller [DLJ] under the Company Documents." Teshima Aff, Ex E, I&I, §5.02(a), p. 42. The I&I, therefore, evidences the parties' intention that money damages are limited to amounts due under that agreement and amounts necessary to enforce the rights under the I&I and LPA. There are no facts alleged tending to show that the parties contemplated that Ambac could recover lost opportunities for profit or damages caused by increased reserves necessary to pay resulting claims. Further, the LPA clearly limits damages to the Repurchase Protocol for breaches of representations and warranties. Teshima Aff, Ex F, LPA, §2(d).

The motion to strike the demand for punitive damages is premature due to the court's ruling that plaintiffs have stated a claim for breach of the covenant of good faith and fair dealing.

The Account's Capacity to Sue

Governmental entities created by legislative enactment are artificial creatures of statute with neither an inherent nor a common-law right to sue. *Cmty. Bd. 7 v Schaffer*, 84 NY2d 148, 155-156 (1994). Their right to sue must be derived from the relevant enabling legislation or some other concrete statutory predicate. *Id.* Express legislative authority need not be explicit, but may be implied. *Id.*

Under Wisconsin law, a court order may be entered appointing the Commissioner of Insurance to rehabilitate the business of an insurer, to take possession of its assets and to administer them under orders of the court. Wisc. Stat.§ 645.32. The general powers of rehabilitators are as follows:

Subject to court approval, the rehabilitator may take the action he or she deems

> necessary or expedient to reform and revitalize the insurer and the rehabilitator has all the powers of the officers and managers, whose authority shall be suspended, except as they are redelegated by the rehabilitator. The rehabilitator shall have full power to direct and manage, to hire and discharge employees subject to any contract rights they may have, and to deal with the property and business of the insurer.

Wis. Stat. § 645.33(2).

Ambac claims that the rehabilitator has explicit statutory authority to litigate claims on behalf of the insurer. However, the statute it relies on relates to claims against insiders. It provides:

> PURSUIT OF INSURER'S CLAIMS AGAINST INSIDERS.
> If the rehabilitator finds that there has been criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer by any person, the rehabilitator may pursue all appropriate legal remedies on behalf of the insurer.

Wisc. Stat. § 645.33(4). This action is not a claim against insiders.

The Account could only have implied capacity because there is no express statutory authority and plaintiffs present no Wisconsin court order conferring authority on the rehabilitator to maintain this action or pursue litigation in general. Plaintiffs raise the following arguments to support the Account's implied capacity: 1) the Account is a separate insurer under Wisconsin Statutes § 611.24(e);[3] 2) the Wisconsin court issued a separate certificate of authority to the Account to operate as an insurer on March 24, 2010; and 3) the capacity to maintain the action can be implied from the Account's statutory powers. Defendants urge that either Ambac assigned its right to the Account and can no longer maintain this action, or Ambac retained its

---

[3] "Each segregated account shall be deemed an insurer within the meaning of s. 645.03 (1) (f)." Wis. Stat. § 611.24(e).

right to bring these claims and the Account has no capacity to maintain them.

As the Account has "full power" to deal with the property and business of the insurer, a right to sue on claims of the insurer can be implied. Wis. Stat. § 645.33(2). Additionally, the creation of the Account under Wisconsin law is not the functional equivalent of an assignment. Wisconsin law provides that the Account is a separate insurer with its own operating certificate, which exists simultaneously with Ambac, and that claims allocated to the Account remain Ambac's property. Wis. Stat. § 611.24(3)(e). It is undisputed that the claims against defendants are allocated to the Account. Consequently, Ambac has an interest in them. The court also notes that defendants have not explained what prejudice will result from including the Account as a party, as the CPLR allows the court to add or drop parties at any time in the interest of justice, should that become necessary. CPLR 1003.

Ambac's Demand for a Jury Trial

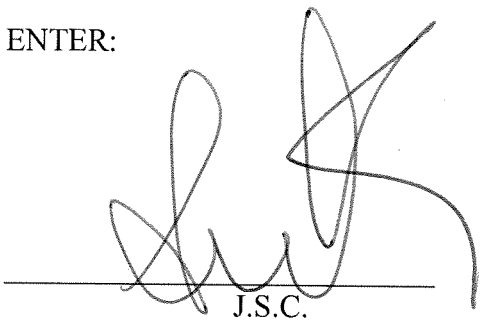
The motion to strike the demand for a jury trial is granted. Defendants argue that plaintiffs are bound to the jury waiver in the I&I. Parties may expressly waive their right to a jury trial on any claim by written agreement. *Tiffany at Westbury Condominium by Its Bd. of Mgrs. v Marelli Dev Corp.*, 34 AD3d 791 (2d Dept 2006). Plaintiffs argue that the jury waiver does not apply to a fraud claim that would deny enforcement of the agreement containing the waiver. As the fraud claim has been dismissed, plaintiffs' argument that the jury waiver in the I&I cannot be enforced falls. Accordingly, it is

ORDERED that the motion by defendants DLJ MORTGAGE CAPITAL, INC. and CREDIT SUISSE SECURITIES (USA), LLC, to dismiss the 1st, 2nd, 4th, 5th, 6th and 7th causes of action in the amended complaint of AMBAC ASSURANCE CORPORATION and the

SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION; to strike the demands for consequential and punitive damages; to strike the jury demand; and to dismiss the SEGREGATED ACCOUNT OF AMBAC ASSURANCE CORPORATION as a party plaintiff; is granted solely to the extent of dismissing the first cause of action for fraudulent inducement, striking plaintiffs' claim for consequential damages, and striking the jury demand, and, otherwise, is denied.

Dated: April 7, 2011

ENTER:



J.S.C.