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| **IKB Intl. S.A. in Liquidation v Stanley** |
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| 2014 NY Slip Op 51548(U) |
| Decided on October 28, 2014 |
| Supreme Court, New York County |
| Friedman, J. |
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Decided on October 28, 2014

Supreme Court, New York County

**IKB International S.A. in Liquidation and IKB DEUTSCHE INDUSTRIEBANK AG, Plaintiffs,**

**against**

**Morgan Stanley, et al., Defendants.**

653964/2012

Counsel for Plaintiff: Mark S. Arisohn, Labaton Sucharow, 140 Broadway, New York, NY 10005. Counsel for Defendants: James P. Rouhandeh, Davis Polk & Wardwell LLP, 450 Lexington Avenue, New York, NY 10017

Marcy S. Friedman, J.

This fraud action arises out of the purchase by plaintiff IKB International S.A. in

Liquidation (IKB SA) of residential mortgage backed securities (RMBS), which were securitized and sold by the Morgan Stanley defendants (Morgan Stanley). Defendants move to dismiss the complaint, pursuant to CPLR 3211, on the grounds that it is barred by the statute of limitations and fails to state a cause of action, and that plaintiffs lack standing.

*Standing*

The allegations of the complaint regarding the assignment of plaintiffs' fraud claims are as follows: IKB SA purchased the 25 certificates at issue between June 2005 and April 2007, 22 directly from Morgan Stanley at the time of each securitization, and the remaining three certificates on the secondary market. (Compl., & & 38, Table 1.) On November 20, 2008, IKB SA sold 23 of the certificates to plaintiff IKB Deutsche Industriebank, AG (IKB AG), its parent company, and "realized the losses at issue in this litigation." (*Id.*, & 38.) [FN1] On December 4, 2008, both IKB AG and IKB SA "expressly assigned all claims arising from the purchase of the Certificates, including claims against the issuers, underwriters and sellers of the [*2]Certificates," to Rio Debt Holdings (Ireland) Limited (Rio), concurrently with IKB AG's sale of these certificates to Rio. (*Id.*) Rio re-assigned all such claims to IKB AG, without transferring the related certificates, on May 9, 2012. (*Id.*)

In moving to dismiss for lack of standing, defendants allege not that the complaint fails to plead an assignment of fraud claims from Rio to IKB AG but, rather, that the assignment is void as champertous. Morgan Stanley contends that the "intent and purpose" of the assignment of the claims, without the certificates themselves, was to bring suit, and that this purpose may be inferred from the timing of the assignment, which took place on May 9, 2012, after Morgan Stanley, IKB AG, IKB SA, and Rio entered into a tolling agreement on November 16, 2011, and seven days before the tolling agreement expired on May 16, 2012. (Defendants' Memo. in Support at 12, Rouhandeh Aff. Ex 30, 31.)

Section 489 (1) of the Judiciary Law provides that no corporation shall "take an assignment of . . . any claim . . . with the intent and for the purpose of bringing an action or proceeding thereon . . . ." This statute is a codification of the champerty doctrine which "developed to prevent or curtail the commercialization of or trading in litigation." (*Trust for*

*the Certificate Holders of the Merrill Lynch Mtge. Invs., Inc. Mtge. Pass-Through Certificates, Series 1999-C1 v Love Funding Corp.*, 13 NY3d 190, 198-199 [2009] [*Love Funding*].) As the Court of Appeals explained, "the prohibition of champerty has always been limited in scope and largely directed toward preventing attorneys from filing suit merely as a vehicle for obtaining costs" (*id.* at 199), although the prohibition has been extended to claims against non-attorneys. (*Id.*) Moreover, it "does not apply when the purpose of the assignment is the collection of a legitimate claim" but, rather, bars "the purchase of claims with the intent and for the purpose of bringing an action . . . where such claims would not be prosecuted if not stirred up . . . ." (*Id.* at 201 [internal citations and quotation marks omitted].)

As the Court of Appeals also explained, in order for an assignment of rights to a claim to be champertous, the purchaser's or assignee's "intent to sue on that claim must at least have been the primary purpose for, if not the sole motivation behind, entering into the transaction." (*Bluebird Partners, L.P. v First Fidelity Bank, N.A.*, 94 NY2d 726, 736 [2000].) The Court emphasized that "the question of intent and purpose of the purchaser or assignee of a claim is usually a factual one to be decided by the trier of facts." (*Id.* at 738 [internal citations and quotation marks omitted].) Thus, consistent with the limited scope of the champerty doctrine, the Court has been hesitant to find that an action is champertous as a matter of law. (*Id.* at 735 [reversing grant of motion to dismiss based on holding that developed record was needed to determine primary purpose of acquisition of certificates, where there was some evidence that purchaser acquired certificates in order to gain leverage in settlement of action involving other tranches of related certificates]; *see also Love Funding*, 13 NY3d at 195 [holding, in answer to a certified question from the US Court of Appeals, Second Circuit, that an assignment of a claim is not champertous "if its purpose is to collect damages, by means of a lawsuit, for losses on a debt instrument in which it holds a preexisting proprietary interest"]; *Fairchild Hiller Corp. v McDonnell Douglas Corp.*, 28 NY2d 325, 330 [1971] [holding, on summary judgment motion, that assignment was non-champertous where claim was acquired as "an incidental part of a substantial commercial transaction" and not for the "sole and primary purpose of bringing an action on the assignment"].)

Here, the acquisition of the claims shortly before the expiration of the tolling

agreement does not, without more, demonstrate that the claims were acquired for the primary purpose of [*3]commencing litigation. The acquisition of the claims without the certificates presents a more difficult question. Morgan Stanley has not, however, shown on this record that IKB AG's primary or sole purpose was not to enforce a legitimate claim, or that the claim was not acquired as part of a larger transaction or for leverage in other disputes between the parties. (*See generally SB Schwartz & Co., Inc. v Levine*, 82 AD3d 742 [2d Dept 2011].)[FN2] Given that the "question of intent and purpose of the purchaser or assignee of a claim is a factual one," (*Bluebird Partners*, 94 NY2d at 738), the record must be factually developed as to IKB AG's intent. This intent cannot be determined without evidence as to specific terms of the assignment, which has not been provided on the record, and the business dealings between the parties, including other RMBS purchases. Morgan Stanley must also address the relationship between IKB AG and Rio. Accordingly, Morgan Stanley's motion to dismiss for lack of standing will be denied with respect to the fraud claims brought by IKB AG as the assignee of Rio, which relate to 23 of the 25 certificates at issue.

*Statute of Limitations*

Under CPLR 202, New York's borrowing statute, where a non-resident sues on a cause of action accruing outside New York, "the cause of action [must] be timely under the limitation periods of both New York and the jurisdiction where the cause of action accrued." (*Global Fin. Corp. v Triarc Corp.*, 93 NY2d 525, 528 [1999].) The parties disagree as to whether the cause of action accrued in Germany, and is therefore subject to Germany's three year statute of limitations, or whether it accrued in Luxembourg, which has a thirty year statute of limitations. In cases involving purely economic loss, "the place of injury usually is where the plaintiff resides and sustains the economic impact of the loss," which would typically be a corporation's place of incorporation or principal place of business. (*Global Fin. Corp.*, 93 NY2d at 529; *Portfolio Recovery Assocs., LLC v King*, 14 NY3d 410, 416 [2010], *rearg denied* 15 NY3d 833.) Although there is authority that a court "can properly consider all relevant factors in determining where the loss is felt" (*Lang v Paine, Webber, Jackson & Curtis, Inc.*, 582 F Supp 1421, 1424-1426 [SD NY 1984]), this exception has been applied only in extremely rare cases. (*See Metropolitan Life Ins. Co. v Morgan Stanley* (2013 WL 3724938, * 7 [Sup Ct, NY County June 8,

2013] [and authorities cited therein]; *Global Fin Corp.*, 93 NY2d at 530 [summarizing *Lang* as involving a "Canadian plaintiff [who] intentionally maintained separate financial base in Massachusetts; under the circumstances, injury of losing Massachusetts funds was felt in Massachusetts, not Canada"].)

Here, the complaint pleads that IKB SA, a commercial bank incorporated in Luxembourg, purchased certificates in reliance on defendants' misrepresentations, and suffered losses as a result. The complaint does not contain allegations about the price or terms of the sale of the certificates from IKB SA to IKB AG, but specifically alleges that the certificates had [*4]already declined in market value at the time of the sale to IKB AG. (*See* Compl. & & 38, 260-261, 270.) In claiming that the German statute of limitations is applicable, defendants argue that all of IKB SA's "alleged losses flowed to its controlling parent" IKB AG, and were sustained in Germany where it is incorporated, notwithstanding that IKB SA, its wholly owned subsidiary, maintained its principal office in Luxembourg and purchased the certificates there. (*See* Ds.' Memo. In Support at 6.)

In support of the motion, defendants claim that IKB AG and IKB SA were "closely financially intertwined." (Ds.' Memo. in Support at 6; Memo. in Reply at 4-5.) Defendants offer excerpts of IKB SA's Management Report for 2007/2008, which state that IKB SA's "continued existence" depended on whether IKB AG could achieve unsecured long-term refinancing; that its Annual Financial Statements were included in the Consolidated Financial Statement of IKB AG; and that IKB AG made capital increases to and submitted a "letter of comfort" for IKB SA. (Rouhandeh Aff., Ex. 3 at 20, 28.) On the reply, defendants submit excerpts from IKB AG's Annual Financial Statements and Management Report for 2008/2009, referring to a € million loss at IKB SA which "had an impact on the investment valuation of IKB SA." (Rouhandeh Reply Aff., Ex. 2 at 28.)

The evidence that defendants produce for the first time on the reply, to which plaintiffs had no opportunity to respond, is not properly considered by the court. (*See McDonald v Edelman & Edelman, P.C.*, 118 AD3d 562 [1st Dept 2014].) Even if all of the evidence were considered, however, it is not the type of evidence on which a motion to dismiss may be based because — unlike, for example, an unambiguous contract — it does not "conclusively establish[] a defense to the asserted claims as a matter of law." (*Leon v Martinez*, 84 NY2d 83, 88 [1994].) The management reports or financial statements are not

self-explanatory. There is no discussion of the accounting standards under which they were prepared, or the reporting obligations imposed on the IKB AG and IKB SA by the laws of Germany and Luxembourg, respectively. Moreover, defendants do not claim, let alone demonstrate, that IKB SA, although wholly owned by IKB AG, was not a separate entity with its own losses.

Defendants also do not cite any authority for their contention that the losses of this wholly owned subsidiary "flowed" to the parent and were therefore incurred by the parent for statute of limitations purposes. *Baena v Woori Bank* (2006 WL 2935752 [SD NY Oct. 11, 2006] [Castel, J.]), the sole case on which defendants rely, held that the Belgian parent's place of incorporation (which was also its principal place of business) was the location of economic injury and therefore the place of accrual for statute of limitations purposes. There, however, the parent used funds from its own corporate treasury in Belgium to make the payments — namely, capital contributions to the Korean subsidiary and earn-out payments in connection with the acquisition of the subsidiary — which the parent claimed were its damages as a result of a fraud aimed at the parent. Here, in contrast, the subsidiary made the payments for the securities which resulted in the losses, claims for which were only later assigned to the parent. Moreover, there is nothing in the record to establish the terms of the assignment or that IKB SA did not sustain losses on the certificates prior to the assignment.

Defendants accordingly fail on this record to establish as a matter of law that the cause of action accrued in Germany. (*See IKB Deutsche Industriebank AG v Credit Suisse Secs. (USA) LLC*, 2014 WL 859355, * 5-6 [Mar. 3, 2014] [*IKB*] [this court's prior decision denying similar claim].) In view of this holding, the court need not decide whether plaintiffs' claims are barred [*5]by the German statute of limitations.

Defendants also contend that claims related to four certificates (MSAC 2005-HE3 BI, MSAC 2005-WMC6 M4, ACCR 2005-3 M4 and M5), which were purchased prior to November 16, 2005 and more than six years before the parties entered into their tolling agreement, are untimely under New York law. (*See* Ds.' Memo. in Support at 7.) These claims are barred by the two year discovery rule imposed by the New York statute of limitations. (CPLR 213 [8].) On the authority and reasoning relied on by this court in prior RMBS decisions, based on publicly available evidence, including the downgrades of the certificates and bankruptcies of and litigation against major originators of the underlying loans, plaintiffs could with reasonable diligence have discovered the fraud prior to

November 16, 2009, the date two years before entry into the tolling agreement. (*See Deutsche Zentral Genossenschaftsbank AG v Credit Suisse*, Index No., 650967/2013, Decision on the Record, May 1, 2014; *Deutsche Zentral-Genossenschaftsbank AG, New York Branch v Morgan Stanley*, Index No. 654035/2012, Decision on the Record, June 10, 2014.)

*Sufficiency of Pleadings*

This court discussed the extensive legal authority on the sufficiency of substantially similar pleadings in *Allstate Ins. Co. v Credit Suisse Secs. (USA) LLC*, 2014 WL 432458 (Jan. 24, 2014) (*Allstate*), *HSH Nordbank AG v Barclays Bank PLC*, 2014 WL 841289 (Mar. 3, 2014) (*HSH Nordbank*), and *IKB*. The cases considered fraud claims based, as here, on representations as to loan to value ratios and appraised values for the underlying loans, owner occupancy of the mortgaged properties, loan originators' compliance with underwriting standards, credit ratings, and assignment of the loans to the trusts. On the authority and reasoning set forth in these cases, the court again holds that the allegations of the complaint adequately plead actionable material misrepresentations that support the fraud cause of action, but that the fraud cause of action should be dismissed to the extent based on allegations regarding the transfer of notes and mortgages to the trusts. As further held in the above decisions, the second cause of action for fraudulent concealment and the fourth cause of action for negligent misrepresentation should also be dismissed.

*Certificates Purchased on Secondary Market*

Morgan Stanley also argues that plaintiffs' fraud claims are not maintainable with respect to three certificates that IKB SA purchased on the secondary market, because IKB SA did not receive an assignment of fraud claims from the original purchasers of the certificates. (Ds.' Memo. In Support at 12.) In the alternative, Morgan Stanley contends that IKB SA could not have reasonably relied on defendants' statements made in the offering documents for each securitization, some 16 to 32 months prior to the purchase. (*Id.* at 17, n 26.) In opposition, plaintiffs claim that these fraud claims are not based on assignments but, rather, on reliance on defendants' representations in the offering materials. (Ps.' Memo. In Opp. at 7 n 12.)

Defendants have not, however, cited any authority that purchasers in a secondary market are barred as a matter of law from relying on offering materials. Under these circumstances, the court adheres to its holding in prior RMBS decisions that the pleadings are sufficient to withstand this motion to dismiss. As the court has observed in previous RMBS cases, however, in light of the duty of a sophisticated plaintiff investor to exercise due diligence, significant issues of fact and law exist as to the reasonableness of plaintiffs' reliance on defendants' representations. (*See HSH Nordbank*, 2014 WL 841289 at * 20-21; *Allstate*, 2014 WL 432458 at * 12.)

The court has considered defendant's remaining contentions and finds them to be without merit.

It is accordingly hereby ORDERED that the motion of defendants to dismiss the complaint is granted to the following extent: The first cause of action for fraud and the third cause of action for aiding and abetting fraud are dismissed in their entirety only as to claims related to the four certificates purchased prior to November 16, 2005, and with respect to all other certificates are dismissed only to the extent that they are based on alleged misrepresentations regarding transfer of notes and mortgages to the trusts. The second cause of action for fraudulent concealment and the fourth cause of action for negligent misrepresentation are dismissed.

This constitutes the decision and order of the court.

Dated:New York, New York

October 28, 2014

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MARCY FRIEDMAN, J.S.C.

## Footnotes

**Footnote 1:**IKB SA retains tort claims against the issuers and underwriters of the two remaining certificates, ACCR 2004-3 (2M3) and NCHET 2005-C (M7). These tort claims were not transferred as a part of IKB SA's sale of the two certificates, allegedly "at a substantial loss," to an unidentified third party. (*Id.*, n 4.)

**Footnote 2:**Defendants also fail to address the separate body of law holding that where an assignment transfers title to a claim, and not merely a power of attorney to prosecute the claim, the assignee has standing to sue even if the assignment provides for remission of the proceeds obtained upon collection of the claim to the assignor. (*See Cortlandt Street Recovery Corp. v Hellas Telecommunications, S.A.R.L.*, 2014 WL 4650231 [Supreme Court, NY County, Sept. 16, 2014] [and authorities cited therein]; *Sprint Communications Co., L.P. v APPC Services, Inc.*, 554 US 269, 285 [2008].)

Return to Decision List