Structuring and Enforceability of Big Boy Letters and Non-Reliance Provisions in Private Investment Transactions

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Who’s a Big Boy? Non-Reliance Provisions and Claims of Insider Trading In Securities and Non-Securities Markets

By Brian S. Fraser and Tamala E. Newbold

The reported settlements of two cases earlier this year involving the use (or misuse) of contractual disclaimers of reliance (so-called “Big Boy” provisions) in connection with distressed debt trading, and the recent widely-publicized request for information relating to potential insider trading from the SEC, present the question of the enforceability and utility of such provisions.

Both cases involved the purchase and sale of distressed bonds, which as securities are subject to a very different legal analysis than trades in distressed bank debt. While there are not a lot of cases that address the issue of Big Boy provisions in distressed debt trading, the law is relatively clear that the enforceability of such provisions will depend on whether the instrument being traded is a security or a non-security and the specificity of the provision describing the information that is not disclosed.

A Big Boy Letter:

- will be of no use in defending a breach of contract or breach of fiduciary duty claim arising from the purchase and sale of securities, including distressed bonds, or non-securities, such as distressed bank loans, when the trader is on a creditors’ committee or owes some other duty of trust or confidence to the borrower;
- will be of no use in defending governmental civil or criminal proceedings arising from the purchase and sale of securities, including distressed bonds;
- will be of limited or uncertain usefulness in defending private lawsuits for fraud arising from the purchase and sale of securities, including distressed bonds; but
- may provide some protection in defending a fraud case brought by a counterparty arising from the purchase and sale of a non-security such as bank debt as long as the parties are sophisticated, the disclaimer is specific as to the information that is not disclosed and the counterparty acknowledges that it has had the opportunity to conduct its own due diligence. The key to enforceability in these circumstances is a clear description of the type and quality of information being withheld.

1 A Big Boy letter is an agreement entered prior to or contemporaneous with a transaction in which the parties acknowledge that the buyer and seller are both sophisticated investors, and that one party may possess material nonpublic information regarding the issuer to which the counterparty does not have access. Each party specifically disclaims any reliance on the other’s disclosures or omissions, and represents in effect that it is a “big boy” and is entering into the transaction notwithstanding the information disparity and its potential effect on the value of the transaction.
THE RECENT EVENTS

In Securities and Exchange Commission v. Barclays, 07-CV-04427 (S.D.N.Y.), the SEC alleged that Barclays obtained material nonpublic information about various debtors through Barclays' membership on a creditors' committee. The Barclays employee who served as Barclays' representative on the creditors' committee also traded bonds of the debtor for Barclays' account. In some instances, Barclays issued Big Boy letters to inform its bond trading counterparties that it possessed material nonpublic information about the debtor, and the 4 counterparties agreed to trade with Barclays notwithstanding the possible information disparity. See Barclays Bank Pays $10.9 Million to Settle Charges of Insider Trading on Bankruptcy Creditor Committee Information, S.E.C. Litig. Rel. No. 20132 (May 30, 2007). The case was settled before trial.

In R2 Investments v. Salomon Smith Barney, the plaintiffs alleged that they purchased bonds issued by an insolvent telecommunications company, World Access, and that defendant Salomon Smith Barney ("SSB") possessed material nonpublic information through its participation on a World Access creditors' committee about World Access' financial condition. SSB executed a Big Boy letter with Jefferies & Co. ("Jefferies"), a broker intermediary that subsequently sold the bonds to R2 Investments without disclosing that it had executed a Big Boy letter with SSB. Two days later, World Access announced that it was out of cash, and the value of the bonds R2 Investments purchased declined 30 percent. See Jenny Anderson, Side Deals in a Gray Area, New York Times, May 22, 2007, p. C1. The case settled on the first day of trial for an undisclosed amount.

Finally, the New York Regional Office of the Securities and Exchange Commission has recently formulated a new 27-page request for information that it is using in its examination of registered investment managers. SEC Pushes for Hedge Fund Disclosure, Wall Street Journal, September 19, 2007, p. C3. Among the many types of information that the SEC has requested are the following:

- Disclosure of threatened, pending, and settled litigation or arbitration to which the Advisor was a party during the Examination Period, including a description of the allegations forming the basis of each issue, the status of each pending issue, and a brief description of any "out of court" or informal settlement.
- Disclosure, relating to receipt of non-public information/misuse of non-public information, of all companies on whose Creditors' Committees employees or affiliates of the Adviser serve.
- Disclosure of all securities held in any client account during the past two years that were involved in a bankruptcy workout, identifying, for each security listed, all accounts that held equity and/or fixed income positions in the issuer at the time of the bankruptcy filing.

It is clear from these requests that the SEC is looking into the potential for insider trading in connection with distressed securities and that any litigation or threatened litigation involving claims of insider trading in distressed securities will come to the SEC's attention when a fund manager is examined.

ENFORCEABILITY OF BIG BOY PROVISIONS IN CONNECTION WITH SECURITIES TRANSACTIONS

Both R2 Investments and Barclays involved the trading of distressed bonds. The antifraud provisions of the federal securities laws prohibit trading in securities, including bonds, while in possession of material nonpublic information about the issuer, and current law requires anyone who possesses material nonpublic information about an issuer to disclose the information or abstain from trading. See 17 C.F.R. § 240.10b5-1 (2000); Chiarella v. United States, 445 U.S. 222, 228 (1980).

Under the misappropriation theory of insider trading, a person who has received confidential business information from another, pursuant to a fiduciary, contractual, or similar relationship of trust and confidence, has a duty to keep that information confidential. He commits fraud 'in connection with' a securities transaction, and violates § 10(b) and
Rule 10b-5, when he misappropriates confidential information for securities trading purposes, by breaching the duty owed to the source of that information. U.S. v. O’Hagan, 521 U.S. 642, 652 (1997). In the Barclays matter, the SEC alleged, without expressing any opinion on the legality of the Big Boy letters that Barclays entered into with some of its counterparties, that Barclays misappropriated the material nonpublic information it obtained through its participation on creditors’ committees by failing to disclose its trades to the creditors’ committees, the issuers, or any other “sources” of the information. Without admitting or denying any of the charges, Barclays agreed to pay more than $10.9 million in disgorgement, prejudgment interest, and civil penalties. Id.

It is doubtful that the Big Boy letters would have provided Barclays with an effective defense had the case proceeded to trial. Big Boy provisions are only disclaimers of reliance, one of the usual elements necessary to prove a claim of fraud. The SEC, however, by statute, is not required to prove reliance to prove securities fraud in an insider trading case. See 17 C.F.R. § 240.10b5-1(b) (2000). A defendant could argue, perhaps, that his use of a Big Boy letter is proof that he had no intent to defraud, but that defense has not been tested.

On the other hand, private litigants must prove, by a "preponderance of the evidence," that they relied on their counterparty’s representations or omissions. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S. Ct. 2499, 2513 (2007) (plaintiff alleging fraud in § 10(b)/10b-5 action must prove her case by a preponderance of the evidence). Do Big Boy letters provide any better protection in private securities fraud cases?

Section 29(a) of the Securities Exchange Act of 1934 forbids waivers of compliance with obligations imposed by the federal securities laws. See 15 U.S.C. § 78cc (2005). A case can be made that a Big Boy letter is an impermissible and unenforceable waiver under § 29(a).

ENFORCEABILITY OF BIG BOY PROVISIONS WHEN TRADING NON-SECURITIES

Bank Loans Are Not Securities
Above we discussed defending against fraud in securities cases brought by the SEC and by private plaintiffs. Bank loans, however, so far have not been
held to be securities.4 Do Big Boy provisions provide greater protection in bank loan trading?

The first question is what type of non-public information does the party to the transaction possess? There are two types of confidential information that bank loan investors can typically acquire: Syndicate Confidential Information and Borrower Confidential Information.

Syndicate Confidential Information is "material information provided by or on behalf of a borrower (or its affiliates) which is nonpublic except that it is deliberately made available by or on behalf of such borrower to all of the members and potential members of a particular lending syndicate." Section 2(a)(i), Confidential Information Supplement to the LSTA Code of Conduct (May 1998). Syndicate Confidential Information is not confidential between syndicate members, is readily available to brokers, and can be disclosed to potential buyers of the debt with an appropriate confidentiality agreement. Id. Bank loans generally are freely traded (among syndicate members and prospective members, not the public) on the basis of Syndicate Confidential Information, and the possessors of Syndicate Confidential Information typically do not owe any fiduciary duty to the borrower or other creditors. See id.; Section III(A)(1), LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants (Dec. 2006).

Borrower Confidential Information, on the other hand, is material information relating to a borrower that is nonpublic and is either obtained from the borrower or from another person that the market participant has reason to believe is subject to a duty not to disclose, and that has not been made available to all members or potential members of the syndicate. Section 2(a)(ii), Confidential Information Supplement to the LSTA Code of Conduct. Investors often acquire Borrower Confidential Information through their participation on creditors’ committees or as an advisor to the borrower. Borrower Confidential Information typically cannot be shared without breaching a confidentiality agreement with, or a fiduciary duty to, the borrower, or violating a court order of confidentiality. See Section III(A)(2), LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants (Dec. 2006).

Trading in the debt of a borrower while in possession of Borrower Confidential Information presents a number of issues that are not present when trading while in possession of Syndicate Confidential Information. A party who trades in the bank loans of a borrower while in possession of Borrower Confidential Information, which it does not disclose to the counterparty, may be susceptible to allegations of breaches of fiduciary duty to the bankruptcy estate and other creditors as well as claims for fraud. See, e.g., In re Papercraft Corp., 211 B.R. 813, 825-26 (W.D. Pa. 1997).

The most common method of dealing with the problem of creditors who wish to continue trading the debt while at the same time serving on a committee is the creation of internal information walls that separate the traders from the recipients in the firm of Borrower Confidential Information. See Sections V(A)-V(C), LSTA Statement of Principles for the Communication and Use of Confidential Information by Loan Market Participants (Dec. 2006); Order Approving Specified Information Blocking Procedures and Permitting Trading in Securities of the Debtors Upon Establishment of a Screening Wall, In re Fibermark, Inc., No. 04-10463, Docket No. 684 (Bankr. D. Vt. Oct. 19, 2004); Robert C. Pozen and Judy Mencher, “Chinese Walls for Creditors’ Committees,” 48 Bus. Law. 747, 756-57 (Feb. 1993).

If an information wall is not feasible, because the firm that wishes to trade is too small or there are other internal structural impediments to a wall, can a Big Boy letter provide protection? In such cases, a Big Boy letter

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4 The Supreme Court’s analysis in Reves v. Ernst & Young, 494 U.S. 56 (1990), provides the analytic framework for determining whether a particular transaction involves the purchase or sale of a “security.” These factors include (1) whether the instrument is motivated by investment or commercial purposes; (2) the “plan of distribution” for the instrument; (3) the reasonable expectations of the public; and (4) whether an alternative regulatory scheme or other risk-inducing factor renders application of the securities laws unnecessary. Id. at 66-67. Is there a risk that, as an efficient secondary market for par and distressed bank loans continues to develop, these instruments may begin to look like securities to regulators (and potential private plaintiffs)? So far the answer has been “no.”
may still protect against causes of action for fraud, but it will not help defend against allegations of breach of fiduciary duty, because the reliance or non-reliance of the counterparty to the trade is immaterial to claims of self-interest and unjust enrichment brought by other constituents of the borrower. See, e.g., Granite Partners, L.P. v. Bear, Stears & Co., Inc., 17 F. Supp. 2d 275, 306, 311 (S.D.N.Y. 1998) (setting forth the elements of breach of fiduciary duty and unjust enrichment).

There Are Cases In Which The Courts Have Refused To Enforce Disclaimers Of Reliance On Public Policy Grounds Or On The “Peculiar Knowledge” Exception
Blanket exculpatory agreements will not shield parties from liability for intentional, fraudulent, or grossly negligent conduct. See Turkish v. Kasenetz, 27 F.3d 23, 27-8 (2d Cir. 1994) (“parties cannot use contractual limitation of liability clauses to shield themselves from liability for their own fraudulent conduct”); Kalisch-Jarcho, Inc. v. City of New York, 58 N.Y.2d 377, 385 (1983) (“an exculpatory clause is unenforceable when . . . the misconduct for which it would grant immunity smacks of intentional wrongdoing”). This general rule has been relaxed, however, where sophisticated business people, negotiating at arms length, agree to a specific disclaimer provision that tracks the substance of the alleged misrepresentations or omissions. Harsco Corp., 91 F.3d at 344-45 (Turkish does not apply where a contract "clearly delineates what representations have been made"); Citibank, N.A. v. Plapinger, 66 N.Y.2d 90, 94-5 (1985) (defendants who agreed to specific disclaimer of reliance were foreclosed from establishing reliance in cause of action for fraud); Kalisch-Jarcho, Inc., 58 N.Y.2d at 384 (enforcement of contractual waiver clause is "especially" warranted when contract was "entered into at arms length by sophisticated contracting parties"). There is nevertheless a risk that a court that detects strong evidence of intentional fraud, or "picking off", will decline to enforce a Big Boy provision even between sophisticated parties.

Similarly, courts will not enforce disclaimers of reliance where the complaining party can demonstrate that its claims are based on facts peculiarly within the knowledge of the nondisclosing party, so that reasonable diligence could not have uncovered the undisclosed information. Banque Arabe Et Internationale D’Investissement v. Maryland Nat’l Bank, 57 F.3d 146, 155 (2d Cir. 1995); see Merrill Lynch & Co., Inc. v. Allegheny Energy, Inc., 382 F. Supp. 2d 411, 418 (S.D.N.Y. 2003) (refusing to dismiss fraud claims, despite parties’ specific, narrowly tailored disclaimer of reliance, where plaintiffs alleged that information about Merrill’s “sham energy trades with Enron” and Merrill’s concern that a principal had stolen $43 million were peculiarly within Merrill’s knowledge); OnBank & Trust Co. v. FDIC, 967 F. Supp. 81, 86-7 (W.D.N.Y. 1997) (disparity between principal amount of mortgage pass-through certificates and the mortgage loan balance was peculiarly within RTC’s knowledge because, as servicer of the loans, RTC knew that certain loans had been paid off but that the principal amount had not been reduced accordingly).

Big Boy Letters May Protect Against A Private Counterparty’s Action For Fraud Arising From Trading In Non-Securities Under Some Circumstances
The elements of a claim for fraud or fraudulent inducement are (1) that defendant made a material false representation, (2) with the intent to defraud the plaintiff, (3) the plaintiff reasonably relied upon the representation, and (4) the plaintiff suffered damage as a result of that reliance. Banque Arabe, 57 F.3d at 153. Fraudulent concealment claims contain the additional element that the defendant had a duty to disclose the material information.5

First, while a Big Boy letter may successfully prevent a plaintiff from arguing that it relied on the non-disclosure, it can present other issues. Most importantly, it may affect the transaction itself, as the prospective counterparty may be reluctant to agree to the transaction without full disclosure, or may seek to insert a provision that would permit the parties to "unwind" the transaction if certain events occur. The presence of a Big Boy letter may also affect downstream marketability of the debt, as any subsequent purchasers may be unwilling to purchase debt that is already subject to a Big Boy provision.

5 The question of when a duty to disclose material non-public information in non-securities cases arises is itself an interesting question, but not one addressed here.
Second, assuming all attendant concerns have been assessed and the parties agree to execute a Big Boy provision, the drafters of such provisions need to consider the following issues. Courts have enforced disclaimers of reliance where the disclaimer:

- is the product of negotiation among sophisticated parties;
- specifically describes the type and quality of the information being withheld in terms that are tailored to the specific transaction at hand;
- requires the parties to acknowledge that each party has voluntarily entered the transaction notwithstanding the nondisclosure of material non-public information;
- requires each party to perform its own due diligence and to disclaim any reliance on the other.

In addition, the Big Boy letter should contain a merger clause that clearly sets forth the parameters of the entire agreement between the parties, and the representations upon which the parties may rely.

**The Big Boy Letter Must Be The Product of Negotiation Between Sophisticated Entities**

Parties to distressed bank loan trades in the secondary market should be, and almost always are, financially sophisticated, and all relevant documents between the parties should clearly reflect their sophistication. Sophisticated parties are presumed to have equal bargaining power and can negotiate terms or insist on greater disclosure. When a contract is between two sophisticated parties, courts recognize that reliance is unreasonable not merely on expressly disclaimed representations, but also on representations that a knowledgeable party should have insisted on including in the agreement but that were not included. For instance, in *UniCredito Italiano SPA v. JP Morgan Chase Bank*, 288 F. Supp. 2d 485 (S.D.N.Y. 2003), plaintiffs, sophisticated Italian and Polish financial institutions, alleged that JP Morgan Chase (“Chase”) and Citigroup defrauded them in connection with the formation of and payment under certain Enron-related syndicated credit facilities for which Citigroup and Chase served as co-Administrative agents. The agreements precluded plaintiffs from claiming that they relied on any alleged representations by Chase or Citigroup. The court dismissed fraud and negligent misrepresentation claims against Chase and Citigroup on grounds that

[h]aving failed to bargain for the right to rely on the banks as monitors of Enron’s compliance with its disclosure, financial condition and other covenants, or for the right to benefit from any knowledge gained by the Defendant banks or their affiliates in connection with their own business dealings with Enron and its affiliates, Plaintiffs cannot, as a matter of law, be held reasonably to have relied on any misrepresentations or omissions by the Defendants concerning those matters.6

Likewise, in *Lazard Freres & Co. v. Protective Life Ins. Co.*, 108 F.3d 1531 (2d Cir. 1997), negotiations for a time-sensitive sale of bank debt between two large, sophisticated bank debt traders required Protective to make an oral commitment to purchase the bank debt before it had a chance to review a key report on the debtor’s financial condition. Protective subsequently alleged that Lazard's representative made false representations regarding the underlying purchase of bank debt, and could easily have protected itself by insisting, as a condition to closing, on an examination of documents pertaining to the transaction or by negotiating contractual provisions to protect parties' interests. Id. at 1543. Protective's failure to protect itself rendered reliance on the misrepresentation "unreasonable as a matter of law." *Id.*

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6 Id. at 499; see also *Emergent Capital Inv. Mgmt., LLC v. Stonepath Group, Inc.*, 165 F. Supp. 2d 615, 622 (S.D.N.Y. 2001) (dismissing fraud claim on grounds that “fraud claim will not stand where the clause was included in a multi-million dollar transaction that was executed following negotiations between sophisticated business people and a fraud defense is inconsistent with other specific recitals in the contract”).
The Big Boy Letter Must Specifically Describe The Information Withheld

Cases in the Second Circuit hold that a party who specifically disclaims reliance upon a particular representation in a contract cannot, in a subsequent action for fraud, claim it was fraudulently induced to enter into the contract by the very representation it has disclaimed reliance upon. Banque Arabe, 57 F.3d at 155. To be effective, the Big Boy letter or provision should be specific enough that the counterparty clearly is on notice as to what may not be reasonably relied on, yet not so specific as to disclose the substance of the confidential information. The letter must avoid boilerplate generalities and specifically reference the representations and warranties on which each party is entitled to rely, if any. See Harsco Corp., 91 F.3d at 346 ("the exhaustive nature of the [Agreement’s] representations adds to the specificity of [the Agreement’s] disclaimer of other representations.").

Where a party to a distressed bank loan transaction possesses Borrower Confidential Information, it would be advisable to disclose the type of information withheld, i.e., business plans, earnings projections or financial statements, as well as the party’s relationships with the issuer, i.e., committee member, adviser, member of the Board of Directors.

For example, the plaintiff in DynCorp v. GTE Corp., 215 F. Supp. 2d 308 (S.D.N.Y. 2002), purchased a telecommunications company from Contel, a wholly owned subsidiary of GTE. GTE in turn agreed not to compete with the business, and also agreed to guarantee its subsidiary’s performance of certain obligations. The parties’ purchase agreement specifically provided that GTE made no express or implied representations or warranties with respect to the business being sold, or to its probable success or profitability, or to any other information provided to plaintiff. In addition, plaintiff agreed that GTE would not be subject to any liability or indemnification obligation resulting from the distribution to plaintiff of the offering memorandum any other information or documents. The court held that the parties’ particularized disclaimers made it impossible for plaintiff to prove reasonable reliance. DynCorp, 214 F. Supp. 2d at 320-21.7

In contrast, in Merrill Lynch & Co. v. Allegheny Energy, Inc., Merrill provided certain Evaluation Material to Allegheny in connection with the contemplated sale of Merrill’s energy commodity trading business. After Allegheny acquired the business from Merrill, Allegheny discovered that Merrill knew that a principal in the business had been suspected of engaging in considerable fraudulent activity, and that the business’ financial performance was based in part on sham trades with Enron. 382 F. Supp. 2d at 415. The court held that the parties’ disclaimer did not track the substance of the alleged misrepresentations because the disclaimer did not state that Merrill Lynch disclaimed any prior representations about the Enron transactions or the principal’s qualifications. Id. at 417.

The Disclaiming Party Should Acknowledge That It Has Agreed To Complete The Transaction Notwithstanding the Nondisclosure Of Material Nonpublic Information

Big Boy letters also must require the disclaiming party to acknowledge that its counterparty may have Borrower Confidential Information that it cannot disclose, but that the disclaiming party has voluntarily entered the transaction notwithstanding the nondisclosure. The LSTA Distressed Standard Terms suggest the following standard Big Boy provision:

5(n): Buyer acknowledges that (i) Seller currently may have, and later may come into possession of, information with respect to the Transferred Rights, the Assumed Obligations, Borrower, Obligors or any of their respective Affiliates that is not known to the Buyer and that many be material to a decision to sell the Transferred Rights and to retain the Assumed Obligations ("Buyer Excluded Information"), (ii) Buyer has determined to purchase the Transferred Rights and to retain the Assumed Obligations

7 See also Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 321-23 (1959) (finding that where a party specifically disclaims reliance on a particular representation, the party is precluded from claiming fraudulent inducement to enter into the contract based on that very representation, and that a contrary result would allow the plaintiff to “deliberately misrepresent[]” its purported nonreliance in the contract).
subsequently filed suit, alleging that defendants misrepresented the status of the construction of several plants in Asia and Europe, the financial prospects of the business’ operations, and the business’ intellectual property rights. The Second Circuit affirmed dismissal of Harsco’s claims, holding that many of the misrepresentations complained of were "exactly what [the agreement] disclaim[ed]." *Id.* at 345. The Second Circuit also held that to the extent Harsco claimed misrepresentations about plants other than those specifically referenced in the agreement, "Harsco should be treated as if it meant what it said when it agreed" to specifically disclaim reliance on representations not in the agreement. *Id.* at 345-46. See also *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 320-21 (1959) (dismissing fraud claims by purchaser of lease, based on seller's alleged false representations as to the building’s operating expenses and profitability, where plaintiff specifically acknowledged in the agreement that seller had not made and did not make any representations as to, among other things, "the physical condition, . . . expenses, [or] operation" of the premises).

The Second Circuit has noted that a party who has been put on notice of the existence of material facts which have not been documented and nevertheless proceeds with the transaction without negotiating language into the agreement for his protection, "will not be heard to complain that he has been defrauded." *Lazard Freres & Co.*, 108 F.3d at 1543. Similarly, the courts in *McCormick v. Fund American Cos.*, Inc., 26 F.3d 869 (9th Cir. 1994) and *Jensen v. Kimble*, 1 F.3d 1073 (10th Cir. 1993), dismissed securities fraud charges by parties who were put on notice that their counterparties would not disclose certain information. Defendants in *McCormick* and *Jensen* explicitly informed plaintiffs that they would not disclose certain material information, and the plaintiffs entered the transactions notwithstanding the nondisclosures. The *Jensen* court held that there could be no fraud because the plaintiff "knew what he didn’t know" when he entered the transaction. 1 F.3d at 1078.

Like all other aspects of the disclaimer, the acknowledgment of non-reliance must be specifically tailored to the agreement. For instance, the agreement in *Harsco Corp. v. Segui* provided that Harsco acknowledged that the sellers of a business were not warranting “projections, estimates or budgets ... of future revenues, expenses or expenditures, future results of operations, ... or any other information or documents made available” to Harsco. *Harsco Corp.*, 91 F.3d at 342. Harsco also acknowledged that it could only rely on those representations specifically set forth in the agreement. *Id.* Harsco purchased the business and

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8 ¶ 4(o) of the LSTA Distressed Standard Terms and Conditions contains a nearly identical provision for the Seller.

9 See, e.g., Sections 5.1(f) and 5.1(f) of the LSTA Standard Terms and Conditions, which provide that the buyer:

- has adequate information concerning the business and financial condition of the Borrower and Obligors . . . to make an informed decision regarding the purchase . . .
- has independently and without reliance upon Seller, and based on such information as Buyer has deemed appropriate, made its own analysis and decision to enter into this Agreement, . . .
- acknowledges that Seller has not given Buyer any investment advice, credit information or opinion on whether the purchase of the Transferred Rights or the assumption of the Assumed Obligations is prudent[, and] . . .
- has not relied and will not rely on Seller to furnish or make available any documents or other information regarding the credit, affairs, financial condition or business of Borrower or any Obligor, or any other matter concerning Borrower or Obligor.

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In the past, some courts have enforced disclaimers of reliance, over the plaintiffs' protests that facts concerning the transaction were peculiarly within the defendants' knowledge, where the disclaimers placed the burden on the buyer to perform its own due diligence. See UniCredito Italiano, 288 F. Supp. 2d at 500-01 (where plaintiffs specifically agreed they would make their own credit decisions and would not rely on defendants in deciding whether to enter Enron credit facilities, court refused to apply the peculiar knowledge exception to defeat the parties' contractual allocations of risks away from the defendants). But see Merrill Lynch v. Allegheny Energy, 382 F. Supp. 2d at 415 (notwithstanding the general disclaimer of reliance, the language in the parties' agreement placed a disclosure burden on Merrill, rather than a diligence burden on Allegheny, and information about the sham trades and about Merrill's suspicions about the principal's conduct was peculiarly within Merrill's knowledge).

The Bog Boy Letter Should Contain A Merger Clause
Finally, to underscore the specific disclaimers and acknowledgments contained therein, a Big Boy letter also should contain a merger clause. See Emergent Capital Investment Mgmt, LLC v. Stonepath Group, Inc., 195 F. Supp. 2d 551, 562 (S.D.N.Y. 2002), vacated in part on unrelated grounds, 343 F.3d 189 (2d Cir. 2003) ("when the contract states that the defendant makes no representations other than those contained in another more exhaustive clause of the contract, a fraud claim may be precluded"). The merger clause should indicate that the Big Boy letter and any other pertinent transaction documents constitute the entire agreement between the parties, supersede any prior agreements and understandings, written or oral, between the parties with respect to the subject matter of the agreement, and contain the only representations or warranties on which the parties are entitled to rely. See, e.g., Harsco Corp., 91 F.3d at 345 ("no other representations" clause in merger agreement precluded claims alleging misrepresentations about Russian plant facility during due diligence process, where parties' agreement did not contain any representations about the Russian plant);

Consolidated Edison, Inc. v. Northeast Util., 249 F. Supp. 2d 387, 401 (S.D.N.Y. 2003), rev'd in part on unrelated grounds, 426 F.3d 524 (2d Cir. 2005) (plaintiffs could not prove reasonable reliance on oral statements made in the course of due diligence where the parties' agreement contained specific disclaimer, combined with integration clause which provided that Merger Agreement and Confidentiality Agreement were the entire agreement between the parties and superseded all prior written and oral understandings).

CONCLUSION
When drafting a Big Boy provision, potential loan trading counterparties should consult the standards provisions in the LSTA Standard Terms and Conditions ("LSTA Standard Terms") as a springboard in their negotiations, but should supplement the LSTA Standard Terms with particularized language that is tailored to their contemplated transaction. Courts are more likely to enforce disclaimers of reliance in Big Boy letters where the parties specifically enumerate any and all representations, warranties or omissions on which the parties are entitled to rely, and specifically disclaim reliance on all others. The Big Boy letter also should clearly state whether the transaction involves undisclosed Borrower Confidential Information, and if so, should require that the counterparties acknowledge that they are entering the transaction notwithstanding the nondisclosure.
QUESTIONS
If you have questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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Who’s a Big Boy II: Superior Knowledge and the Duty to Disclose

By Brian S. Fraser and Tamala E. Newbold

In our October 2007 memorandum titled “Who’s A Big Boy? Non-Reliance Provisions and Claims of Insider Trading in Securities and Non-Securities Markets,” we addressed questions regarding the enforceability of contractual disclaimers of reliance (“Big Boy provisions”), in which the parties to a transaction agree that one or both of them may have access to material non-public information to which the other party does not have access. We concluded that the usefulness of such provisions is generally limited to preventing a finding of reasonable reliance in a common-law fraud case arising from a transaction between sophisticated parties in a non-security such as bank debt, and then only when the Big Boy provision clearly describes the type and quality of the information being withheld.

In a situation involving a non-disclosure (as opposed to a misrepresentation), however, the threshold issue is whether there is a duty to disclose in the first place. So where does the duty come from? Under the “misappropriation” theory of insider trading under the federal securities laws, the duty arises from 1) a fiduciary relationship with or 2) a contractual confidentiality obligation owed to the source of the information. New York common law, however, which applies to many non-securities financial transactions, provides a different framework for determining when a party to a transaction has a duty to disclose.

In the non-securities context, the issue that gets litigated is not insider trading, but rather fraud or fraudulent concealment in a civil action for rescission or for damages. In the absence of an affirmative misstatement, liability can result from non-disclosure only if there is a duty to speak, and the general rule is caveat emptor. There is a line of cases, however, that holds that one party’s “superior knowledge” may trigger a duty to disclose to the party that does not have the same information.

Below, we describe the evolution and application of the “superior knowledge” exception to caveat emptor under New York law, and conclude that where sophisticated parties, negotiating at arms length, agree to a detailed Big Boy provision that affirms that each is entering the transaction notwithstanding that one party may have access to material nonpublic information that it will not disclose, a New York court is likely to reject a claim for fraud based on failure to disclose superior knowledge. We do so with a disclaimer of our own: the cases are heavily fact-driven, and the results are difficult to reconcile. Also, it is safe to assume that if a court concludes that there has been willful and intentional fraud, a Big Boy provision will not be much help.
New York common law also recognizes a duty to disclose (1) to make partial or ambiguous statements not misleading, and (2) where the parties have a fiduciary or confidential relationship. New York law, however, differs from federal securities law in one crucial respect: it requires disclosure where one party simply and legitimately possesses superior knowledge about a material fact regarding the transaction, and knows that the counterparty is entering the transaction with a mistaken belief regarding that fact.

CAVEAT EMPTOR NOTWITHSTANDING, THERE IS A DUTY TO DISCLOSE UNDER NEW YORK LAW UNDER CERTAIN CIRCUMSTANCES

There can be no fraudulent concealment under New York law absent a duty to disclose.1 P.T. Bank Central Asia v. ABN AMRO Bank N.V., 301 A.D.2d 373, 754 N.Y.S.2d 245, 250 (1st Dep’t 2003). The general rule is caveat emptor: "A duty to speak cannot arise simply because two parties may have been on opposite sides of a bargaining table when a deal was struck between them." Brass v. American Film Technologies, Inc., 987 F.2d 142, 150 (2d Cir. 1993) (applying New York law).

Although the question of when a duty to disclose arises is complex and highly-contested, the rule on its face is deceptively simple. A party to a business transaction has a duty to speak in only three situations: first, where the party has made a partial or ambiguous statement, and it would be misleading to omit other information to correct the misimpression; second, when the parties stand in a fiduciary or confidential relationship with each other; or third, where one party’s superior knowledge of material facts renders a transaction without disclosure “inherently unfair.” See Jana L. v. West 129th St. Realty, 22 A.D.3d 274, 802 N.Y.S.2d 132, 134 (1st Dep’t 2005); Brass, 987 F.2d at 150-52.

PARTIAL OR AMBIGUOUS STATEMENTS

A duty to disclose can arise where necessary to correct

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1 The elements of fraudulent concealment under New York law are: (1) a duty to disclose material facts; (2) knowledge of material facts by a party bound to make such disclosures; (3) nondisclosure; (4) scienter; (5) reliance; and (6) damage. P.T. Bank Central Asia v. ABN AMRO Bank N.V., 301 A.D.2d 373, 754 N.Y.S.2d 245, 250 (1st Dep’t 2003). The duty to disclose also can arise in negligent misrepresentation claims. Under New York law, a claim of negligent misrepresentation requires proof that the defendant had a duty, as a result of a special relationship, to give correct information. Soluta Inc. v. FMC Corp., 456 F. Supp. 2d 429, 448-49 (S.D.N.Y. 2006) (citing Kimmell v. Schaefer, 89 N.Y.2d 257, 652 N.Y.S.2d 715, 719 (1996)).
misunderstandings when one party has made what amounts to partial or ambiguous disclosures. The general rule is that “once a party has undertaken to mention a relevant fact to the other party it cannot give only half the truth.” Brass, 987 F.2d at 150. For instance, to the extent such information is not readily discoverable, a company cannot disclose strong earnings without also disclosing losses that nearly wipe out its profits. See Peerless Mills, Inc. v. AT&T, 527 F.2d 445, 449 (2d Cir. 1975).

The partial disclosure requirement has been somewhat eroded, however, in a number of Federal court cases in which the court found, under New York law, that partial disclosures between sophisticated parties are not fraudulent where the disclosures revealed sufficient information to impose a duty on the recipient to make further inquiry. For example, in Lazard Freres & Co. v. Protective Life Ins. Co., the United States Court of Appeals for the Second Circuit, applying New York law, held that where a party has been put on notice of the existence of material facts which have not been documented and that party 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.” Lazard Freres & Co., 108 F.3d 1531, 1543 (2d Cir. 1997) (citing Rodas v. Manitaras, 159 A.D.2d 341, 552 N.Y.S.2d 618, 620 (1st Dep’t 1990)).

More recently, in Century Pacific, Inc. v. Hilton Hotels, Inc., plaintiffs sued Hilton Hotels for fraud after the value of the Red Lion hotel franchise license plaintiffs purchased dropped significantly once Hilton divested Red Lion from its family of hotels. Century Pacific, Inc., 528 F. Supp. 2d 206, 233 (S.D.N.Y. 2007). The court held, again applying New York law, that even though Century raised a triable issue of fact as to defendants’ partial or ambiguous statements regarding Hilton’s intent to retain the Red Lion name as part of its portfolio, Century could not have reasonably relied on such statements because “the contents of its customized Agreement, and its relative sophistication as a party shows that Century should have understood exactly what legal assurances it was being given (and not given) and on what elements of the business deal it was knowingly assuming a risk.” Id.

FIDUCIARY RELATIONSHIP

In New York, it is “well established that, when a fiduciary, in furtherance of its individual interests, deals with the beneficiary of the duty in a matter relating to the fiduciary relationship, the fiduciary is strictly obligated to make “full disclosure” of all material facts.” Blue Chip Emerald LLC v. Allied Partners Inc., 299 A.D.2d 278, 750 N.Y.S.2d 291, 294 (1st Dep’t 2002) (citing cases). Absent such full disclosure, the transaction is voidable. For example, the court in Blue Chip held that a co-venturer “had no right” to keep to itself material information about its efforts to sell or lease the venture’s property, and determined that as a result, contractual disclaimers the trial court invoked as grounds for dismissing plaintiff’s action were “voidable as the fruit of the fiduciary’s breach of its obligation to make full disclosure.” Id. at 294-95; see also Ajettix Inc. v. Raub, 9 Misc.3d 908, 804 N.Y.S.2d 580, 588-89 (N.Y. Sup. 2005) (rescinding corporation’s agreement to redeem former vice-president’s stock where vice-president failed to disclose facts that affected the value of his shares); Pebble Cove Homeowners’ Ass’n, Inc. v. Shoratlantic Development Co., Inc., 191 A.D.2d 544, 595 N.Y.S.2d 92, 93 (2d Dep’t 1993) (directors of homeowners’ association had duty to disclose facts which could damage the association).

However, a conventional, arms-length business relationship does not give rise to a fiduciary duty under New York law and therefore does not trigger a duty to speak. Oursler v. Women’s Interart Center, Inc., 170 A.D.2d 407, 566 N.Y.S.2d 295, 297 (1st Dep’t 1991). Nor does the fact that counterparties have entered a confidentiality agreement transform a purely commercial relationship into a fiduciary one under New York law. See Boccardi Capital Systems, Inc. v. D.E. Shaw Laminar Portfolios, L.L.C., No. 05 cv 6882 (GBD), 2009 WL 362118, at *7 (S.D.N.Y. Feb. 9, 2009) (“Plaintiff’s allegations
The court then held that the true facts were peculiarly within defendant’s knowledge, and that it was difficult to see “how the exercise of common prudence and the use of ordinary intelligence, or of the faculty of sight, would have enabled plaintiff to detect the falsity of Mather's statement, and, therefore, why she was not entitled to rely absolutely upon it.” *Id.*

In its current iteration, the superior knowledge doctrine (also known as the “peculiar” knowledge doctrine) is premised on the notion that “[w]hen matters are...peculiarly within the defendant's knowledge,...plaintiff may rely without prosecuting an investigation, as he has no independent means of ascertaining the truth.” *DIMON, Inc. v. Folium, Inc.*, 48 F. Supp. 2d 359, 368 (S.D.N.Y. 1999) (citing Lazard Freres & Co., 108 F.3d at 1542) (both applying New York law); see also *Strasser v. Prudential Securities, Inc.*, 218 A.D.2d 526, 527, 630 N.Y.S.2d 80, 82 (1st Dep’t 1995).

In order to establish a duty to disclose material information based on superior knowledge, the plaintiff must prove (1) that the defendant had superior knowledge; (2) that the information was not readily available to the plaintiff; and (3) that the defendant knew that plaintiff was acting on the basis of mistaken knowledge.

Superior knowledge is, quite simply, material information about a transaction that a counterparty does not know and cannot find out through reasonable diligence. It is material information, known and

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2 For example, in *Frigitemp Corp. v. Financial Dynamics Fund, Inc.*, 524 F.2d 275 (2d Cir. 1975), the Second Circuit, applying New York law, held that information about corporate holdings was not superior knowledge where the information was readily available to any potential purchaser who asked for it, so purchasers could therefore assume that the plaintiffs were not acting on the basis of mistaken knowledge. 524 F.2d at 282-83.

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knowable only to one party, that renders false the counterparty’s basic assumptions about the transaction. See, e.g., Laugh Factory, Inc. v. Basciano, 608 F. Supp. 2d 549, 559 (S.D.N.Y. 2009) (defendant knew, but plaintiff did not, that at the time he was offering plaintiff full rights to use the name Laugh Factory of NYC, he also contemplated offering the name to other investors); Janel World Trade, Ltd. v. World Logistics Services, Inc., No. 08 Civ. 1327 (RJS), 2009 WL 735072, at *10 (S.D.N.Y. Mar. 20, 2009) (plaintiff could not rightfully obtain exclusive rights to all defendant’s assets because defendant had entered side deal secretly granting a portion of those assets to a third party).

A party’s knowledge is not “superior” where the relevant information was either a matter of public record, was not pursued by plaintiffs, or was disclosed at least in part. See Grumman Allied Indus., Inc. v. Rohr Indus., Inc., 748 F.2d 729, 739 (2d Cir. 1984). Nor is knowledge “superior” when a buyer has an opportunity equal to that of a seller to obtain information. Brass, 987 F.2d at 151; Congress Financial Corp., 790 F. Supp. at 474 (finding no duty to disclose, and thus no fraudulent concealment, where plaintiff had “unrestricted” access to the books, records, facilities and personnel at issue and the means to utilize the access, but “failed to exercise diligence to discover allegedly omitted information”). In addition, courts apply a sliding scale when determining access to information, such that “the more sophisticated the buyer, the less accessible the information must be to be considered within the seller’s [superior] knowledge.” Solutia Inc. v. FMC Corp., 456 F. Supp. 2d 429, 448 (S.D.N.Y. 2006) (citing cases).

What Superior Knowledge Is Not?
Knowledge is not “superior” where it involves knowledge of extrinsic facts such as market conditions or changes in the law. Courts assume that that kind of information, though known to only one party, could have been obtained by either party. The United States District Court for the Southern District of New York recently rejected a superior knowledge claim in Century Pacific, Inc. v. Hilton Hotels Corp. on grounds that Hilton’s desire to sell the Red Lion hotel chain was “discernable based on public information [including the standalone nature of Red Lion’s business and the trajectory of Red Lion and other Hilton brands] equally available to a prospective franchisee in the course of reasonable diligence as to someone inside the company.” Id. at 233.

Similarly, a plaintiff could not recover for fraud arising out of a failed real estate investment where he had not researched the local market, requested supporting documentation about a developer’s other projects, or investigated the project site. See Stuart Silver Assocs., Inc v. Baco Devel. Corp., 245 A.D.2d 96, 665 N.Y.S.2d 415, 418 (1st Dep’t 1997).

Nor is disclosure required because one party has performed better research or due diligence than another. Again, the law presumes that a counterparty could have obtained the same information. See Grumman Allied Indus., Inc. v. Rohr Indus., Inc., 748 F.2d 729,739 (2d Cir. 1984) (claim that defendant possessed superior knowledge was “without merit” where plaintiff had unrestricted access to defendant’s facilities, books and records, and personnel but failed to use its access to discover the allegedly omitted information). In fact, a court recently held that “as a matter of law,” one party’s knowledge was not superior where the counterparty had access to the same sources of information and could have hired its own private investigators to search public records, “as defendant apparently did.” See Albion Alliance Mezzanine Fund, L.P. v. State Street Bank and Trust Co., 8 Misc. 3d 264, 797 N.Y.S.2d 699, 704-05 (N.Y. Sup. 2003). Another court held that a seller who hired professional drillers to test oil wells and discovered that the wells were “dry” did not have to disclose this information to purchasers, because the purchasers could have hired their own experts. See Barcomb v. Alford, 125 A.D.2d 907, 510 N.Y.S.2d 267, 269 (3d Dep’t 1986).

So When Will A Court Find Superior Knowledge Giving Rise To A Duty to Disclose?
Then, one might ask, under what circumstances will a mere disparity in knowledge among sophisticated parties bargaining at arm’s length evolve into something more, triggering disclosure obligations to a counterparty? Although the law does not require a
party that expended considerable capital and effort to
diligence a transaction to disclose the fruits of that
diligence, unfortunately the courts have not provided a
clear roadmap of what amounts to acceptable and
unacceptable nondisclosures. Below, we attempt to
harness a few of the general concepts that have
emerged under New York law.

Courts applying New York law generally hold that
knowledge is “superior” to that of a sophisticated
counterparty where (1) the subject of the transaction
(whether tangible or intangible) contains a material
defect or an encumbrance or other restriction on use or
value that is intrinsic to the subject matter of the
transaction and is known only to the seller, and the
buyer could not have been expected to discover the
defect; or (2) the defendant withholds facts about its
own fraudulent transactions or conduct that affect the
value of the subject matter.

The classic example of a case finding a duty to disclose
based on superior knowledge about the inherent
character or value of the subject matter is Donovan v.
Aeolian Co., where a piano retailer placed a five year
old, partially rebuilt piano on its showroom floor
alongside new pianos, but did not disclose that the
piano was used when it sold the piano to plaintiff, who
believed she was buying a new piano. Donovan v.
Aeolian Co., 270 N.Y. 267, 270-71 (1936). More recent
examples include a finding that a corporation was “duty
bound” to disclose restrictions on alienability of stock
underlying a transaction for the sale of warrants, where
the corporation knew the purchaser believed the
underlying securities were freely transferable. Brass, 987
F.2d at 152. Similarly, the court in OnBank & Trust Co. v.
FDIC held that the disparity between principal amount
of mortgage pass-through certificates and the mortgage
loan balance was peculiarly within RTC’s knowledge
because, as servicer of the loans, RTC knew that certain
loans had been paid off but that the principal amount
had not been reduced accordingly. OnBank & Trust
Co., 967 F. Supp. 81, 86 (W.D.N.Y. 1997) (applying New
York law). Another court held that a defendant had a
duty to disclose that it could not legally grant plaintiff

exclusive rights to all of its assets because it had already
granted a portion of those assets to a third party. Janel
World Trade, Ltd. v. World Logistics Services, Inc., No.
08 Civ. 1327 (RJS), 2009 WL 735072, at *10 (S.D.N.Y. Mar.
20, 2009). These and other cases suggest that
knowledge of a latent defect in the subject of the
transaction, not discoverable through the exercise of
ordinary diligence, triggers a duty of disclosure.

Courts have also held that information about a
defendants’ own fraudulent transactions or conduct that
affects the value of the subject matter of the transaction
is superior knowledge that must be disclosed, the
rationale being that “[b]y its nature, this information is of
the type that was in defendants’ possession, not at
plaintiff’s fingertips, and which, one can envision,
defendants would have desired to keep close to the
chest.” Nomura Sec. Int’l, Inc. v. E*Trade Sec., Inc., 280
Wathne, Ltd., No. 98 Civ. 6087, 1999 WL 566311, at *16
(S.D.N.Y. Aug. 3, 1999). In Nomura, the court held that
the defendant should have disclosed to counterparties
in securities lending transactions the fact that it had
manipulated the market by purchasing the entire public
float of a company’s stock, so that the only possible
lenders of the stock would be insiders who were not
legally permitted to lend stock. Id. at 206. Finally, the
court in Minpeco, S.A. v. Conticommodity Servs., Inc,
552 F. Supp. 332, 337-38 (S.D.N.Y. 1982), held that a
broker should have disclosed the fact that an increase in
the global price of silver was the result of the broker’s
own efforts to monopolize the silver market.

So what is the practical, real world application of these
concepts? Does the superior knowledge doctrine
require the parties to disclose all of their strategies,
motives, intentions or maneuverings? Clearly not. For
instance, would the developer of a real estate project
seeking to purchase a large block of land be required to
disclose its true intention to the seller of each individual
lot? Would an investor who seeks to buy a controlling
block of the bank debt of a company in distress for the
purpose of acquiring the equity in bankruptcy have to
disclose its intentions to potential sellers of the debt?
Disclosure should not be required in such situations.

Where the non-disclosing party is not otherwise violating the law or manipulating a market, the Nomura and Minpeco decisions should not apply in most real world situations. More importantly, cases such as Donovan, Janel World Trade and Laugh Factory illustrate that the determining factor in superior knowledge cases is whether the non-disclosing party knows that the undisclosed information is so material to the counterparty that the counterparty has a mistaken belief about the very essence of the transaction. In the hypothetical examples above, the fact that the developer was buying up all surrounding lots in order to build and the investor was buying bank debt to obtain a controlling or blocking position does not adversely affect the inherent value of the subject matter of the transaction. While the seller has lost possible leverage over the buyer, it has not lost the benefit of its expected bargain.

DISCLOSURE OBLIGATIONS MAY BE MODIFIED BY CONTRACT: RE-ENTER THE BIG BOY

It has been the general rule in New York since at least 1959 that a disclaimer, no matter how specific, will not operate where one party has superior knowledge not readily available to the other. Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 184 N.Y.S.2d 603-04 (1959). However, both New York state courts and federal courts applying New York law have made an exception to that general rule and have held that, among sophisticated parties, disclosure obligations may be modified by contract. The guiding principle here is that courts are loathe to rewrite detailed, bargained for contractual provisions that allocate risks between sophisticated parties. DynCorp v. GTE Corp., 215 F. Supp. 2d 308, 322 (S.D.N.Y. 2002) (citing Grumman Allied Indus., 748 F.2d at 735). These cases hold that a where the sophisticated plaintiff has contractually agreed to absolve a counterparty of the duty to disclose material information, the plaintiff may not then claim fraud based on the counterparty’s failure to disclose material information.

A prime example of this line of cases is Chase Manhattan Bank v. New Hampshire Insurance Co., 193 Misc. 2d 580, 749 N.Y.S.2d 632, 647 (N.Y. Sup. 2002), in which the court rejected a claim that the superior knowledge exception barred enforcement of the parties’ specific disclaimer. The insurer in Chase Manhattan Bank agreed to a disclaimer wherein the insurer specifically acknowledged that there might be misstatements or omissions, waived any obligation on Chase’s part to speak, acknowledged that only very limited specified information had been provided by Chase, and agreed that the insurance policy could not be avoided even if Chase brokers were guilty of misstatements or omissions. Id. at 647. The court held that the insurers, having agreed to such a detailed disclaimer, “will not be heard to complain that Chase did not do what the insurers contractually agreed Chase did not have to do, and that Chase is responsible for what the insurers contractually agreed Chase was not responsible.” Id.

The court in Rodas v. Manitaras likewise held that “where, as here, 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.” 159 A.D.2d 341, 552 N.Y.S.2d 618, 620 (1st Dep’t 1990). There, plaintiff sought to rescind its purchase of a restaurant based on allegations that defendant falsely induced plaintiff to enter the contract by falsely representing that the weekly income of the business was $20,000. Id. at 620. Plaintiff had requested permission to review defendant’s business records and was denied access, but nonetheless agreed to proceed with the purchase of defendant’s business. The court rejected plaintiff’s argument that information about the weekly income of the business was peculiarly within defendant’s knowledge, holding instead that “[i]t is apparent that they were aware that the income of the business was a material fact [for] which they had received no documentation. In entering into the contract with the
banks had a duty to disclose information regarding or gained from their business dealings with Enron, and that any reliance by Plaintiffs on misrepresentations by the Defendants was reasonable.” *Id.* See also Century Pacific, 528 F. Supp. 2d at 233, infra; Aaron Ferer & Sons Ltd. v. Chase Manhattan Bank, N.A., 731 F.2d 112, 123 (2d Cir. 1984) (stating that a party’s knowledge is not superior knowledge where relevant information “was disclosed, at least in part”).

**CONCLUSION**

Under New York law, a party with “superior knowledge” of material facts that are not readily available to its counterparty has a duty to disclose those facts. Indeed, except where sophisticated parties are involved, a disclaimer provision (or Big Boy) will not protect against the failure to disclose.

The “superior knowledge” rule, however, should not apply where a sophisticated counterparty is on notice that there are undisclosed, possibly material, facts. Where sophisticated parties, negotiating at arms length, agree to a Big Boy provision that affirms that each is entering the transaction notwithstanding that one party may have access to material nonpublic information that it will not disclose, a New York court is likely to reject the claim, especially if the Big Boy provision is specific about the type of information being withheld.

In *Banque Arabe*, the Second Circuit found that the parties’ participation agreement “operate[d] as a waiver absolving [defendant] of responsibility to make affirmative disclosures concerning the financial risks of the . . . Loan.” *Banque Arabe*, 57 F.3d at 155; see also *Banco Espanol de Credito v. Security Pacific Nat’l Bank*, 973 F.2d 51, 56 (2d Cir. 1992) (same). And finally, the court in *Unicredito Italiano SPA v. JPMorgan Chase Bank, J.P.*, 288 F. Supp. 2d 485, 498 (S.D.N.Y. 2003), dismissed plaintiffs’ fraud claims because “the contracts pursuant to which they made their Enron loan investments preclude them from establishing essential elements of those claims, namely, that the Defendant

assistance of counsel and without conducting an examination of the books and records, plaintiffs clearly assumed the risk that the documentation might not support the $20,000 weekly income that was represented to them.” *Id.* See also VO2Max, LLC v. Greenhouse Int’l, LLC, No. 0102624/2007, 2008 WL 4461402 (Trial Order) (N.Y. Sup. Ct. Sept. 24, 2008) (rejecting peculiar knowledge argument where party who was aware it was not receiving material information did not insist on receipt of the information prior to closing, but instead entered “as is” agreement that contained no representations or warranties about alleged material information).

Federal courts applying New York law have ruled similarly. For instance, in *DynCorp v. GTE Corp.*, DynCorp alleged that GTE gave “selective” disclosures that painted an inaccurate picture of the current and future profitability of the underlying transaction, but withheld information that the deal was behind schedule and losing money. *DynCorp*, 215 F. Supp. 2d 308, 320-21 (S.D.N.Y. 2002). The court rejected DynCorp’s fraud claim because DynCorp, having agreed to a disclaimer that specifically limited the amount of information it would receive from GTE, knew that “it had not received any warranty that the information was representative of the business” DynCorp intended to purchase. *DynCorp*, 215 F. Supp. 2d at 321. Further, DynCorp, as a sophisticated party to a major transaction, “could not avoid its disclaimer by complaining that it had received less than full information.” *Id.* at 321-22.
QUESTIONS
If you have questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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New York Court Enforces “Big Boy” Disclaimers in Credit Default Swap Transaction but Permits Novel Credit Rating Claim to Proceed

By Brian S. Fraser, Charles D. Thompson II and Tamala E. Newbold

A New York trial court recently enforced contractual disclaimers of reliance (“Big Boy” provisions) in a credit default swap (“CDS”) context. In MBIA Insurance Corp. v. Merrill Lynch, Pierce, Fenner & Smith Inc., No. 09-601324 (N.Y. Sup. Ct. Apr. 7, 2010), the court granted Merrill Lynch’s motion to dismiss plaintiffs’ fraudulent inducement, fraudulent omission and negligent misrepresentations claims.1 The court, however, let stand a breach of contract claim in which it was alleged that promised AAA-rated securities were not truly AAA-rated (even though they were so rated) – because they did not deserve the AAA rating.

BIG BOY

In earlier articles, we concluded that although a duty to disclose may arise in certain situations among sophisticated parties to an arms-length transaction, particularly where one party possesses superior knowledge that is not readily available to its counterparty, New York state and federal courts permit parties to contractually modify disclosure obligations. Superior Knowledge and the Duty to Disclose, October 8, 2009. We also examined the enforceability of “Big Boy” provisions in cases in which sophisticated parties specifically disclaim reliance on any representations by their counterparties and agree to conduct independent investigations prior to entering a transaction. Non-Reliance Provisions and Claims Of Insider Trading, November 2006.

The decision in MBIA Insurance Corp. v. Merrill Lynch pits MBIA’s argument that Merrill Lynch had a duty to disclose arising from its superior knowledge against Merrill Lynch’s defense based on the parties’ “Big Boy” provisions. The decision reaffirms our view that courts in New York will enforce specific disclaimers of reliance in arms-length transactions between sophisticated parties, particularly where the parties (1) disclaim both reliance and duty to disclose and (2) represent that each party will conduct its own independent investigation of the underlying transaction. The court in this case, however, did not address the precedent in which disclaimers were not enforced because the court found willful misconduct or intentional wrongdoing.2

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The facts in MBIA v. Merrill Lynch are as follows: MBIA’s subsidiary, LaCrosse Financial Products LLC (“Protection Seller”), entered into eleven credit default swaps with various counterparties (“Protection Buyers”) pursuant to which it sold protection on eleven purportedly “senior” and “super senior” tranches of four collateralized debt obligations (“CDOs”) with a total notional value of approximately $5.7 billion. With respect to each CDS contract, MBIA (“Financial Guarantor”) executed a Financial Guaranty Insurance Policy pursuant to which it guaranteed Protection Seller’s payment obligations to Protection Buyer under the related CDS contract. This is a standard structure for financial guarantees of structured products.

The documents that created each CDS included an ISDA Master Agreement, Schedule and a swap confirmation referencing the indenture pursuant to which the wrapped notes of the relevant CDO were issued. The Protection Seller had access to the offering circulars, pitch books and other material Merrill Lynch issued as arranger and marketer of the CDOs. Merrill Lynch also procured letters from rating agencies assigning credit ratings to each debt tranche of the CDOs.

MBIA and LaCrosse Financial sued Merrill Lynch seeking money damages and rescission of the credit default swaps, claiming that they relied, to their detriment, on various materials in entering the CDSs and guarantees that turned out to be false. In their First Amended Complaint, MBIA and LaCrosse Financial alleged that Merrill Lynch engaged in a fraudulent scheme to “offload billions of dollars of deteriorating U.S. subprime mortgages and other collateral that Merrill held on its books by packaging them into CDOs or hedging their exposure through swaps with insurers” and then marketing those “toxic assets” to plaintiffs. The truth, according to plaintiffs, was that by the closing date of the CDOs, the underlying collateral had degraded so significantly that MBIA, the Protection Seller, was exposed to an immediate risk of loss. MBIA claimed that as a result of Merrill Lynch’s alleged fraud, MBIA faced expected losses nearing a half-billion dollars.

The gist of plaintiffs’ duty to disclose argument was that Merrill Lynch, “as the arranger, broker-dealer, and warehouse provider for each of the CDOs at issue” had loan-level data that provided it with “real-time information concerning the declining credit quality of the collateral,” but that “Merrill Lynch did not disclose this superior knowledge to MBIA but instead marketed the CDS Contracts based on ratings, and related indicia of credit quality, that it knew to be false and misleading. Merrill Lynch did not disclose to MBIA that it knew the ratings were false or that it used alternative indicia of credit quality for its own books. In effect, Merrill Lynch sold the deals to MBIA based on one set of values—the ratings of the wrapped tranches and collateral—while marking its own books based on materially different valuations derived from loan-level performance data.”

Moreover, plaintiffs argued that “Merrill Lynch knew that it had procured the ratings on the basis of inadequate information—including its nondisclosure of the problems in loan-level performance—and that the ratings did not fairly reflect the actual credit quality of either the CDO tranches or the collateral.” As a result of Merrill Lynch’s alleged foregoing superior knowledge, plaintiffs claimed the offering materials fraudulently misrepresented (1) the “A- or above” credit quality of the collateral underlying the CDOs; (2) the “senior” or “super-senior” subordination protection of the insured CDO tranches; (3) the “AAA” ratings of the CDO tranches; and (4) the historical default rates of comparable CDOs.

The court granted Merrill Lynch’s motion to dismiss the fraudulent inducement, fraudulent omission and negligent misrepresentation claims based on the specific disclaimers in the parties’ agreements and the

3 Unless otherwise noted, the quotations herein relate to the Court’s Order entered April 7, 2010.
5 First Amended Complaint at ¶ 14.
offering materials. First, in each Financial Guaranty Insurance Policy (collectively, the “Guaranty”), MBIA waived all defenses to payment and also represented that it unconditionally and irrevocably guaranteed to Protection Buyer the full payment on behalf of LaCrosse Financial of any insured amount “without the assertion of any defenses to payment, including fraud in the inducement or fact.” Paragraph 12 of the Guaranty also contained a “sweeping disclaimer of reliance on, among other things, any assertion that MBIA (A) was not acting for its own account, (B) was not capable of assessing or understanding (on its own behalf or through independent professional advice) and accepting the terms, conditions and risks of issuing the Policy, (C) was not capable of assuming the risks of the Policy.”

LaCrosse Financial likewise specifically disclaimed reliance on Merrill Lynch and represented that it was capable of assessing and evaluating the transaction. For instance, the Schedule to the ISDA Master under which the swap confirmations between LaCrosse Financial and Merrill Lynch were executed specifically provided that LaCrosse Financial was “not relying on any advice, statements or recommendations (whether written or oral) of the other party regarding the Transaction, other than the written representations expressly made by that other party in this Agreement and in the Confirmation,” and that LaCrosse Financial had “the capacity to evaluate (internally or through independent professional advice) the Transaction (including decisions regarding the appropriateness or suitability of the Transaction) and has made its own decision to enter into the Transaction [.]” LaCrosse Financial further represented that it “acknowledges and agrees that [Merrill Lynch] is not acting as a fiduciary or advisor to it in connection with the Transaction.”

Notwithstanding the various disclaimers in their agreements and offering materials, plaintiffs argued that their reliance on Merrill Lynch was justified and reasonable because “it was not customary, and would have been very unusual, for any buyer or any credit protection provider at the super-senior level to value complex CDOs by assessing the thousands of underlying securities and the tens or hundreds of thousands of underlying loans, in order to verify whether the arranger’s representations of credit quality were truthful.”6 Plaintiffs further alleged that the “buyside industry standard approach to evaluating senior debt tranches of complex and illiquid CDOs . . . was (1) due diligence of the expertise and integrity of the arranger and collateral manager...”7

The court rejected plaintiffs’ reliance arguments based on long-standing precedent,8 holding that to allow MBIA and LaCrosse Financial “to now disavow their express and specific promise not to raise the affirmative defense of fraud would be to allow them to condone [their] own fraud in deliberately misrepresenting their true intention when putting their signatures to their “absolute and unconditional” guarantee.” In addition, the court cited precedent9 which held that a specific disclaimer in a guarantee bars the guarantor’s claim for fraud in the inducement where the guarantor specifically disclaims reliance on the information it claims caused it to be misled. The court also stressed that clauses that declare an agreement unconditional and absolute and waive affirmative defenses (such as those in the Guaranty) “reinforc[e] the specificity of the disclaimer.” The court found the disclaimers in the Guaranty sufficiently specific to withstand challenge, especially in light of the fact that the disclaimers “were the product of intensive negotiations among the parties, whose sophistication and business acumen and experience cannot be overstated.” Ultimately, the court dismissed plaintiffs’ claims for fraud in the inducement, fraud by omission and negligent misrepresentation, “all of which require a claim of reasonable reliance on representations plaintiffs expressly stated they were not relying on.”

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6 First Amended Complaint at ¶ 10. 
7 First Amended Complaint at ¶¶ 10, 62. 
8 Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 323 (1959). 
“UNDERSERVED” AAA RATINGS

One important aspect of MBIA’s complaint remains viable. MBIA claimed that Merrill, through its subsidiary Merrill Lynch International (“MLI”), breached promises in the CDS contracts to deliver securities that were AAA rated with senior or super senior subordination characteristics. Specifically, plaintiffs alleged that although the securities were rated AAA, the credit-quality of the collateral underlying the securities “did not warrant their AAA-ratings and did not have the levels of subordination represented by Defendant MLI.” 10 The court held that plaintiffs stated a claim for breach of contract on the “bogus” credit ratings because “plaintiffs had a right to expect that the AAA ratings were backed by intelligence which could verify that the notes were actually of the “credit quality” an AAA rating implied.”

As far as we know, this is the first time a court has held that a defendant faces potential liability for stating that securities were AAA rated when they were in fact AAA rated but it later turns out that the third-party rating agency should not have rated them AAA.

Finally, the court held that plaintiffs failed to plead breach of contract on the subordination issue because none of the documents that formed the parties’ agreements contained an express right to any fixed level of subordination. The court dismissed the remaining causes of action as duplicative, or for failure to state a recognizable cause of action. Plaintiffs are appealing the decision.

QUESTIONS

If you have questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or the person listed below.

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10 First Amended Complaint at ¶ 96.
Big Boy Update: Recent New York Case Demonstrates Limits of Big Boy Provisions Where Affirmative Acts of Concealment Are Alleged

By Brian S. Fraser and Tamala E. Newbold

Courts in New York routinely dismiss complaints alleging fraud in connection with transactions between sophisticated parties where the parties have agreed, pre dispute, to a specific disclaimer of reliance on any misrepresentations or omissions by either party in the course of negotiating or entering into the transaction. Such disclaimers are commonly known as “Big Boy” provisions. See generally Brian S. Fraser and Tamala E. Newbold, Who’s a Big Boy? Non-Reliance Provisions And Claims Of Insider Trading In Securities And Non-Securities Markets. New York courts, however, will not enforce such disclaimers of reliance where the complaining party can demonstrate that its claims are based on facts peculiarly within the knowledge of the non-disclosing party, so that reasonable diligence could not have uncovered the undisclosed information. Who’s a Big Boy? at 12. Courts applying New York law generally hold that knowledge is “peculiar” where (among other circumstances) the defendant withholds facts about its own fraudulent transactions or conduct that affect the value of the subject matter. Brian S. Fraser and Tamala E. Newbold, Who’s a Big Boy II: Superior Knowledge and the Duty to Disclose at 6.

The recent decision in Harbinger Capital Partners v. Wachovia Capital Markets LLC, 27 Misc.3d 1236(A), 2010 WL 2431613 (N.Y. Sup. May 10, 2010) reaffirms the reluctance of New York courts to enforce disclaimers of reliance, even between sophisticated parties and even where the disclaimer is specific, where it is alleged that the non disclosing party itself engaged in fraudulent conduct or actively concealed the information alleged to have been withheld. The Plaintiffs in Harbinger sued Wachovia Capital Markets LLC (“WCM” or “Wachovia”) in connection with a $285 million syndicated loan for beverage manufacturer Le Nature’s, Inc. (“Le Nature’s”) in September 2006. Wachovia arranged the loan just two months before Le Nature’s’ creditors placed the company in involuntary bankruptcy. Le Nature’s’ 2005 financial statements reported net sales of more than $275 million. However, a bankruptcy trustee subsequently determined that actual revenues were almost 90% lower than what had been reported.

The Plaintiffs were sophisticated lenders who purchased an interest in the loans either directly from Wachovia or in the secondary market. Plaintiffs alleged that Wachovia knew that Le Nature’s was engaged in fraud; specifically that Wachovia
knew (i) that Le Nature’s was unable to make timely interest payments; (ii) that Le Nature’s reported sales data was inaccurate; (iii) that a special committee’s investigation into the abrupt resignation of Le Nature’s CFO and several other senior officers identified serious issues with the company’s financial reporting; and (iv) that Le Nature’s products were being pulled from stores.

Most importantly, however, Plaintiffs alleged that, in an effort to conceal Le Nature’s inability to pay interest on its existing credit facilities, Wachovia, through its affiliate Wachovia Bank, “fronted” interest payments to syndicate lenders by paying out interest without having received payment from Le Nature’s. Plaintiffs claimed that this “fronting” constituted a misrepresentation of Le Nature’s financial condition, that it was peculiarly within Wachovia’s knowledge, and that they would not have made or acquired the loans had Wachovia disclosed the information.

Wachovia moved to dismiss on grounds that plaintiffs’ purported reliance on the alleged misrepresentations or omissions was unreasonable as a matter of law, based on the express disclaimers in the parties’ credit agreement. Wachovia also argued that it had no duty to disclose information about Le Nature’s financial condition to lenders because, in addition to the disclaimers of reliance, the credit agreement also disclaimed any duty or responsibility on Wachovia’s part “to provide any Lender with any credit or other information concerning the business, operations, condition (financial or otherwise), prospects or creditworthiness” of Le Nature’s which may come into the possession of Wachovia or its affiliates.

In support of its motion to dismiss the complaint, Wachovia relied heavily on UniCredito Italiano SPA v. JPMorgan Chase Bank, 288 F. Supp. 2d 485, 498 (S.D.N.Y. 2003), in which plaintiffs, sophisticated Italian and Polish financial institutions, alleged that JP Morgan Chase ("Chase") and Citigroup had defrauded them in connection with the formation of and payment under certain Enron-related syndicated credit facilities for which Citigroup and Chase served as co-administrative agents. The loan agreement precluded plaintiffs from claiming that they relied on any alleged representations by Chase or Citigroup, and absolved defendants of any responsibility to make disclosures regarding the financial risks of the transaction. The court dismissed plaintiffs’ fraud and negligent misrepresentation claims on grounds that “the contracts pursuant to which they made their Enron loan investments preclude them from establishing essential elements of those claims, namely, that the Defendant banks had a duty to disclose information regarding or gained from their business dealings with Enron, and that any reliance by Plaintiffs on misrepresentations by the Defendants was reasonable.” Id. The UniCredito court likewise refused to apply the peculiar knowledge exception, holding that “[e]xtension of the peculiar knowledge exception to defeat contractual allocation of risks away from Defendant banks in this case because the principal (Enron) was so adept at concealment of its fraud would require at a minimum some factual basis for finding reasonable Plaintiffs’ reliance on parties on whom it agreed it would not rely in any respect in making the operative decisions.” Id. at 501.

The Harbinger court, however, rejected the comparison with the UniCredito case and, on May 10, 2010, denied Wachovia’s motion to dismiss plaintiffs’ fraud claim. The court held that, although the disclaimers in the credit agreement were sufficiently specific, dismissal was inappropriate because plaintiffs’ complaint adequately invoked the “peculiar knowledge” and “superior knowledge” doctrines. The court declined to apply UniCredito and other New York cases like it because Plaintiffs alleged that Wachovia, through its affiliate Wachovia Bank, “actively prevented any possibility that lenders could have discovered Le Nature’s true financial condition” by covertly fronting Le Nature’s interest payments to syndicate lenders in order to conceal the fact that Le Nature’s was not able to make timely interest payments. Harbinger Capital Partners LLC, 2010 WL 2431613, at *7. Accepting the allegations as true, as it
must on a motion to dismiss, the court found that even though plaintiffs were sophisticated investors to whom the Credit Agreement granted broad access to Le Nature’s’ financial information and employees, it was not apparent at the motion to dismiss stage whether “the true nature of the situation” would have been revealed even upon inspection, and there was no way of knowing the degree of effort necessary to discern the truth.  Id.

New York state and federal courts have held many times that the peculiar knowledge exception does not apply in situations where a sophisticated party agrees to perform its own due diligence and knows that it is not receiving full information.  Courts in New York also hold, however, that information about a defendants’ own fraudulent transactions or conduct that affects the value of the subject matter of the transaction must be disclosed because “[b]y its nature, this information is of the type that was in defendants’ possession, not at plaintiff’s fingertips, and which, one can envision, defendants would have desired to keep close to the chest.”  See Nomura Sec. Int’l, Inc. v. E*Trade Sec., Inc., 280 F. Supp. 2d 184, 206 (S.D.N.Y. 2003).  The Harbinger plaintiffs’ allegations, at least at the pleading stage, arguably meet this standard.

Wachovia has filed a Notice of Appeal and seeks to have the trial court’s decision reversed.  Whatever the outcome after an appeal, the Harbinger case should not affect current practices regarding Big Boy letters between sophisticated parties.  Specific, detailed disclaimers that closely track the terms of a transaction remain useful in most non-securities transactions.  Harbinger simply reinforces the long held view in New York that contractual disclaimers of reliance cannot serve to shield intentionally fraudulent conduct.

QUESTIONS
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trademark infringement in violation of Section 32 of the Lanham Act, 15 U.S.C. § 1114, false designation of origin in violation of Section 43(a) of the Act, 15 U.S.C. § 1125(a), common law trademark infringement and unfair competition, and the violation of New York General Business Law Sections 360–l and 349, for which the Court awards GTFM $5,304,387 representing Solid’s profits for its infringing sales and $1,419,459 representing GTFM’s lost profits, for a total of $6,723,846. A verdict is given for the defendant on the plaintiff’s remaining claims.

GTFM’s motion to preclude certain evidence is denied. A verdict is rendered in favor of the plaintiffs on Solid’s counterclaim seeking the cancellation of GTFM’s registration of the “05” trademark.

GTFM shall submit within two weeks of the date of this Opinion an application for the amount of its fees and costs, a request for prejudgment interest, and an appropriate Order of injunction. Solid shall submit any opposition to that submission within two weeks of plaintiffs’ submission.

SO ORDERED.

DYNCORP, Plaintiff,

v.

GTE CORPORATION, Defendant.

No. 01 Civ. 7445(AKH).

United States District Court,
S.D. New York.

July 17, 2002.

Buyer of corporation providing telecommunications and information services sued guarantor of seller, alleging breach of contract and fraud. Guarantor moved to dismiss. The District Court, Hellerstein, J., held that: (1) buyer would be given additional opportunity to allege it had made claims prior to expiration of contractual limitations periods; (2) contractual liability limitations provisions were valid, despite buyer’s claim that breaches were intentional rather than involuntary; (3) guarantor’s liability was limited to breaches of representations, warranties and covenants of agreement; (4) contractual disclaimers of reliance on any warranties or representations not contained in contract precluded fraud in inducement claims; (5) no fraud claims could be based on breaches of express representations and warranties, due to exclusivity of contract remedies; (6) fraud claims could be maintained for period between signing of contract and closing; and (7) there was no negligent misrepresentation.

Complaint dismissed with permission to replead.

1. Limitation of Actions ⊑14

Under New York law, the parties to a contract may agree to shorten the period of limitations within which an action must be commenced.

2. Damages ⊑76

Under New York law, sophisticated parties with equal bargaining power can agree to limit the liability that the other may recover from a breach of contract.

3. Damages ⊑85

Limitations of liability for breach of contract, governing purchase of corporation providing telecommunications and information services, were applicable under New York law despite claim that breaches by seller and its guarantor were willful rather than involuntary.

4. Guaranty ⊑36(5)

Limitation of liability of seller’s guarantor, to breaches of representations and
warranties and breaches of covenants contained in agreement for purchase of corporation providing telecommunications and information services, precluded breach of contract claims under New York law based on other allegedly wrongful behavior on part of seller or guarantor.

5. Fraud ⇐23

Buyer could not show reliance necessary for fraudulent inducement claim on alleged precontractual misrepresentations when purchase agreement stated seller made no express or implied representation or warranty with respect to business being sold or information provided to seller, and buyer acknowledged that seller would not be liable for any information made available to seller.

6. Fraud ⇐23, 36

Buyer could not recover for fraud based on alleged misrepresentations concerning facts of which seller had peculiar knowledge, when buyer knew information provided to it by seller was selective, buyer did not receive any warranty that information seller provided was representative of business, buyer disclaimed reliance on information it received from seller, and buyer could have negotiated more complete representations.

7. Fraud ⇐14

Under New York law, a claim of fraud for breaching representations and warranties provided by a contract is not legally sufficient unless the complaining party can (1) demonstrate a legal duty separate from the duty to perform under the contract, (2) demonstrate a fraudulent misrepresentation or breach collateral or extraneous to the contract, or (3) seek special damages that are caused by the misrepresentations and breaches and are unrecoverable as contract damages.

8. Fraud ⇐14, 32

Under New York law, buyer of corporation providing telecommunications and information services could not maintain fraud claims based on breaches of representations and warranties contained in purchase agreement; no legal duties were asserted other than those rising under contract, there were no allegations of fraudulent misrepresentation or breach collateral or extraneous to contract, and contract barred any special damages which could sustain fraud claim.

9. Fraud ⇐32

Buyer of corporation providing telecommunications and information services could maintain fraud claims, under New York law, arising from alleged misrepresentations contained in financial reports and management discussions and analyses of acquired corporation’s business, required by contractual covenant to be furnished to buyer during period between signing of purchase agreement and closing date; purchase contract did not prohibit reliance on information and reports provided during period in question.

10. Fraud ⇐36

Buyer of corporation providing telecommunications and information services could not maintain negligent misrepresentation suit, under New York law, against seller and guarantor; contractual provision limiting liability for misrepresentations to those expressly contained in agreement barred liability for misrepresentations made prior to signing of purchase contract, and absence of required special relationship between parties barred any claim arising from alleged misrepresentations made between signing of contract and closing.

William J. McSherry, Jr., Daniel C. Savitt, Arent, Fox, Kintner, Plotkin & Kahn, PLLC, New York City, for Plaintiff.
OPINION AND ORDER PARTIALLY GRANTING MOTION TO DISMISS AND GRANTING LEAVE TO AMEND

HELLERSTEIN, District Judge.

Plaintiff DynCorp filed this suit against defendant GTE Corporation, claiming fraud, breach of contract, and other wrongs in connection with defendant’s sale of a business to plaintiff, and seeking recovery in excess of $100 million in compensatory damages, and punitive damages. GTE Corporation moves to dismiss the complaint and for related relief pursuant to Federal Rule of Civil Procedure 12(b)(6), on the ground that the parties are bound by the terms and conditions of their Purchase Agreement dated as of October 29, 1999. I hold that the agreement made by the parties, which defined and allocated their rights, obligations, risks and limits of recovery in the event of breach of the representations, warranties and covenants contained in the Agreement, provides the grounds upon which plaintiff may sue and recover, and I dismiss the complaint insofar as it exceeds those grounds. I grant plaintiff leave to amend its complaint to conform to the rulings expressed in this Opinion and Order.

I. The Purchase Agreement of October 29, 1999

In June 1999, GTE sold most of the assets of its wholly owned subsidiary, GTE Government Systems Corporation, to General Dynamics Corporation, and spun-off and separately organized the remaining assets. GTE contributed the (spun-off) assets, those not sold to General Dynamics, to a limited liability company, GTE Information Systems LLC (“GTE Information”). In September 1999, GTE transferred its ownership interests in GTE Information to Contel Federal Systems, Inc. (“Contel”), another wholly-owned subsidiary of GTE. The business of GTE Information was to provide telecommunications and information services to government and commercial customers, domestically and internationally.

Contel then sold GTE Information to DynCorp. As of October 29, 1999, DynCorp and Contel entered into a Purchase Agreement, whereby DynCorp agreed to buy, and Contel agreed to sell, all Contel’s ownership interests in GTE Information. GTE Corporation (“GTE”), the defendant, agreed to “join in” the transaction to the extent set forth in a schedule to the agreement: essentially, GTE agreed not to compete with DynCorp in relation to the business being sold, and to guarantee Contel’s performance of certain indemnification obligations that were set out in Article IX of the Purchase Agreement. The transaction was to close on November 29, 1999, subject to various conditions set out in Article VII of the Purchase Agreement: notably, the absence of a governmental restraint, the obtaining of necessary regulatory approvals and, important to this case, compliance by Contel as Seller with Section 7.2 of the Purchase Agreement. Section 7.2 provided:

(a) . . . the representations and warranties of Seller contained [in the Purchase Agreement] . . . shall be true and correct in all material respects . . . on the date of [the Purchase Agreement] and on the Closing Date . . .

(b) . . . Seller shall have in all material respects performed all obligations and complied with all covenants set forth in [the Purchase Agreement] which are required to be performed or complied with by it at or prior to the Closing . . .

(e) . . . there shall not have been any change in or event affecting the Company [GTE Information] that constitutes a Material Adverse Circumstance . . .

Material Adverse Circumstance was defined as “any fact, circumstance or condi-
tion” that would “(a) have a material adverse effect on the Business, or on the operations, assets, or financial condition of [GTE Information]” or “(b) . . . result in a loss, liability or obligation . . . having a monetary effect greater than $500,000.”

The representations and warranties of the Seller, Contel, referenced in Section 7.2(a), were set out in Article II of the Purchase Agreement. Pursuant to Section 2.3, Contel represented and warranted:

(a) the audited balance sheet . . . and the related statements of income, parent company investment, and cash flows for the year ended December 31, 1998 . . . have been prepared from the books and records of the Company [GTE Information] and Government Systems [the GTE Division prior to the sale of assets to General Dynamics and the contribution of assets to GTE Information] in accordance with GAAP and present fairly, in all material respects, the financial condition and the results of operations of the Business as of the date, and for the period, thereon referenced.1

(b) Except as set forth on Schedule 2.3(b), since December 31, 1988, there has not been, occurred or arisen any change or event affecting [GTE Information] that constitutes a Material Adverse Circumstance . . . .

(c) . . . Except as set forth on Schedule 2.3(c), as of the date hereof, [GTE Information] has not incurred any [] liabilities in excess of $100,000 . . . .

(d) . . . The Adjusted Net Assets of [GTE Information], determined in accordance with GAAP consistently applied . . . shall be no less than $41,000,000 as of the Closing Date.

Contel also represented and warranted, with respect to GTE Information’s contracts with the government, that no notice of termination for default, or notice for cure or show cause was in effect or threatened. (Purchase Agreement, § 2.20).

In Article III of the Purchase Agreement, setting out the representations and warranties of the Buyer, DynCorp disclaimed reliance on any representations or warranties by Contel or its affiliates (including GTE) other than those provided in the Purchase Agreement. Thus, DynCorp represented and warranted that it relied, in entering into the Purchase Agreement, not on the mix of data and information supplied to it by GTE and Contel with respect to which it performed its investigating and due diligence work, but only on the “representations and warranties contained in [the Purchase Agreement].” Section 3.8, reflecting DynCorp’s disclaimers, provides:

Except for the representations and warranties contained in this Agreement, Buyer acknowledges that [the] Seller . . . makes no express or implied representation or warranty with respect to the . . . Company [GTE Information], the Business [the business that Contel is selling and that DynCorp is buying] or otherwise or with respect to any other information provided to Buyer, . . . including as to (a) merchantability or fitness for any particular use or purpose, (b) the operation of the Business by Buyer after the Closing in any manner other than as used and operated by Seller or (c) the probable success or profitability of the ownership, use or operation of the Business by Buyer after the Closing.

Section 3.8 provided also that GTE and Contel were not to be liable to DynCorp because of representations made, or information or data given, before DynCorp and

1. The financial statements were for GTE Government Systems Corporation as of December 31, 1998, prior to the sale of most of its assets to General Dynamics, and prior to the spin-off of the remaining business and assets to GTE Information and Contel.
Contel entered into the Purchase Agreement:

Neither Seller nor any other Person will have or be subject to any liability or indemnification obligation to Buyer or any other Person resulting from the distribution to Buyer, or Buyer’s use of, any such information, including the Confidential Offering Memorandum dated July 1999 . . . related to the Business and any information, documents or material made available to the Buyer in certain “data rooms,” management presentations, functional “break-out” discussions, responses to questions submitted on behalf of Buyer, whether orally or in writing, or in any other form in expectation of the transactions contemplated by this agreement.

Article IV of the Purchase Agreement added covenants relating to the period between the effective date of the Purchase Agreement, October 29, 1999, and the Closing, expected to occur a month later, on November 29, 1999.2 Pursuant to Section 4.1, Contel covenanted that DynCorp and its experts would have access to the books and records of the business being sold, “and all other information with respect to the Business as [DynCorp] may from time to time reasonably request . . . .” Pursuant to Section 4.2, Contel covenanted to make available to DynCorp monthly unaudited balance sheets and income statements for GTE Information, and “a written management discussion and analysis of the Company’s financial condition and results of operations consistent with the Company’s and its predecessor’s past practices . . . prepared in accordance with the past practices of the Company consistently applied.” Pursuant to Section 5.7 of the Purchasing Agreement, as a “Continuing Covenant,” Contel covenanted to deliver audited balance sheets and related statements of income and cash flows for

the GTE Information Systems Division for the year ended December 31, 1997 (two years before the transaction with General Dynamics and the separate organization of GTE Information), and an unaudited balance sheet and related statements of income and cash flows for the Information Systems Division for the nine months ended September 30, 1999.

Article IX of the Purchase Agreement provided the parties’ rights and obligations, and limited the remedies, with respect to “Indemnifiable Losses,” defined broadly by the Purchase Agreement as “any cost, damage, disbursement, expense, liability, loss, deficiency,” etc. Pursuant to Section 9.1, Contel, joined by GTE, agreed to “defend, indemnify and hold harmless” DynCorp (and associated companies and employees) against “any and all Indemnifiable Losses based upon or arising from” (a) “any inaccuracy in any of the representations and warranties made by Seller on the Closing Date with respect to [the Purchase] Agreement,” and (b) “any breach or nonperformance of any of the covenants of Seller contained in [the Purchase] Agreement . . . .”

Section 9.4 limited the duration of the representations and warranties, and of the covenants, with respect to which indemnification claims may be made, to 545 days in the case of representations and warranties, and one year in the case of covenants. If, however, a claim had been asserted and remained unresolved, the duration period was to be extended. Thus, Section 9.4 provided:

Any matter as to which a claim has been asserted by notice to the other party that is pending or unresolved at the end of any applicable limitation period shall continue to be covered by this Article IX . . . until such matter is finally terminat-

ed or otherwise resolved by the parties under [the Purchase] Agreement. Notices and communications called for by the agreement were to be in writing. (Purchase Agreement, § 10.14).

Section 9.5 limited potential recoveries. Section 9.5 provided that Contel and GTE were not required to pay any Indemnifiable Loss which, in the aggregate, was less than 1.5% or that exceeded 15% of the Purchase Price of $165 million—damages, that is, had to exceed a threshold of $2,475,000 and could not exceed $24,750,000:

Seller shall not be required to indemnify any Person under Section 9.1(a) unless the aggregate of all amounts for which indemnity would otherwise be payable by Seller exceeds 1.5% of the Purchase Price, and in such event, Seller shall be responsible for only the amount in excess of such 1.5% of the Purchase Price. In no event shall the total indemnification to be paid by Seller under this Article IX exceed 15% of the Purchase Price.

Recoveries were further limited to “actual damages sustained by the Indemnified Party by reason of such breach or nonperformance . . . net of any insurance proceeds and Net Tax Benefits.” The Purchase Agreement provided that the limited indemnification remedy of Article IX was to be “the sole and exclusive remedy for any post-Closing claims . . . made for breach of a representation or warranty,” but was not to be the “exclusive remedy for claims arising out of . . . any covenant under this Agreement.” (Purchase Agreement, § 9.7). And there could be no recovery for consequential, special or punitive damages, or loss of future income or business opportunity. Thus, Section 10.12 provided:

Notwithstanding anything to the contrary elsewhere in [the Purchase] Agreement, no party (or its Affiliates) shall, in any event, be liable to the other party (or its Affiliates) for any consequential, special or punitive damages, including loss of future revenue or income, or loss of business reputation or opportunity relating to the breach or alleged breach of [the Purchase] Agreement.

The governing law was to be New York law (Purchase Agreement, § 10.5), and any litigation “arising under or in connection with [the Purchase] Agreement” was to be brought in the state or federal courts in the County of New York (Purchase Agreement, § 10.21). The Purchase Agreement also contained an integration clause:

the [Purchase] Agreement, the Confidentiality Agreement and the Related Agreements, together with the schedules and exhibits thereto, (i) constitute the entire agreement among the parties pertaining to the subject matter hereof and (ii) supersede all prior agreements and understandings of the parties in connection therewith . . . .

II. Plaintiff’s Allegations of Negotiations and Breach

The complaint, covering 24 pages, 64 paragraphs and 16 exhibits, alleges a narrative relating the origin of GTE Information, its organization, the negotiations between GTE, Contel, and DynCorp, and the ultimate sale to DynCorp of GTE Information. Plaintiff alleges that defendant deceived it at every turn, and that plaintiff should therefore recover damages that compensate it for its loss, and reward it with punitive damages because of the egregious nature of defendant’s conduct. Plaintiff alleges three theories that authorize a recovery—contract, fraud and negligence—and alleges and realleges each and all the allegations of its narrative as the basis of each of its three claims of relief.
A. Background of Sale

In mid–1999, DynCorp and GTE began negotiations to purchase and sell GTE Information. GTE gave DynCorp an Offering Memorandum, dated July 1999, which discussed its contracts, customers, results of operations, and projected revenues and profit margins. GTE also gave DynCorp access to a “data room” containing selected financial and other information about the business, and employees of GTE added to this information by discussions of the activities, revenues and future prospects of the business. On September 1, 1999, GTE transferred ownership of GTE Information to Contel Federal Systems, Inc. (“Contel”), a wholly owned subsidiary of GTE with no employees. On October 29, 1999, DynCorp and Contel entered into the Purchase Agreement.

B. GTE’s Alleged Pre–Contract Misrepresentations

DynCorp alleges that GTE misled it about the current and future values and profitability of GTE Information. In particular, DynCorp alleges that GTE intentionally misrepresented the value of a major contract it had with the United States Bureau of Prisons to provide telephone service to inmates (“the BOPITS II contract”), representing that BOPITS II was and would continue to be profitable, and concealing information which would have shown that BOPITS II was unprofitable and experiencing serious problems. DynCorp alleges that as of the end of August 1999, GTE Information had installed only 17 of 54 scheduled sites, that call volume and revenues were lower than expected, and that an internal review found serious customer dissatisfaction, poor management and inadequate personnel resources. DynCorp alleges that GTE Information management had determined, by November 10, 1999, that the BOPITS II contract could not be profitable unless concessions were negotiated with the Bureau of Prisons concerning call volume and pricing. DynCorp alleges that these adverse conditions were not disclosed to it, neither at the time the Purchase Agreement was executed nor prior to closing, and that GTE throughout represented that the BOPITS II contract was and would continue to be profitable and provided misleading financial information to substantiate its false representations.

C. GTE’s Alleged Breaches of Warranties and Covenants

DynCorp alleges that GTE’s representations and warranties provided in the Purchase Agreement—that the financial statements pertaining to GTE Information fairly reflected its financial condition and results of operations, that there were no material adverse changes or material undisclosed liabilities, and that adjusted net value at closing would be $41 million—were false and fraudulent, that GTE knew that when it executed the contract, and that DynCorp relied to its detriment.

D. GTE’s Alleged Misrepresentations Post–Contract and Prior to Closing

DynCorp alleges that GTE continued to provide false information about GTE Information and the BOPITS II contract after the Purchase Agreement was executed and prior to closing. DynCorp alleges that the October Financial Summary as of October 31, 1999, provided by GTE on November 24, 1999, failed to disclose losses associated with the BOPITS II contract and overstated net worth, and that GTE’s explanations for poorer than expected performance were also false. DynCorp alleges also that information GTE was required to provide under Sections 4.1 and 4.2 of the Purchase Agreement—monthly unaudited balance sheets and income statements and management discussions and analyses of GTE Information’s financial
condition and results of operations—were also false in material respects, masked fur-
ther undisclosed losses, and misstated the business and financial condition of GTE
Information.

E. DynCorp’s Theories of Action and Alleged Damages

DynCorp alleges three claims for relief, and realleges all its allegations of fact in
each count, not making any effort to catego-
riize them according to materiality or legal effect. Count One, for breach of
contract, alleges that GTE’s misrepresen-
tations concerning BOPITS II and the
overall value of GTE Information consti-
tuted material breaches of the representa-
tions and warranties of Section 2.3 of the
Purchase Agreement, and of the covenants
of Sections 4.1 and 4.2 of the Purchase
Agreement. Count Two, for fraud, alleges
that GTE knowingly and fraudulently
made its misrepresentations, before and at
the time the Purchase Agreement was ex-
ecuted and again, prior to and at closing,
that the misrepresentations were material,
and that DynCorp relied on them. Count
Three, for negligent misrepresentation,
al-
leges that GTE made its misrepresen-
tations negligently.

DynCorp alleges that it suffered, and
claims to recover, damages of $100 million,
including the costs of restructuring GTE
Information’s debt, $1.8 million of note
prepayment costs, $10 million in surren-
dered shares, $11 million in transactional
expenses, $8 million in additional interest
costs, $2.5 million in advisory services, and
$24.5 million in interest paid. DynCorp
also seeks punitive damages.

GTE’s motion attacks the legal sufficien-
cy of DynCorp’s claims, even assuming
that they can be proved.

III. Discussion

A. Rule 12(b)(6) Standards

On a motion to dismiss under Rule
12(b)(6), Fed.R.Civ.P. 12(b)(6), all material
allegations of the complaint are to be ac-
tcepted as true, and all reasonable infer-
ences are to be drawn in favor of the
Stock Exchange, Inc., 258 F.3d 93, 99 (2d
Cir.2001). However, if “it appears beyond
doubt that the plaintiff can prove no set of
facts in support of his claim that would
entitle him to relief,” the complaint should
be dismissed. Id. The court may consider
documents referenced in the complaint, as
well as its allegations. Brass v. American
Film Technologies, Inc., 987 F.2d 142, 150
(2d Cir.1993). Furthermore, since the in-
terpretation of a contract generally is a
question of law to be determined by the
court, United States v. Liranzo, 944 F.2d
73, 77 (2d Cir.1991), the court may dismiss
a complaint based on a contract if the
contract unambiguously shows that the
plaintiff is not entitled to the requested
relief. Marketing/Trademark Consul-
tants, Inc. v. Caterpillar, Inc., No. 98 Civ.
2570(AGS), 2000 WL 648162, at *3
(S.D.N.Y. May 19, 2000).

B. The Breach of Contract Claims
Against GTE

DynCorp alleges its claim of breach of
contract, not against Contel, the party with
which DynCorp is in privity, but against
GTE, Contel’s parent. In the absence of a
claim that GTE is liable for the acts of its
subsidiary, GTE’s may be liable only on
the extent it joined the Purchase Agree-
ment. It “joined” “solely . . . for the pur-
pose of guaranteeing the performance by
Seller [Contel] of its obligations under Ar-
ticle IX of [the Purchase] Agreement.”

Article IX, Section 9.1, requires Contel
to indemnify DynCorp from “any and all
Indemnifiable Losses,” that is, for Dyn-
Corp’s damages and expenses (a) “based on or arising from any inaccuracy in any of the representations and warranties made by Seller [Contel] on the Closing Date in or pursuant to [the Purchase] Agreement” or (b) “based upon or arising from any breach or nonperformance of any of the covenants of Seller contained in [the Purchase] Agreement.” GTE guaranteed those obligations of Contel. However, the representations, warranties, and covenants binding Contel and GTE are time limited. The representations and warranties expire on “11:59 p.m. on the 545th day following the closing date,” that is, on June 7, 2001, while the Article IV covenants are time limited “for one year” that is, until December 10, 2000. These limits do not apply, however, to “any matter” as to which a claim has been asserted and remains “pending or unresolved.” (Purchase Agreement, §§ 9.4, 9.7). The immediate issue, therefore, is whether or not the contractual time limitations expired before DynCorp made claim or filed suit.

1. The Issue of Timeliness

[1] Under New York law, the parties to a contract may agree to shorten the period of limitations within which an action must be commenced. See Incorporated Village of Saltaire v. Zagata, 280 A.D.2d 547, 547–48, 720 N.Y.S.2d 200 (2d Dep’t 2001). Although a defendant may raise the affirmative defense that the plaintiff’s claim is time-barred on a 12(b)(6) motion to dismiss, a court may grant such a motion only if it is clear from the face of the complaint that the action was not timely-filed. Ghartey v. St. John’s Queens Hosp., 869 F.2d 160, 162 (2d Cir.1989). Since DynCorp filed this suit on August 10, 2001—two months after the Section 2.3 representations and warranties and eight months after the Section 4.1 and 4.2 covenants appear to have expired—and did not allege that it previously made claim that any such representations, warranties or covenants had been breached and that such claim remained unresolved, the breach of contract action against GTE must be dismissed.

However, DynCorp has requested leave to amend its complaint to allege that it made timely claim that the representations and warranties provided by Section 2.3, and the covenants provided by Sections 4.1 and 4.2, were breached. DynCorp proposes to allege that “in a series of extensive communications, both written and oral . . . beginning as early as December 1, 2000, DynCorp timely gave notice to GTE concerning the matters as to which a claim has been asserted in this lawsuit . . . .” DynCorp also refers to its letter to GTE of March 8, 2001, enclosing a draft complaint, and argues that this also constituted timely notice of claim. GTE disputes the legal sufficiency of DynCorp’s submissions, and argues that notice was not sufficiently specific, for Section 9.4 provides for an enlargement of time, beyond the 545 and one-year period provided by Article IX of the Purchase Agreement, only as to “matter[s]” as to which a claim was asserted and remains “pending or unresolved.”

I grant leave to DynCorp to add allegations of timely notice to an amended complaint. Since Section 9.4 provides different periods of limitation for claims of breach of Section 2.3 representations and warranties, and for Sections 4.1 and 4.2 covenants, DynCorp shall allege, specifically for each such section, such notices as it claims to have given. And since Section 10.14 provides that notice shall be given in writing, DynCorp’s amendment shall clearly allege and attach the written notices that it alleges were timely given. Defendant’s argument relating to inadequacy of notice is premature at this early stage because it depends on factual allegations not referenced in the complaint, see Chambers v. Time Warner, Inc., 282 F.3d 147,
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Cite as 215 F.Supp.2d 308 (S.D.N.Y. 2002)

§ 9.5). In addition, the damages must be “actual damages,” sustained “by reason of such breach or nonperformance” of the Section 2.3 representations and warranties and Sections 4.1 and 4.2 covenants, (id.) and not “consequential, special or punitive damages.” (Id., § 10.12).


[3] DynCorp argues that the limitation of liability provisions should not be enforced if the breach was fraudulent, willful or grossly negligent, citing AT & T, 833 F.Supp. at 989–90, Ally Gargano/MCA Ad-

153–54 (2d Cir.2002), but may be raised by motion at a later time.3

DynCorp argues that since Section 9.7 of the Purchase Agreement provides that the remedy provided by Article IX is the “sole and exclusive” remedy for “post-Closing claims . . . made for breach of a representation or warranty”, but is not the “exclusive” remedy for breach of “any covenant under this Agreement,” the short period of limitations provided by Section 9.4 of Article IX should not bar its claim. The argument lacks merit. GTE, since it is not in contractual privity with DynCorp, is potentially liable to it for breach of contract only to the extent that GTE “joined” the DynCorp/Contel Purchase Agreement, and GTE “joined” only to the extent of guaranteeing Contel’s obligations under the Indemnification provisions of Article IX, including the provisions of Article IX with regard to time limits and notice. (Purchase Agreement, Schedule “Joinder” (“GTE Corporation hereby joins in this Purchase Agreement solely . . . for the purpose of guaranteeing the performance by Seller of its obligations under Article IX of this Agreement.”)).

2. Limitation of Potential Damages Recoveries

DynCorp seeks to recover $100 million in compensatory damages and an unspecified amount of punitive damages pursuant to its breach of contract claim against GTE. The Purchase Agreement, however, limits Article IX indemnification to $24,750,000: 15% of the purchase price of $165 million. (Purchase Agreement, § 9.5).

3. The advisability of early, limited discovery on the issue of notice may be taken up with me at a Case Management Conference. See the last section of this Opinion.

4. The language of Section 9.5 of the Agreement is ambiguous as to whether it limits indemnification to 15% of the total purchase price ($24,750,000), or to the difference between 15% of the total purchase price and 1.5% percent of the total purchase price ($22,275,000). GTE does not argue for the latter interpretation, and I decline to decide at this point which interpretation of the damages limitation is correct. Some limited discovery concerning the parties’ intent concerning this issue may be appropriate.
ver. v. Cooke Properties, Inc., No. 87 Civ. 7311 (RWS), 1989 WL 126066 (S.D.N.Y. Oct. 13, 1989), and Williamsburg Food Specialties, Inc. v. Kerman Protection Sys, Inc., 204 A.D.2d 718, 719, 613 N.Y.S.2d 30 (2d Dep't 1994). However, the decision of the New York Court of Appeals in Metropolitan Life is authoritative, and it holds that an allegation that a breach of contract was willful rather than involuntary does not allow a court to disregard an unambiguous limitation of liability provision agreed to by parties of equal bargaining power. Metropolitan Life, 84 N.Y.2d at 435, 618 N.Y.S.2d at 882, 643 N.E.2d 504. DynCorp and Contel, both sophisticated parties represented by sophisticated counsel, unambiguously provided the limit of recovery in the event of breach, and I may not rewrite how the parties defined their rights and obligations, allocated their risks, and limited their liabilities and rights of recovery.

I therefore dismiss DynCorp’s allegations seeking recovery in contract against GTE in excess of $24,750,000, and seeking damages that are not “actual,” or which are “consequential, special or punitive,” damages. I also dismiss paragraph 52 of the complaint, alleging that GTE may not rely on the limitation of liability sections of Article IX because “of the fraudulent or grossly negligent breaches of contract.”

3. Allegations Immaterial to Breach of Contract

[4] DynCorp’s breach of contract claim against GTE is not limited to allegations of breaches of Section 2.3 representations and warranties and Sections 4.1 and 4.2. DynCorp’s claims of breach of contract also reallege, in Count One of the complaint, the entire history of GTE Information, replete with numerous incidents of alleged wrongful behavior on the part of GTE. DynCorp’s narrative is immaterial. Its claim against GTE can proceed only under Article IX, and the specific portions of the Purchase Agreement incorporated in Article IX.

A claim for relief is supposed to be stated by “a short and plain statement of the claim showing that the pleader is entitled to relief.” Fed.R.Civ.P. 8. Failure to abide by this standard can produce great mischief in a case as complex as this one. Unnecessary allegations promote discovery abuse, contentiousness and difficulties in understanding and treating the case for motions, legal sufficiency and trial. Accordingly, paragraph 47 of DynCorp’s complaint, realleging its entire narrative, is stricken. DynCorp may reallege only those paragraphs directly relevant to its breach of contract claim against GTE: breach, that is, of the Section 2.3 representations and warranties and the Sections 4.1 and 4.2 covenants, alleged in paragraphs 48 through 51 of the complaint.

C. Fraud Claims

DynCorp alleges, as Count Two of its complaint, that GTE and Contel made fraudulent and misleading representations concerning the value, current operations, and future profitability of GTE Information, during negotiations and due diligence before the Purchase Agreement was executed, in the Purchase Agreement itself, and between the execution of the Purchase Agreement and the closing of the transaction. DynCorp claims that it has stated a claim for fraud under New York law: (1) that GTE made representations of material facts, (2) that were false, (3) with the intention to defraud, (4) that DynCorp reasonably relied on GTE’s misrepresentations, and (5) that DynCorp suffered resulting damages. See Small v. Lorillard Tobacco Co., Inc., 94 N.Y.2d 43, 57, 698 N.Y.S.2d 615, 720 N.E.2d 892 (1999);
DynCorp's particularized disclaimers make it impossible for it to prove one of the elements of a claim of fraud: that it reasonably relied on the representations that it alleges were made to induce it to enter into the Purchase Agreement.  

Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc., 98 F.3d 13, 19 (2d Cir.1996).

1. Fraud Claims Based on Pre-Contractual Misrepresentations

[5] DynCorp alleges that GTE fraudulently induced it to enter into the Purchase Agreement of October 29, 1999 with Contel by misrepresenting the financial condition and results of operations of GTE Information and the projected revenues of the BOPITS II contract, in the 1999 Offering Memorandum given to DynCorp in July 1999, in presentations to DynCorp in August 1999, and in other written materials describing untrue high ratings for its service to customers and its technical expertise.

DynCorp expressly acknowledged, however, in Section 3.8 of the Purchase Agreement, that the “Seller . . . makes [no] express or implied representation or warranty” with respect to “the business” being sold “or otherwise,” or its “probable success or profitability,” “or with respect to any other information” provided to DynCorp. DynCorp acknowledged, further, that “[n]either Seller nor any other Person will have or be subject to any liability or indemnification obligation” resulting from the distribution to DynCorp or its use of “the Confidential Offering Memorandum” or “any information, documents or material made available . . . in certain 'data rooms,' management presentations, functional ‘break-out’ discussions, responses to questions . . . or in any other form . . . .” DynCorp thus disclaimed reliance on the pre-contractual representations which form the basis of its claim of fraudulent inducement to enter the Purchase Agreement. The only exceptions to DynCorp's disclaimers are “the representations and warranties contained in the Agreement.” (Purchase Agreement, § 3.8).
Such a specific disclaimer destroys the allegations in plaintiff’s complaint that the agreement was executed in reliance upon these contrary oral representations.

Id. at 320–21, 184 N.Y.S.2d 599, 157 N.E.2d 597. Businessmen dealing at arm’s length should be able to agree, Judge Burke ruled, “that the buyer is not buying in reliance on any representations of the seller as to a particular fact.” Id. at 323, 184 N.Y.S.2d 599, 157 N.E.2d 597. And the ruling on the legal sufficiency of a complaint based on such representations may properly be made on the complaint and contract alone, without waiting for discovery.

Judge Fuld, dissenting, argued that the disclaimer clause was essentially “boilerplate,” and that regardless and in view of cases traced back to the English Chancellor, “no one [should be able to] escape liability for his own fraudulent statements by inserting in a contract a clause that the other party shall not rely upon them.” Id. at 326–28, 184 N.Y.S.2d 599, 157 N.E.2d 597 (Fuld, J., dissenting). The majority nevertheless rejected Judge Fuld’s discussion, and affirmed the contract, and the ability of contracting parties under New York law to allocate their respective rights, obligations and risks, and to disclaim or limit the ability of one to sue the other for untrue or fraudulent misrepresentations.

In Harsco Corp. v. Segui, 91 F.3d 337, 345 (2d Cir.1996), the Second Circuit Court of Appeals applied the rule of Danann Realty to the purchase and sale of a business. Harsco Corp. was interested to expand its production and marketing of steel products internationally by purchasing the stock of MultiServ, a Netherlands company. MultiServ’s representatives represented that a set of projections, given to Harsco to induce it to enter into a contract of purchase, “reflected conservative economic assumptions and accounted for the prospects of ‘questionable plants.’” In additional negotiations, Harsco asked for further details from MultiServ’s chief financial officer, but did not receive all the MultiServ documents that it had requested. The contract of purchase and sale between Harsco and MultiServ’s owners provided that this due diligence was for the purpose of “confirming the accuracy of the representations and warranties of the [sellers],” and that Harsco had the right to terminate the deal during a fourteen-day period if it determined that the seller’s representations were not true and accurate in all material respects. The agreement provided that Harsco disclaimed representations by the sellers that were not provided in the agreement, and acknowledged that the sellers were not warranting “projections, estimates or budgets . . . of future revenues, expenses or expenditures, future results of operations, . . . or any other information or documents made available” to Harsco. Id. at 342. A merger clause provided that the written agreement was the entire agreement and superseded all prior arrangements or understandings.

Harsco, after its due diligence, determined to proceed, and paid the cash and assumed the debt necessary to close the transaction. Later, it determined that the business it purchased was not the business that had been represented to it; the status of MultiServ’s plant construction, the financial prospects for its operations, and the status of its intellectual property rights had all been misrepresented. Harsco sued for breach of contract and alleged a variety of fraud and misrepresentation theories, much like DynCorp’s suit here.

The district court dismissed the complaint, on the complaint and contract and before discovery, and the court of appeals affirmed. The Second Circuit ruled that because the buyer had disclaimed all but
the representations and warranties explicitly provided by the written contract, the buyer could not show that it reasonably relied on the misrepresentations on which it based its claim. "We think," the court of appeals ruled, "that Harsco should be treated as if it meant what it said when it agreed in Section 2.05 that there were no representations other than those contained in Sections 2.01 through 2.04 that were part of the transaction." Id. at 346.

_Harsco_, like the DynCorp case before me, involved a claim that not all documents were produced in response to the buyer's request, and that the documents not produced would have shown that the picture presented by the sellers was not a true picture. The Court of Appeals dismissed Harsco's claim, ruling that "it cannot be said that denial of a request to see documents could constitute fraud, unless that denial suggested falsely and deceitfully that those documents did not exist (of which there is no suggestion here)." _Id._ at 347; _see also Grumman Allied Indus., Inc. v. Rohr Indus., Inc._, 748 F.2d 729, 735 (2d Cir.1984) ("where the parties to an agreement have expressly allocated risks, the judiciary shall not intrude into their contractual relationship;" a party cannot complain of having been misled if "the substance of the disclaimer provisions tracks the substance of the alleged misrepresentations, notwithstanding semantical discrepancies").

DynCorp's disclaimers, expressed in Section 3.8 of the Purchase Agreement, match the representations on which it bases its claim of pre-contractual fraud. Under the rule of _Danann Realty Corp._ and _Harsco_, those aspects of its claim must be stricken.

2. _The Peculiar Knowledge Exception is not Applicable_

[6] DynCorp argues that even though it disclaimed reliance on representations made by the seller outside the contract, it nevertheless should have the right to sue for fraud because it was misled by misrepresentations concerning facts of which GTE had "peculiar knowledge." The information that GTE gave it, DynCorp alleges, was "selective," painting an inaccurate picture of the current and future profitability of the BOPITS II contract. DynCorp alleges that GTE withheld information that its implementation of the BOPITS II contract was behind schedule, plagued with technical difficulties and losing money. DynCorp argues that it could not reasonably have discovered this information by its investigations. DynCorp relies on a dictum of _Danann Realty Corp._: [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 subjective representation, he must make use of those means, or he will not be heard to complain that he was induced to enter into the contract by misrepresentations.

_Id._, 5 N.Y.2d at 322, 184 N.Y.S.2d 599, 157 N.E.2d 597.

DynCorp was aware, however, that the information it had received had been selected, and that it had not received any warranty that the information was representative of the business it was interested to purchase. Indeed, DynCorp disclaimed reliance on the mix of information that it had received, for Section 3.8 of the Purchase Agreement specifically provided that the Seller would not be liable to DynCorp based on claims arising from the information provided to it, but only for the specific representations, warranties and covenants of the Purchase Agreement. The disclaimer was broad, and related to all information given to DynCorp: the "Confidential Offering Memorandum", the "documents
or material made available to the Buyer in certain ‘data rooms,’” “management presentations, functional ‘breakout’ discussions, responses to questions,” and “any other form in expectation of the transactions contemplated by this agreement.” As DynCorp acknowledged in its complaint, GTE gave it some, not all, the information that DynCorp requested. (Complaint, at ¶ 43 & Exs. J, K).

Sophisticated parties to major transactions cannot avoid their disclaimers by complaining that they received less than all information, for they could have negotiated for fuller information or more complete warranties. Thus, in Rodas v. Manitaras, 159 A.D.2d 341, 552 N.Y.S.2d 618 (1st Dep’t 1990), the buyer of a restaurant business complained that the seller had misrepresented its weekly income and that, even though it had disclaimed reliance on representations of “past, present or prospective income or profits,” it should be allowed to sue for fraud. The buyer argued that because the seller refused to allow access to its books and records, the facts misrepresented were peculiarly within the knowledge of the seller. The court rejected the seller’s argument, holding that since the seller had proceeded with the 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., at 343, 552 N.Y.S.2d 618; see also Grumman Allied Indus., Inc. v. Rohr Indus., Inc., 748 F.2d 729, 737 (2d Cir.1984) (“The principle that access bars claims of reliance on misrepresentations has been expressly recognized by this Court. . . . Where sophisticated businessmen engaged in major transactions enjoy access to critical information but fail to take advantage of that access, New York courts are particularly disinclined to entertain claims of justifiable reliance.”).

In the case before me, DynCorp specifically disclaimed reliance on pre-contractual representations or the mix of information provided to it. It relied on specific representations and warranties set out in Section 2.3, and covenants set out in Sections 4.1 and 4.2, of the Purchase Agreement. It could have negotiated for further access or more complete representations, but it either declined, or was unable, to do so. It is not the role of the courts to relieve sophisticated parties from detailed, bargained-for contractual provisions that allocate risks between them, and to provide extra-contractual rights or obligations for one side or the other. See Grumman Allied Indus., 748 F.2d at 735 (following Danann Realty Corp.; “where parties to an agreement have expressly allocated risks, the judiciary shall not intrude into their contractual relationship.”).

This is not a case where it is claimed that GTE’s alleged fraud was hidden in its
accounting records, requiring extraordinary effort and sophisticated consultants to unmask. *Cf. Dimon Inc. v. Folium, Inc.*, 48 F.Supp.2d 359 (S.D.N.Y.1999). In *Dimon*, the plaintiffs claimed that they were fraudulently induced to overpay for a corporate acquisition by a “carefully masked accounting scheme” orchestrated by the defendant sellers to misrepresent and overstate the value of the acquired company, and which went undetected even by the company’s public auditors. *Id.* at 362. Although the contract in *Dimon* also contained disclaimers that the sellers made no “representation or warranty, either express or implied, as to the accuracy or completeness of any of the information made available” to the plaintiffs, and further relieved the sellers of liability for any “information provided . . . or statements made” to the purchasers except to the extent of express representations and warranties made in the contract itself, *id.* at 367, there was nothing that the buyer could practically do to investigate the statements made to it and uncover the imbedded fraud. This impracticality of detection led United States District Judge Lewis A. Kaplan to distinguish *Dimon* from the cases cited above, and to allow plaintiff’s fraud claim to proceed beyond the pleadings stage.

The plaintiff in *Dimon* was suing, not because the disclosed mix of information failed to tell a fair and complete story, but because of imbedded fraud in the very books and records and audited financial statements of the company to which it was given access. Judge Kaplan found, in *Dimon*, that the buyer’s further investigation could not have uncovered that fraud. Similarly, in *Tahini Investments Ltd. v. Bobrowsky*, 99 A.D.2d 489, 490, 470 N.Y.S.2d 431 (2d Dep’t 1984), the buyer of a parcel of land could not reasonably have discovered that 15 drums of hazardous material were buried underneath the property. Here, however, DynCorp knew that it had not received full information concerning GTE Information and the BOPITS II contract when it signed the Purchase Agreement. Nevertheless, DynCorp accepted the disclaimers of Section 3.8, the limitations of damage recoveries provided by Article IX, and the short limitations periods also provided by Article IX, and relied on the sufficiency of the Section 2.3 representations and warranties and the Sections 4.1 and 4.2 covenants. Where there is no suggestion that unequal bargaining power coerced contractual disclaimers or other concessions, a court should not rewrite the allocations of risks, rights and obligations agreed to by the parties.

3. Whether Claims of Fraud may be Pursued if also Constituting Breaches of the Representations and Warranties Provided by the Purchase Agreement

DynCorp complains that GTE’s breaches of the representations and warranties provided by the Purchase Agreement were willful and fraudulent, and that it should therefore be able to sue GTE for fraud as well as for breach of contract. DynCorp alleges that, contrary to the representations and warranties of Section 2.3 and willfully and fraudulently, GTE Information had incurred (a) Material Adverse Circumstances since December 31, 1998 and (b) material undisclosed liabilities, and (c) its Adjusted Net Assets were less than $41 million at closing. DynCorp claims that it reasonably relied upon GTE’s false warranties and representations in entering into the Purchase Agreement.

The issue before me is whether claims for fraud may be maintained independently of a claim for breach of contract, when it appears that the party’s agreement was intended to preclude such claims. This intent of the parties is reflected in several sections of the Purchase Agreement,
among them: Section 3.8, which provides that the Seller “makes [no] express or implied representation or warranty,” and will have “no liability or indemnification obligation to Buyer,” “[e]xcept for the representations and warranties contained in this Agreement,” Sections 9.1 and 9.5, which provide that GTE’s potential liability is to be limited to “any inaccuracy in any of the representations and warranties made by Seller on the Closing Date in or pursuant to [the Purchase Agreement],” and which limits potential liability to “In-

demnifiable Losses” under the Purchase Agreement which do not in the aggregate exceed 1.5% of the Purchase Price and are less than 15% of the Purchase Price; Section 9.7, which provides that the remedies provided by Article IX were the “sole and exclusive” remedies for “breach of repre-

sentation or warranty under this Agreement”; and Section 10.21, which provides that the Purchase Agreement (and other agreements not relevant to this dispute) “constitute the entire agreement” and “su-

persede all prior agreements and understandings.”

[7] Under New York law, a claim of fraud for breaching representations and warranties provided by a contract is not legally sufficient unless the complaining party can “(i) demonstrate a legal duty separate from the duty to perform under the contract; or (ii) demonstrate a fraudu-

lent misrepresentation or breach collateral or extraneous to the contract; or (iii) seek special damages that are caused by the misrepresentations and breaches and are unrecoverable as contract damages.”


[8] GTE’s duty to DynCorp was defined entirely by their contractual relationship, as the discussion in the previous sections of this opinion makes clear. GTE owed no duty to DynCorp except as pro-

vided in the Purchase Agreement that Contel and DynCorp executed as of October 29, 1999. DynCorp cannot satisfy the first criterion of Bridgestone/Firestone.

The second and third criteria of Bridgestone/Firestone are less easily resolved. DynCorp argues that since GTE’s alleged fraudulent misrepresentations were of present facts rather than future promises, the misrepresentations may be considered “collateral or extraneous” to the contract. DynCorp also argues that since the Purchase Agreement capped damage recover-

ies against GTE to 15% of the $156 million purchase price (Purchase Agreement, § 9.5), its damages in excess of that difference may be considered “special damages” that are “unrecoverable as contract dam-

ages.” For the reasons discussed below, I hold that DynCorp’s arguments lack merit, and I therefore dismiss DynCorp’s fraud claims based on the breach of contractual warranties and representations in the Purchase Agreement itself as duplicative of its claims for breach of contract.

In Bridgestone/Firestone, the plaintiff had contracted with a collection agency to obtain collection of delinquent credit card accounts, to remit collected funds bi-weekly, to maintain records of collection efforts, and to submit monthly reports. The collect-

tion agency, however, destroyed records despite contractual and subsequent prom-

ises not to do so, and stole money from the funds that it had collected. The district court held that these activities amounted to fraud on the part of the collection agency and its principal, and granted a recov-

ery to plaintiff in the amount that it estimated was stolen and for attorneys’ fees. The Court of Appeals reversed the finding of fraud and the award of attorneys’ fees. The Court of Appeals held that the repre-

sentations of defendants were not “collat-

eral or extraneous to the terms of the parties’ agreement,” that defendants did
not owe a duty to plaintiff “distinct from their obligation to perform under the collection agreement,” and that the award of attorneys’ fees, not having been clearly authorized by the parties’ agreement, could not be sustained. Id. at 20–21.

DynCorp’s claims of fraud also are not “collateral or extraneous to the terms of the parties’ agreement,” since the false representations that they allege are the representations and warranties that are provided in Section 2.3 of the Purchase Agreement. DynCorp argues, however, that there is a distinction between a representation and warranty of a present fact, and a covenant or promise to do something in the future, during the pendency of a contract. DynCorp thus argues that it may claim both fraud and breach of contract for misrepresentations of present facts, even if such representations were also contractual warranties. Its argument concedes, however, that part of its claim is based on breaches of promises concerning future events: the representation that GTE Information’s Adjusted New Worth will not be less than $41 million at closing. (Purchase Agreement, §§ 2.3(d)). DynCorp’s argument is therefore confined to the representations and warranties regarding the fairness of the financial statements incorporating GTE Information’s business and assets for the year ended December 31, 1998, the year prior to the Purchase Agreement, and the non-occurrence since that date of undisclosed Material Adverse Circumstances. (Id., §§ 2.3(a), (b)).

Deerfield Communications Corp. v. Cheesebrough–Ponds, Inc., 68 N.Y.2d 954, 956, 510 N.Y.S.2d 88, 502 N.E.2d 1003 (1986), cited and distinguished by Bridgestone/Firestone, involved parol representations concerning geographic restrictions limiting product resales that were not contained in the contract, but which were not negativized by the contract; hence, the parol representations were held “collateral or extrinsic” to the contract, and were thus enforceable. Similarly, in Cohen v. Koenig, 25 F.3d 1168, 1170, 1172 (2d Cir.1994), sellers of the assets of a business were allowed to sue the buyers for fraudulently misrepresenting their financial condition and thereby inducing the sellers to accept part of the purchase price in credit. The Court of Appeals held that since the misrepresentations were made before the formation of the contract and were “extraneous to the contract,” the sellers had stated a legally sufficient claim of fraud.

The sellers in Chase v. Columbia Nat’l Corp., 832 F.Supp. 654, 660 (S.D.N.Y. 1993), aff’d, 52 F.3d 312 (2d Cir.1995), overstated the book value of the business being sold by overstating and double-counting closing inventory of scrap metal and accounts receivable in a manner that made their fraud extremely difficult to detect. The contract provided that the sellers guaranteed the business’ net worth, and limited damages to the reduced net worth, or indemnification of the buyer’s loss. The contract also provided a short period within which suit could be brought. The district court held that the buyers could sue in tort as well as contract, and that the contract’s short period of limitations would not bar the action in tort. The court found that the contract did not negate reliance by the buyers on the seller’s pre-contractual representations, that is, on representations that were collateral and extraneous to the representations provided by the contract, thus justifying the action for fraud. See, generally, Four Finger Art Factory, Inc. v. Dinicola, No. 99 Civ. 1259, 2000 WL 145466, at *4 (S.D.N.Y. Feb.9, 2000) (discussing the “apparent tension” between different strains of New York cases in applying the “collateral or extraneous” rule discussed in Bridgestone/Firestone); VTech Holdings Ltd. v. Lucent Techs., Inc., 172 F.Supp.2d 435,

In the case at bar, unlike other cases cited by plaintiff, the Purchase Agreement made clear that GTE would have “no liability or indemnification obligation to Buyer,” “[e]xcept for the representations and warranties contained in this Agreement.” This condition of exclusivity was sounded throughout the Purchase Agreement, in the sections providing DynCorp’s disclaimers, in the sections limiting damage recoveries, and generally, as my citations a few pages earlier make clear. DynCorp’s claims of fraud concerning the breach of contractual warranties are not “collateral or extraneous” to these terms and conditions; rather, they contradict them. If I were to rule otherwise, the strong New York policy, giving autonomy to contracting parties to allocate risks, and rights, obligations, warranties and disclaimers, as they see fit, would be compromised. See Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 320–21, 184 N.Y.S.2d 599, 157 N.E.2d 597 (1959) (discussed supra.). DynCorp cannot satisfy the second criterion of Bridgestone/Firestone.

The third criterion of Bridgestone/Firestone involves the question whether DynCorp has alleged, or can allege, “special damages” that are “unrecoverable as contract damages” as the proximate result of GTE’s fraudulent representations. DynCorp alleges that it suffered damage because (a) the value of GTE Information was significantly less than it should have received; (b) it refinanced its debt, paying a prepayment penalty of $1,834,986, and surrendered its shares having a fair market value of $10 million in order to gain funds with which to pay the purchase price of $165 million; (c) it incurred transactional expenses related to the financing, of approximately $11 million; (d) it paid $2.5 million for advisory services and, since the closing, (e) it paid incremental interest in excess of $24.5 million and higher interest cost on its new debt in the amount of approximately $8 million, and (f) it has been bearing losses associated with the performance of the BOPITS II contract. (Compl., ¶ 46)

Special damages, in the context of commercial fraud, arise in consequence of a breach and seek to compensate a plaintiff for losses other than the diminished value of the promised performance. Bibeault v. Advanced Health Corp., No. 97 Civ. 6026, 2002 WL 24305, *6 (S.D.N.Y. Jan. 8, 2002) (citing New York cases). The circumstances giving rise to such damages must reasonably be anticipated at the time the contract was made. Id. In Deerfield Communications Corp., 68 N.Y.2d 954, 510 N.Y.S.2d 88, 502 N.E.2d 1003 (1986), the seller was forbidden to sell certain aerosol products because of federal regulations, and was interested to sell the products to a company that represented it would sell the products in overseas markets other than those specifically proscribed. The representation did not become a covenant of the contract, and the buyer disregarded its representation that it would not sell the products in the proscribed areas. The New York Court of Appeals held that a fraud action could be maintained, ruling that the representation was neither “collateral” nor “duplicative” of the contract, and that the seller was seeking, not the dimin-

The damages pleaded by DynCorp were incurred either to enable it to acquire GTE Information, or because GTE Information did not turn out to be as profitable as DynCorp hoped. Damages such as this do not qualify for “special damages.” They are not specially required expenses intended to eliminate a condition which the contracting party had promised either to eliminate or not to bring about. Rather, DynCorp’s damages result from the diminished value of the assets it contracted to purchase.

There is, additionally, another reason why DynCorp’s allegation of damage is not legally sufficient. DynCorp agreed, pursuant to Section 10.12 of the Purchase Agreement:

Notwithstanding anything to the contrary elsewhere in this Agreement, no party (or its Affiliates) shall, in any event, be liable to the other party (or its Affiliates) for any consequential, special or punitive damages, including loss of future revenue or income, or loss of business reputation, or opportunity relating to the breach or alleged breach of this Agreement.

DynCorp is unable to satisfy the third criterion, as well as the first two criteria, of *Bridgestone/Firestone*, as to its claims that the representations and warranties in the Purchase Agreement itself constituted fraudulent misrepresentations. Accordingly, the fraud claims based on the alleged breach of the warranties and representations in Section 2.3 of the Purchase Agreement, like the fraud claims based on alleged pre-contractual misrepresentations by GTE, are dismissed.

4. Liability for Fraud, Post–Contract and Prior to Closing

[9] DynCorp alleges that after the Purchase Agreement was executed, and before closing, GTE gave it monthly financial reports and management discussions and analyses of the business of GTE Information. The covenants of Sections 4.1 and 4.2 of the Purchase Agreement required such information and materials to be given as a condition of the closing. DynCorp alleges that the reports, the management discussions and analyses, and, generally, the information provided by GTE during this period were intentionally false and misleading, and that DynCorp relied upon this information in proceeding to close on the transaction. DynCorp alleges that GTE therefore should be liable for fraud as well as for breach of the contractual covenants. I hold that DynCorp may have leave to state such a fraud claim in an amended complaint.

Article IV of the Purchase Agreement sets out the covenants with respect to the period after the Agreement was executed and prior to closing. Under Section 4.1, Contel agreed to provide DynCorp access to GTE Information’s “properties, books, records . . . and all other information” with respect to GTE Information as DynCorp “may from time to time reasonably request” after the Purchase Agreement was signed and prior to closing. Under Section 4.2, between the date of the Purchase Agreement and the Closing Date, Contel agreed to provide monthly unaudited balance sheets and income statements for GTE Information, and written management discussions and analyses of its financial condition and results of operations, consistent with past practices. DynCorp
alleges that GTE employees gave it false and misleading information pursuant to these access and disclosure obligations, and misrepresented the reasons for DynCorp's poorer than expected performance.

This fraud claim concerning post-contract representations by GTE and Contel differs from DynCorp's other fraud claims in two important respects. First, DynCorp did not expressly disclaim reliance on the post-contract information and reports provided by GTE. (Purchase Agreement, § 3.8). And, second, the representations and warranties provided by the Purchase Agreement, even though extending in part to the closing date (Purchase Agreement, § 7.3(a)), do not by their terms extend to, or preclude reliance on, the information and reports provided by GTE pursuant to Sections 4.1 and 4.2.

The Seller's obligations to provide access to its books and records, and to provide monthly unaudited financial reports and management discussions and analyses, were express preconditions of closing (Purchase Agreement, § 7.2(b)). Clearly, DynCorp relied on the fairness and accuracy of that which Contel and GTE provided. Furthermore, DynCorp is not limited to the remedies provided Article IX of the Purchase Agreement for breach of the Sections 4.1 and 4.2 covenants, for, unlike a breach of Section 2.3 representations and warranties, the remedies provided by the Purchase Agreement are not "sole and exclusive." (Purchase Agreement, § 9.7).

Accordingly, the Purchase Agreement itself does not preclude DynCorp from suing GTE for making allegedly false and misleading representations and disclosures incident to closing, for these were collateral and extraneous to the express warranties and representations provided by the Purchase Agreement. See Bridgestone/Firestone, 98 F.3d at 20.

I therefore hold that DynCorp may have leave to allege a claim of fraud based on post-contract and pre-Closing events, not inconsistent with the preceding discussion. In all other respects, DynCorp's fraud claim—Count Two of the complaint—is dismissed.

D. Negligent Misrepresentation

[10] In addition to its fraud claims based on GTE's alleged misrepresentations concerning GTE Information and the BOPITS II contract, DynCorp alternatively pleads a claim for negligent misrepresentation based on the same alleged misrepresentations. For the reasons stated below, the negligent misrepresentation count of the complaint, Count Three, is also dismissed.

1. No Reasonable Reliance on Pre–Contract Misrepresentations

In order to plead a claim for negligent misrepresentation, just as for fraud, a plaintiff must adequately plead reasonable reliance upon the alleged misrepresentations by the defendant. Heard v. City of New York, 82 N.Y.2d 66, 74, 603 N.Y.S.2d 414, 623 N.E.2d 541 (1993). As I have discussed earlier in this decision, the language in Section 3.8 of the Purchase Agreement absolving GTE from liability for essentially all of its pre-contractual representations obviates any claim by DynCorp that it reasonably relied upon those representations or information. See Harsco Corp. v. Segui, 91 F.3d 337, 342–43 (2d Cir.1996) (contractual disclaimers precluded reasonable reliance resulting in dismissal of fraud and negligent misrepresentation claims); Goodman Manuf. Co. v. Raytheon Co., No. 98 Civ. 2774(LAP), 1999 WL 681382, at *16 (S.D.N.Y. Aug.31, 1999) (same).

2. No "Special Relationship" Between the Parties

While DynCorp did not disclaim reliance on the representations and warranties
made by Contel or GTE in the Purchase Agreement itself or after the Purchase Agreement was executed but before closing, the lack of a "special relationship" between it and GTE requires dismissal of these negligent misrepresentation claims as well. "Under New York law, there is no cause of action for negligent misrepresentation absent a 'special relationship of trust or confidence between the parties.'" St. Paul Fire & Marine Ins. Co. v. Heath Fielding Ins. Broking Ltd. 976 F.Supp. 198, 204 (S.D.N.Y.1996) (quoting American Protein Corp. v. AB Volvo, 844 F.2d 56, 63–64 (2d Cir.1988)). Such a special relationship of trust generally does not exist between sophisticated commercial entities entering into arms-length business transactions, United Safety of America, Inc. v. Consolidated Edison Co. of New York, 213 A.D.2d 283, 286, 623 N.Y.S.2d 591 (1st Dep't 1995), and none is alleged here. Accordingly, DynCorp’s negligent misrepresentation claims are dismissed.

IV. Conclusion

With respect to DynCorp’s first count, for breach of contract, GTE’s motion to dismiss is granted, with leave to DynCorp to replead to show that its claim is not time-barred. GTE’s motion to dismiss DynCorp’s claim for contract damages in excess of $24,750,000, and its claims for consequential and punitive damages, is granted.

With respect to DynCorp’s second count, for fraud, GTE’s motion to dismiss is granted, with leave to DynCorp to replead only those fraud claims concerning post contract, preclosing conditions and events.

With respect to DynCorp’s third count, for negligent misrepresentation, GTE’s motion to dismiss is granted.

DynCorp is given leave to serve and file an amended complaint, not inconsistent with my rulings in this opinion, by August 19, 2002. GTE’s Answer will be due September 18, 2002. I will meet with counsel for a Case Management Conference on September 27, 2002, at 9:30 a.m., in Courtroom 14D, 500 Pearl Street, to discuss all matters relating to the pleadings, motions and discovery, including whether to limit initial discovery thereunder to support any good faith intention to serve and file any dispositive motion directed to the amended pleadings. Either party desiring such limitation shall arrange for service and filing of supporting and opposition submissions, in a single submission jointly prepared to show supporting and opposing positions, three days in advance of said date.

SO ORDERED.

Joy THOMAS, Plaintiff,

v.

CITY OF MOUNT VERNON,
et al., Defendants.

No. 01 Civ. 8644(CM)(LMS).

United States District Court,
S.D. New York.

July 18, 2002.

Domestic violence victim filed § 1983 action alleging that county officials and community college employees failed to take adequate measures to protect her from former boyfriend. On defendants’ motion to dismiss, the District Court, McMahon, J., held that: (1) officials and employees did not have constitutional duty to protect victim; (2) district attorney’s failure to timely process paperwork after she filed domestic violence complaint did not
We, therefore, feel assured that the district court's finding of contempt was warranted.

The order holding appellant in contempt is affirmed.

1. Contracts

Disclaimer provisions of agreement relating to design and testing of prototype bus sold by defendant's subsidiary were sufficiently specific and unambiguous and therefore buyer, which contractually disclaimed reliance upon the representations at issue, could not maintain action for fraud and misrepresentation on basis of allegation that defendant failed to disclose material facts relating to testing of the bus where the disclaimer was not procured by fraud.

2. Fraud

Buyer's right to unrestricted access and its failure to inquire precluded, as a matter of law, its claim of reliance on defendant's alleged misrepresentations and therefore buyer could not maintain action for fraud and misrepresentation based on allegation that defendant failed to disclose material facts relating to the testing of a prototype bus.


Frederick R. Wirtz, J. Anthony Sinclitico, III, Gibson, Dunn & Crutcher, San Diego, Cal., Gregory A. Markel, John A. Redmon, New York City (of counsel), Davis, Markel, Dwyer & Edwards, New York City, for defendant-appellee.

might save protracted litigation, appellant did not raise this particular objection in the district court and we think the denial of awareness of Title III surveillance material "concerning" appellant roughly responds to appellant's affidavit and was adequate given the pressures of time on the government's response.
Before KAUFMAN and WINTER, Circuit Judges and WYZANSKI, Senior District Judge.8

IRVING R. KAUFMAN, Circuit Judge:

On January 3, 1978, Grumman Allied Industries (Grumman), a subsidiary of the Grumman Corporation, acquired all the plants, books, records, and other assets of the Fxible Company (Fxible), a subsidiary of the Rohr Corporation. The price paid was $55 million, and among the assets purchased were two hand-built prototypes—Proto I and Proto II—of a new bus known as the Model 870, and the right to use the design for these prototypes. After the sale was consummated, and after Fxible had sold more than 2,600 Model 870 buses, structural defects arose, and these buses were removed from operation. The dispute before us concerns the propriety of granting Rohr’s motion for summary judgment and the dismissal of Grumman’s complaint alleging Rohr’s misrepresentation and failure to disclose material facts relating to the testing of the Model 870. We affirm the lower court’s holding because Grumman contractually disclaimed reliance upon the representations at issue and enjoyed absolute access to all relevant information necessary to confirm the validity of those representations. In so concluding, we merely give effect to what we perceive to be a clear manifestation of the parties’ intentions concerning the allocation of risks in the purchase of Fxible’s business. Furthermore, we believe that our result comports with modern precepts regarding freedom of contract and limited judicial intervention into private contractual relationships.

Because the intricate factual setting of this case is critical to its resolution, we set forth the facts in some detail.

I.

The Sale of Fxible

The roots of this dispute can be traced to May of 1976, at which time Rohr experienced serious financial difficulties and considered selling one of its subsidiaries, Fxible. To determine the feasibility of selling a bus manufacturing company, Rohr retained the investment banking firm of White Weld & Co., which prepared and circulated to a number of potential buyers a memorandum describing Fxible. Grumman received a copy of this memorandum, and in mid-1976 expressed an interest in acquiring Fxible.

The following fifteen months (May 1976 to September 1977) saw Grumman affirmatively pursue that interest. Armed with an arsenal of seasoned negotiators, sophisticated engineers, experienced executives and capable attorneys and accountants, Grumman sought to uncover all information relevant to its potential acquisition. To this end, Grumman representatives repeatedly toured the Fxible plants and, while there, were accorded unrestricted access to all personnel and records. During this period, Grumman representatives were shown a promotional film containing representations, some of which related to the testing of the Model 870.1

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1 The Honorable Charles E. Wyzanski, Jr., Senior District Judge, District of Massachusetts, sitting by designation.

I. This film was sent to Grumman’s Board of Directors in June 1977. Among the statements made in the sound track of the film were the following:

Like all Fxible buses, the 870 has been thoroughly tested. It’s been hit ... it’s been dropped ... it’s been slammed and subjected to exhaustive endurance and fatigue tests on Rohr’s private test track at the Riverside International Raceway in California.... During this test, the 870 was driven over a series of torturing obstacles, almost 250 feet of 6-inch deep chockholes, and 75 feet of raised parallel strips spaced 2 inches apart in a signwave pattern.

This rigorous testing of the 870 culminates a 5-year transit vehicle research and development program that involved all of the 870’s predecessors, Hi Value, Metro and federally sponsored Transibus.

These vehicles also were tested at Riverside ... the result—the tough and ready 870.

Before the 870 was road-tested, it was subjected to a series of suspension tests carrying the equivalent of a full standee load. These tests simulated thousands of miles of street driving.
On September 29, 1977, and for the following three months, Grumman and Rohr engaged in formal negotiations. In these negotiations, both sides were represented by experienced businessmen, engineers and attorneys. Both parties formulated, reviewed and modified the several draft agreements that were exchanged and discussed during this period. Indeed, Grumman appointed an acquisition team and a negotiating team to review engineering and financial matters and negotiate a contract that would protect Grumman's best interests. Grumman's acquisition team was comprised of fourteen persons, including three lawyers and at least four trained engineers. The "acquisition" personnel traveled to Flexible’s facilities, interviewed its employees and reviewed its documents and products. Grumman's negotiating team was led by Robert Loar, a former Chairman of the Board of Grumman; Robert Landon, who was to become President of Grumman Flexible; Robert Somerville, an experienced engineer who was President of Grumman; and Thomas Genovese, General Counsel to Grumman.

Grumman's negotiating team and Rohr's negotiating team held four formal meetings between September 29, 1977 and December 1, 1977. On September 29, 1977, the rear A-frame of the Proto II cracked during endurance testing and all testing was suspended. Although Grumman had learned that the testing of the Model 870 design was not complete as of July 1977, and that a 10,000 mile endurance test was scheduled, neither the negotiating team nor the acquisition team requested the results of the testing.

After the negotiating teams had agreed on the general terms of sale, Genovese, Grumman's counsel, prepared the initial draft of what ultimately was to become the Final Agreement. Thereafter, revisions were made in a series of drafts, the drafts were subjected to extensive and intensive internal review by Grumman, and their content was discussed by Grumman and Rohr representatives at face-to-face meetings convened in various locations throughout the United States. Genovese acknowledged he had read all seven drafts of the contract, some of them more than once; Somerville, who executed the contract on behalf of Grumman, stated he had read "through all of its iterations" before signing the Agreement.

The Agreement

The fruition of these extensive negotiations and investigations was an 85 page Agreement that was signed on December 15, 1977, executed on December 23, 1977 and closed on January 3, 1978. In this Agreement, the parties set forth the representations they had made to each other and disclaimed representations as to specific matters. In particular, the Agreement provided that (i) Grumman has "made a lengthy, detailed, and independent investigation regarding ... [Rohr's] Model 870 bus design and specifications," [§ 4.3(b)²];

2. Section 4.3(b) provides in pertinent part:

[T]he parties have agreed that except for the warranties and representations set forth in this Agreement and said Exhibits and Schedules, no other statement, warranty, representation or information, verbal or written, shall be legally binding upon any party or shall be the basis for reliance by the other party. Not by way of limitation of the foregoing, Seller specifically disclaims any representation or warranty regarding the marketability of its Model 870 bus or that it will be salable for any specified length of time (Buyer understanding that the position of the U.S. Department of Transportation is that a new group of specifications for its Transbus will be required for all buses let for bid after September 30, 1979, and Buyer further recognizing that, due to the unknown nature of future specifications of the Transbus, the Model 870 may or may not be adaptable to meet Transbus specifications), or regarding the level of profitability of the current model bus or predicting profitability for its Model 870 bus (including Bids therefore already made or Customer Contracts already made) or the current model bus, it being further understood that in the introduction of any new product, and in particular in the case of the utilization of the Model 870 new manufacturing techniques, that predictions of profitability and manufacturing and mass production efficiency are uncertain. Buyer recognizes that work on the Construction in Progress and on the Model 870 Tooling is behind schedule, that Seller's existing prototype Model 870 buses (which are
(ii) “neither the Construction in Progress nor the Model 870 manufacturing techniques have yet been tested by [Rohr], and accordingly no representations and warranties concerning such have been or are hereby made, implied or given” [§ 4.3(b) ]; (iii) “except for the warranties and representations set forth in this Agreement . . . no other statement, warranty, representation or information, verbal or written, shall be legally binding upon any party or shall be the basis for reliance by the other party” [§ 4.3(b) ]; (iv) Rohr shall continue to accord Grumman access to all Fxlimble facilities and records and “do everything reasonably necessary to enable [Grumman] to make a complete examination of the assets and properties of [Rohr] and the condition thereof” [§ 3.4(b) ]; (v) “neither party is relying upon any warranty or representation of the other not fully set forth herein” [§ 6.11 ]; (vi) Rohr’s “sole representation and warranty regarding the know-how” (defined in § 1.1(i) to include “design”) was that Rohr “has the right to use such” [§ 4.1(h) ]; and (vii) Rohr disclaims “any warranty, guarantee or liability expressed by law or otherwise, specifically including a disclaimer of the implied warranties of title, merchantability and fitness for intended use” [§ 2.1(b) ].

3. Section 3.4(b) of the Agreement provides as follows:
[Seller shall] continue to afford Buyer, its representatives, agents and employees, at all reasonable times and in a manner and under circumstances which will not cause unreasonable interference with the operation of Seller’s business, access to, and facilities to use in connection with such access to, all of the Properties, Assets and Business and all of Seller’s books, files, records, tax returns, summary written descriptions of Seller’s insurance policies, and other corporate books and records relating thereto, for the purpose of audit inspection examination and copying thereof, and will do everything reasonably necessary to enable Buyer to make a complete examination of the assets and properties of Seller and the condition thereof and to obtain risk analysis information and other insurance underwriting data necessary to protect the Bus Business after the Closing date.

4. Section 6.11 provides as follows:
This Agreement and the Schedule and Exhibits thereto, together with all documents concurrently executed or effective, constitute the entire understanding between the parties hereto, with respect to their subject matter, and supersede all prior negotiations and agreements. Neither party is relying upon any warranty or representation of the other not fully set forth herein. No party hereto shall be bound by any communications between them on the subject matter thereof unless such are in writing and bear a date contemporaneous with or subsequent to the date hereof and are executed in accordance with the provisions of this Agreement.

5. Section 4.1(h) provides in pertinent part:
As the sole representation and warranty in this Agreement regarding the Know-how [defined in Exhibit A to include, among other things, ‘all engineering, technical data . . . relating to the Bus Business, including designs’], to the best of Seller’s knowledge it has the right to use such, unrestricted by any person whose rights would materially and adversely affect the Properties, Assets and Business.

6. Section 2.1(b) provides as follows:
Buyer accepts the Properties, Assets and Business as is, where is, whether at the Plants, at various job sites, or at vendors’ suppliers’, subcontractors’, or consignees’ places of business as of the Closing Date without warranty as to their condition, fitness, sufficiency for intended use, or compliance with applicable laws or regulations, including without limitation the Occupational Safety and Health Act of 1970, as amended (‘OSHA’), or similar state and local laws or regulations, except for any matter which as of the Closing Date was
Post-Acquisition Activities

At the time the sale was closed on January 3, 1978, the endurance testing of the Model 870 remained incomplete, and records accurately disclosing the defects that surfaced during testing were turned over to Grumman. The endurance testing of Proto II was completed under the auspices of Grumman in April of 1978.

Upon completion of the testing, the Chief Engineer of Grumman, Edward Kravitz, apprised Somerville of the A-frame’s failure during the endurance runs. Somerville did nothing. Indeed, between April 1978 and November 1980, he authorized the manufacture and sale of the Model 870 without any additional testing. After more than 2,600 Model 870 buses were produced and sold to transit agencies throughout the United States, a widely publicized A-frame failure occurred in New York City in December 1980, necessitating the Model 870’s removal from service.

The District Court Proceedings

On April 19, 1983—more than two years after the New York A-frame failure, Grumman brought suit against Rohr in the United States District Court for the Eastern District of New York, alleging Rohr had misrepresented and failed to disclose material facts relating to the testing of the Model 870’s design. In support of these claims, Grumman cited representations made in the soundtrack of the marketing film and in the preliminary prospectus prepared by White Weld & Co., as well as oral statements made by certain Flibble personnel. Grumman’s complaint sought $250 million in compensatory damages, and $250 million in punitive damages.

On December 2, 1988, Rohr moved for summary judgment, asserting that Grumman contractually disclaimed reliance on Rohr’s alleged misrepresentations, that Grumman enjoyed access to all relevant information relating to the Model 870’s testing (vitiating its claim of justifiable reliance) and that Rohr’s relationship with Grumman did not trigger a duty to disclose any facts not covered by the express terms of the agreement or already known by or available to Grumman. On April 4, 1984, Judge Mishler granted Rohr’s summary judgment motion. The judge concluded that given undisputed facts establishing Grumman’s pre-acquisition investigatory activities, Grumman’s expertise and sophistication, the accessibility of Rohr’s plants, personnel and records, the arm’s-length nature of the negotiations, and the plain language of the Agreement, Grumman’s reliance on Rohr’s alleged misrepresentations was unjustifiable as a matter of law. In addition, Judge Mishler concluded that Rohr owed Grumman no duty of disclosure upon which Grumman could premise a claim of fraud by omission.

II.

Essential to understanding the propriety of the district court’s grant of summary judgment is an appreciation of the limited function of the judiciary in interposing its will into the private contractual realm. Much has been written about the tension between classical and modern norms of contract interpretation. Adherents of the

the subject of Pending Litigation shown at Schedule 11, and Seller also disclaims (except as specifically provided in this agreement) any warranty, guarantee or liability expressed by law or otherwise, specifically including a disclaimer of the implied warranties of title, merchantability and fitness for intended use, and Buyer assumes liability for all compliance by the Properties, Assets and Business with all state, federal and local laws, ordinances, regulations and orders, including but not limited to those related to environment, safety (specifically including OSHA), equal opportunity, labor matters, and land use, and Buyer agrees to hold Seller harmless from any Claims and Fees in connection therewith, whether or not any noncompliance or alleged noncompliance occurred before or after the Closing Date.

7. The A-frame is a component of the rear suspension understructure.

classical approach, animated by a belief that a contractual agreement manifests the intent of the parties in a completely integrated form, favor the construction of contracts by reference to the explicit textual language. Modern or "neo-classical" interpretation, on the other hand, seems to derive from the premise that a contextual inquiry is a necessary and proper prerequisite to an understanding of the parties’ intent. Although this battle has been waged in legal journals and courts for decades, we need not enter the fray. Both schools of thought agree that a contextual inquiry is not necessary to determine the meaning of a term where that term is clear on the face of the contract. By giving effect to explicit contractual terms, a court has a better chance to carry out the intentions of the parties. Particularly where the two sides are sophisticated, their allocation of risk and potential benefit is properly treated as supreme to any conflicting understanding we may have. We believe there exists a point at which clear contractual language must be read to control a dispute. And we deem the language of this Agreement to be suitably unambiguous.

Mindful of these precepts, we turn to Grumman’s contention that its misrepresentation claim is not barred despite its specific disclaimers of reliance on Rohr’s representations concerning the testing of the Model 870. We believe such an assertion ignores basic contractual principles, as well as the controlling decisional law.

In Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 157 N.E.2d 597 (1959), the New York Court of Appeals held that where a party specifically disclaims reliance upon a representation in a contract, that party cannot, in a subsequent action for fraud, assert it was fraudulently induced to enter into the contract by the very representation it has disclaimed. In Danann, a buyer of a lease to a building claimed he had been fraudulently induced to make the purchase by false oral representations as to the “operating expenses of the building and as to the profits to be derived from the investment.” 5 N.Y.2d at 319, 184 N.Y.S.2d at 601, 157 N.E.2d at 598. In their contract, however, the parties agreed as follows:

“‘The Purchaser has examined the premises agreed to be sold and is familiar with the physical condition thereof. The Seller has not made and does not make any representations as to the physical condition, rents, leases, expenses, operation or any other matter or thing affecting or related to the aforesaid premises, except as herein specifically set forth, and the Purchaser hereby expressly acknowledges that no such representations have been made, and the Purchaser further acknowledges that it has inspected the premises and agrees to take the premises “as is”’. . . . It is understood and agreed that all understandings and agreements heretofore had between the parties hereto are merged in this contract, which alone fully and completely expresses their agreement, and that the same is entered into after full investigation, neither party relying upon any statement or representation, not embodied in this contract, made by the other. The Purchaser has inspected the buildings standing on said premises and is thoroughly acquainted with their condition.’” (Emphasis supplied by Court.)

9. Although neoclassical partisans would suggest that such an inquiry is necessary even to settle the question whether the terms are clear in the first instance, we do not agree.

10. We note that the judiciary's function in interpreting contracts differs markedly from its role in construing statutes. Unlike contracts, statutes are formulated by collective political bodies, not individual parties. Moreover, they are generally crafted broadly to encompass as many variegated factual situations as possible. Consequently, statutory provisions are often detached from the facts of a particular case and provide courts with minimal assistance in resolving the dispute. Judicial explication is not only proper in such circumstances, it is mandated.

11. Section 6.5 of the Agreement provides that it "shall be construed and interpreted according to the law of the State of New York."
GRUMMAN ALLIED INDUSTRIES v. ROHR INDUSTRIES, INC.

5 N.Y.2d at 320, 184 N.Y.S.2d at 601, 157 N.E.2d at 598. The seller of the lease moved to dismiss the purchaser's action for fraudulent misrepresentation based on the terms of the Agreement. The Court of Appeals granted the motion and dismissed the buyer's complaint, noting the issue was "whether the plaintiff [buyer] can possibly establish ... reliance upon the misrepresentations." 5 N.Y.2d at 319, 184 N.Y.S.2d at 601, 157 N.E.2d at 598. By reference to the contractual provisions, the Court concluded that:

[P]laintiff has in the plainest language announced and stipulated that it is not relying on any representations as to the very matter as to which it now claims it was defrauded. Such a specific disclaimer destroys the allegations in plaintiff's complaint that the agreement was executed in reliance upon these contrary oral representations ...."

Id. at 320–21, 184 N.Y.S.2d at 602, 157 N.E.2d at 599. Pointedly, the Court announced: "If the plaintiff has made a bad bargain he cannot avoid it in this manner." Id. at 323, 184 N.Y.S.2d at 604, 157 N.E.2d at 600. Danann therefore stands for the principle that where the parties to an agreement have expressly allocated risks, the judiciary shall not intrude into their contractual relationship.12 Animated by principles of traditional contract interpretation, the rule of Danann has exhibited great resilience in the face of efforts to delimit its expance. The instant dispute concerns Grumman's multi-faceted attempt to circumvent the Danann doctrine. As we will explain, however, its efforts at semantical legerdemain are unavailing.

A.

11 Grumman asserts that the relevant disclaimer provisions in the Agreement lack the clarity and specificity necessary to trigger the rule of Danann. To support this claim, Grumman cites the following two representations: "the Model 870 had been thoroughly tested for 10,000 miles on an endurance test track at Riverside, California" and "the technological risks associated with the Model 870 were minimal." The latter representation addresses the efficacy of the Model 870's design, and any reliance on the design was explicitly disclaimed in Sections 1.1(b), 2.1(b) and 4.3(b) of the Agreement. Grumman's claim of reliance on the former representation is somewhat more problematic, insofar as reliance on the Model 870's testing was not expressly disclaimed by Grumman in the Agreement. Upon closer examination, however, we believe it is clear that the testing representation could have been material to Grumman only as a means of validating the design of the bus. Indeed, Grumman's President noted that the purpose of "testing is to find out the efficacy of your design in order to have some—a feeling of security that the design will indeed meet the requirements."

For Grumman's argument to be persuasive, then, Danann must be read to require the existence of a precise identity between the misrepresentation and the particular disclaimer. Neither Danann nor its progeny supports such a reading, however. Indeed, quite the opposite conclusion is gleaned from the case law. The Danann rule operates where the substance of the disclaimer provisions tracks the substance of the alleged misrepresentations, notwithstanding semantical discrepancies. That these principles continue to retain their vibrancy was made clear last year in Galvatron Industries Corp. v. Greenberg, 96 A.D.2d 881, 466 N.Y.S.2d 35 (2d Dept. 1983). There, the court held that Danann precludes reliance where a party acknowledged "full familiarity with the financial condition ... of the Corporation' and disclaimed 'reliance on any representations contained in the contract had been made and that the party had conducted his own investigation, he was precluded from alleging and proving the falsity of certain representations includ ed therein'": 3 A. Corbin, Contracts § 578 at 404 (2d ed. 1960).

12. The rule of Danann has been cited with approval by both Williston and Corbin. See 5 S. Williston, A Treatise on The Law of Contracts § 811 at 893 (3d ed. 1961); 6 id. § 873 at 337; 13 id. § 1540 at 62–63 ("where the written agreement stated that no representations not
made by any other party hereto." Id. A similar conclusion was reached in Barnes v. Gould, 88 A.D.2d 900, 442 N.Y.S.2d 150 (2d Dept. 1981), aff'd, 55 N.Y.2d 943, 449 N.Y.S.2d 192, 434 N.E.2d 261 (1982), where the court found a disclaimer of reliance upon representations as to the "physical condition" of a business premises to be sufficiently specific to bar plaintiff's action for fraud regarding the repair of a boiler. Mindful of the principles enunciated in the cases cited above, we believe, as a matter of law, that the disclaimer provisions in the Agreement relating to design and testing are sufficiently specific and unambiguous to invoke the Danann rule.

B.

In addition, Grumman asserts that Danann is inapposite in light of Section 2.3(d) of the Agreement, which reserves Grumman's right to seek rescission of the contract on the basis of a knowing and intentional "false representation by the Seller which was material to the determination of Buyer to consummate the transaction herein." Upon closer examination, Grumman's argument can be bifurcated. Grumman claims that the Agreement's disclaimer language (set forth in Sections 2.1(b), 4.3(b) and 6.11), when viewed in conjunction with Section 2.3(d), becomes ambiguous and lacks the requisite clarity to trigger the Danann rule. Furthermore, Grumman argues that Section 2.3(d) removes this case entirely from the ambit of the Danann doctrine because Grumman has not disclaimed all reliance on Rohr's representations, but rather has expressly reserved the right to bring an action for fraudulent misrepresentation.

The fallacy of both arguments is revealed by reference to fundamental principles of contract interpretation. Grumman's construction of Section 2.3(d) is expressly at odds with the unambiguous terms of Sections 2.1(b) and 4.3(b), as well as Section 6.11, which provides that "neither party is relying upon warranties or representations of the other not fully set forth herein." Moreover, Section 2.3(d) refers to false representations within the Agreement. Nowhere in Section 4.1, which defines "Representations of the Seller," can the material representations alleged by Grumman be found. Grumman's interpretation of Section 2.3(d) would nullify not only the effect of the disclaimer provisions, but also vitiate the clear language of Section 6.11. The principle that "contracts must be viewed so that its terms may have effect rather than be destroyed" militates against such a construction. See Zdanok v. Glidden Co., 288 F.2d 99, 104 (2d Cir. 1961), aff'd, 370 U.S. 530, 82 S.Ct. 1459, 8 L.Ed.2d 671 (1962); Corhill Corp. v. S.D. Plants, Inc., 9 N.Y.2d 595, 598-99, 217 N.Y.S.2d 1, 3, 176 N.E.2d 37, 38 (1961); Restatement (Second) of Contracts, § 203 comment b (1981). In effect, Grumman would have us ignore this most venerable of contract norms. This we are not prepared to do.

C.

Furthermore, Grumman attempts to carve out a limited exception to the Danann rule in instances where the disclaimer provisions were induced by fraud. In framing this argument, Grumman claims that Rohr officials explicitly assured the members of the Grumman negotiating team that the disclaimer language of Section 4.3(b) did not encompass the design and testing of the Model 870. Grumman alleges that its acceptance of this provision was secured only by Rohr's fraudulent assurance. We believe such an argument must fail as a matter of law.

The genesis of the "procured by fraud" exception may be found in the following passage from Danann:

"The complaint here contains no allegations that the contract was not read by the purchaser. We can fairly conclude that plaintiff's officers read and understood the contract, and that they were aware of the provision by which they aver that plaintiff did not rely on such extra-contractual representations. It is not alleged that this provision was not understood, or that the provision itself
was procured by fraud. It would be unrealistic to ascribe to plaintiff's officers such incompetence that they did not understand what they read and signed. Cf. Ernst Iron Works v. Duralith Corp., 270 N.Y. 165, 171, 200 N.E. 683, 685 . . . [T]he larger implication of the Ernst case is that, where a person has read and understood the disclaimer of representation clause, he is bound by it. The court rejected, as a matter of law, the allegation of plaintiffs' 'that they relied upon an oral statement made to them in direct contradiction of this provision of the contract.'"

5 N.Y.2d at 321–22, 184 N.Y.S.2d at 602, 157 N.E.2d at 599. In light of the foregoing, we construe the "procured by fraud" language to refer only to a situation where the party against which the disclaimer is asserted is entirely unaware of the existence of the disclaimer—for example, where the disclaimer is inserted surreptitiously into the final draft of the contract. Nothing in the cases cited by Grumman suggests a contrary reading. See Cohen v. Tenney Corp., 318 F.Supp. 280 (S.D.N.Y. 1970); Goostree v. P. Lorillard Co., 26 Misc.2d 109, 202 N.Y.S.2d 456 (N.Y.Ct. 1960). Grumman has offered no evidence that it was unaware of the disclaimer's existence. Accordingly, the "procured by fraud" exception is inapplicable as a matter of law, and we are impelled to the conclusion that this case is controlled squarely by Danann.

III.

[2] The second pillar of Grumman's argument is that the district court erred in holding that Grumman could not claim reliance on Rohr's representations concerning the testing and design of the Model 870. We believe Grumman's claim of justifiable reliance was properly rejected by the district court in light of undisputed evidence demonstrating that Grumman enjoyed unfettered access to Flibble's plants, personnel and documents; and that it possessed the legal, technical and business expertise necessary to make effective use of that access.

The Supreme Court has stated:

"When the means of knowledge are open and at hand, or furnished to the purchaser or his agent, and no effort is made to prevent the party from using them, and especially where the purchaser undertakes examination for himself, he will not be heard to say that he has been deceived to his injury by the misrepresentations of the vendor."

See Shappirio v. Goldberg, 192 U.S. 232, 241–42, 24 S.Ct. 259, 261, 48 L.Ed. 419 (1904). The principle that access bars claims of reliance on misrepresentations has been expressly recognized by this Court, see Aaron Ferer & Sons, Ltd. v. Chase Manhattan Bank, N.A., 731 F.2d 112, 123 (2d Cir.1984); Frigitemp Corp. v. Financial Dynamics Fund, Inc., 524 F.2d 275, 282 (2d Cir.1975), and New York State courts, see Most v. Monti, 91 A.D.2d 606, 456 N.Y.S.2d 427, 428 (2d Dept.1983); Danann, supra, 5 N.Y.2d at 322, 184 N.Y.S.2d at 603, 157 N.E.2d at 599; Marine Midland Bank v. Palm Beach Moorings, Inc., 61 A.D.2d 927, 928, 403 N.Y.S.2d 15, 17 (1st Dept.1978).

Where sophisticated businessmen engaged in major transactions enjoy access to critical information but fail to take advantage of that access, New York courts are particularly disinclined to entertain claims of justifiable reliance. In Palm Beach Moorings, for example, the court, in granting a motion for summary judgment, rejected a claim of justifiable reliance, noting that to rule otherwise would require a finding that "an experienced businessman, as 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 misrepresentation."

5 N.Y.2d at 322, 184 N.Y.S.2d at 603, 157 N.E.2d at 600.
suming a controlling interest in a corporation and incurring heavy financial obligations, did so on the basis of verbal assurances given to him by the seller and a bank official." See Palm Beach Moorings, supra, 403 N.Y.S.2d at 17. This the court was not prepared to do, particularly given its finding of undisputed access to the corporate records necessary to confirm or disprove the substance of the verbal assurances. See also Most v. Monti, supra, (summary judgment proper where an experienced businessman claimed he justifiably relied on a mere verbal assurance, prompting him to incur a substantial financial obligation).

Grumman—the allegedly defrauded plaintiff—is a Fortune 500 company, renowned world-wide for its engineering expertise. The transaction at issue is a $55 million corporate acquisition. At all stages, Grumman was represented by a sophisticated group of counsel, executives and engineers. Grumman enjoyed unrestricted access to all the facilities, personnel and records of Rohr, and despite its knowledge that the Model 870 was undergoing endurance testing in late 1977, Grumman neither inquired into the results of that testing, nor asked to scrutinize testing reports. In light of the unambiguous case law and the undisputed facts, we agree with Judge Mishler that Grumman did not rely solely upon Rohr’s representations as to the design and testing of the Model 870. If it did, such reliance was plainly unjustifiable given its extensive inquiries and investigations.

To preserve its claim of justifiable reliance, Grumman contends that its duty to investigate hinges on whether the information required to confirm or disprove the validity of the design and testing representations was peculiarly within Rohr’s knowledge. In support of this assertion, Grumman cites Mallis v. Bankers Trust Co., 615 F.2d 68 (2d Cir.1980), cert. denied, 449 U.S. 1128, 101 S.Ct. 998, 67 L.Ed.2d 109 (1981) and Tahini Investments, Ltd. v. Bobrowsky, 99 A.D.2d 489, 470 N.Y.S.2d 431 (2d Dept.1984). We find these cases, however, to be inapposite. In Mallis, a bank that was holding securities as collateral did not inform the purchaser of these securities—even upon direct inquiry—of restrictions on their transfer. See Mallis, supra, 615 F.2d at 73. In Tahini, the purchaser of a 93-acre horse farm failed to discover—despite an inspection of the farm—ten drums of buried chemicals. 99 A.D.2d at 490, 470 N.Y.S.2d at 432. Unlike the case before us, in Mallis and Tahini, the allegedly undisclosed information was only known by—and indeed only available to—the defendants, and incapable of discovery by the plaintiff, no matter how diligent its investigation.

Accordingly, Grumman’s right to unrestricted access and its failure to inquire preclude, as a matter of law, its claim of reliance on Rohr’s alleged misrepresentations.

IV.

The final prong of Grumman’s argument is that the district court erred in holding that Rohr had no duty to disclose to Grumman material facts regarding the testing of the Model 870. We find this argument to be unavailing for all the reasons proffered in Sections II and III of our opinion, because the alleged material omissions are nothing more than affirmative misrepresentations about the testing and design of the Model 870. As such, they are subject to the Agreement’s plain disclaimers as well as Grumman’s unrestricted access and concomitant duty to investigate.

Moreover, this Court has expressly held that, under New York law, a duty to disclose material facts is triggered: “first, knowing the design of the understructure of the Model 870, the testing methods and the defects revealed through testing.”

14. The district court expressly found that “Grumman’s experienced lawyers, engineers and negotiators had full and fair opportunity to investigate [and discover] the matters concern-
where the parties enjoy a fiduciary relationship ... and second, where one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge.” Aaron Ferer & Sons, Ltd., supra, 731 F.2d at 123; see also Frigitemp Corp. v. Financial Dynamics Fund, supra, 524 F.2d at 283. We hold that neither condition is present in this action. Grumman’s attempt to transmute its ordinary arms-length business relationship with Rohr into a fiduciary relationship is unpersuasive. The fact that Rohr has sold aircraft components to a subsidiary of Grumman in no way alters our conclusion. Grumman has completely failed to offer any evidence indicating that the parties placed sufficient trust and confidence in each other to trigger a duty of disclosure. See Aaron Ferer & Sons, Ltd., supra, 731 F.2d at 122 (close debtor-creditor relationship does not establish a fiduciary duty); Frigitemp Corp., supra, 524 F.2d at 279. Indeed, throughout the course of this transaction, Grumman’s representatives confirmed that they were relying upon the advice and counsel of their own engineers, lawyers, and executives to protect Grumman’s best interests—not upon a special relationship with Rohr.

As this Court concluded in Aaron Ferer & Sons, Ltd., supra, 731 F.2d at 123, a party’s knowledge is not superior where the relevant information “was either a matter of public record, was not pursued by plaintiffs, or was disclosed at least in part ....” In light of the undisputed evidence establishing Grumman’s unrestricted access to Flixible’s facilities, personnel and records, as well as Grumman’s arsenal of legal and technical talent, we find the claim that Rohr possessed superior knowledge (that was not readily available to Grumman) to be without merit.

V.

It is against this legal backdrop that we turn to the precise issue presented on appeal—the propriety of the district court’s grant of summary judgment. On a motion for summary judgment, we are mindful of the maxim “the court cannot try issues of fact; it can only determine whether there are issues to be tried.” Heyman v. Commerce and Industry Ins. Co., 524 F.2d 1317, 1319–20 (2d Cir.1975). Moreover, the court must resolve all ambiguities and draw all reasonable inferences in favor of the party against whom summary judgment is sought, see id. at 1320, with the burden on the moving party to demonstrate the absence of any material issue genuinely in dispute, see Adickes v. S.H. Kress & Co., 398 U.S. 144, 157, 90 S.Ct. 1598, 1608, 26 L.Ed.2d 142 (1970). Summary judgment is appropriate where the factual predicates of each legal question are undisputed.

The issue whether, under the rule of Dannan, the specific disclaimers in the Agreement precluded Grumman from asserting it had been defrauded by Rohr is a legal question that can be resolved by reference to settled principles of contract interpretation. See Tokio Marine & Fire Ins. Co. v. McDonnell Douglas Corp., 617 F.2d 936, 940 (2d Cir.1980). Once Rohr set forth facts sufficient, pursuant to Fed.R.Civ.P. 56(c), to make a prima facie showing that the rule of Dannan was applicable, Fed.R.Civ.P. 56(e) required Grum-

15. Rule 56(c) states, in pertinent part:

The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

16. Rule 56(e) states, in pertinent part:

When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him.
man to offer specific facts demonstrating the disclaimers were procured by fraud. We agree with the district court that "[n]o evidence of fraud in the inducement was offered by Grumman."

By proffering evidence demonstrating that Grumman enjoyed access to Flexibe's facilities, personnel and documents and proof that Grumman possessed the legal, technical and business expertise necessary to make effective use of that access, Rohr met its Rule 56(c) burden of establishing no genuine issues of material fact. The burden then shifted to Grumman to set forth specific facts raising triable issues. We agree with Judge Mishler that Grumman's conclusory statement that "Rohr controlled the flow of information between [itself] and Grumman," absent any factual support, was insufficient to satisfy this burden.

Our conclusion that the district court properly granted summary judgment is bolstered by Grumman's extensive and intensive discovery, spanning a number of years and yielding tens of thousands of pages of corporate documents. As such, the factual development necessary to the principled resolution of this complex dispute was not terminated prematurely. We are confident that summary judgment was appropriately granted in this case.

Accordingly, the judgment of the district court is affirmed.

Harry MARTELL, Individually and as Parent and Natural Guardian of William Brent Martell, an infant, Plaintiff-Appellee,

v.

BOARDWALK ENTERPRISES, INC., Nicholas F. Cutro, Individually and d/b/a Boardwalk and/or Lake George Boardwalk and/or Boardwalk on Lake George and/or Boardwalk Boat Rental, William Revy, the Village of Lake George, New York, Kawasaki Motors Corp., U.S.A., and WRD Enterprises, Inc., d/b/a Saratoga Kawasaki, Defendants,

Nicholas F. Cutro, Individually and d/b/a Boardwalk and/or Lake George Boardwalk and/or Boardwalk on Lake George, Boardwalk Boat Rental, William Revy, Kawasaki Motors Corp., U.S.A., Defendants-Appellants.

Nos. 1383 to 1386, Dockets 83-9028, 83-9064, 83-9066 and 84-7276.

United States Court of Appeals, Second Circuit.


Decided Nov. 13, 1984.

Parent of boy injured in boating accident brought suit for boy's injuries and for his own expenses caused by accident and for loss of his son's services against driver of boat which struck watercraft operated by injured boy, lessor of both boat and watercraft operated by injured boy, and manufacturer of watercraft, and others. The United States District Court for the Northern District of New York, Roger J. Miner, J., entered judgment in favor of plaintiff, and appeals taken. The Court of Appeals, Kearse, Circuit Judge, held that: (1) trial court did not abuse its discretion in admitting as relevant certain testimony as to instability of watercraft operated by injured boy and the difficulties in its operation; (2) there was adequate evidence from which reasonable jurors could conclude
Effective: [See Text Amendments]

Code of Federal Regulations Currentness
Title 17. Commodity and Securities Exchanges
Chapter II. Securities and Exchange Commission

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§ 240.10b5–1 Trading “on the basis of” material nonpublic information in insider trading cases.

Preliminary Note to § 240.10b5–1: This provision defines when a purchase or sale constitutes trading “on the basis of” material nonpublic information in insider trading cases brought under Section 10(b) of the Act and Rule 10b–5 thereunder. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b–5, and Rule 10b5–1 does not modify the scope of insider trading law in any other respect.

(a) General. The “manipulative and deceptive devices” prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b–5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.

(b) Definition of “on the basis of.” Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is “on the basis of” material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.

(c) Affirmative defenses.

(1)(i) Subject to paragraph (c)(1)(ii) of this section, a person's purchase or sale is not “on the basis of” material nonpublic information if the person making the purchase or sale demonstrates that:

(A) Before becoming aware of the information, the person had:

(1) Entered into a binding contract to purchase or sell the security,

(2) Instructed another person to purchase or sell the security for the instructing person's account, or

(3) Adopted a written plan for trading securities;

(B) The contract, instruction, or plan described in paragraph (c)(1)(i)(A) of this Section:

(1) Specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;
(2) Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or

(3) Did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not have been aware of the material nonpublic information when doing so; and

(C) The purchase or sale that occurred was pursuant to the contract, instruction, or plan. A purchase or sale is not “pursuant to a contract, instruction, or plan” if, among other things, the person who entered into the contract, instruction, or plan altered or deviated from the contract, instruction, or plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale), or entered into or altered a corresponding or hedging transaction or position with respect to those securities.

(ii) Paragraph (c)(1)(i) of this section is applicable only when the contract, instruction, or plan to purchase or sell securities was given or entered into in good faith and not as part of a plan or scheme to evade the prohibitions of this section.

(iii) This paragraph (c)(1)(iii) defines certain terms as used in paragraph (c) of this Section.

(A) Amount. “Amount” means either a specified number of shares or other securities or a specified dollar value of securities.

(B) Price. “Price” means the market price on a particular date or a limit price, or a particular dollar price.

(C) Date. “Date” means, in the case of a market order, the specific day of the year on which the order is to be executed (or as soon thereafter as is practicable under ordinary principles of best execution). “Date” means, in the case of a limit order, a day of the year on which the limit order is in force.

(2) A person other than a natural person also may demonstrate that a purchase or sale of securities is not “on the basis of” material nonpublic information if the person demonstrates that:

(i) The individual making the investment decision on behalf of the person to purchase or sell the securities was not aware of the information; and

(ii) The person had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of material nonpublic information. These policies and procedures may include those that restrict any purchase, sale, and causing any purchase or sale of any security as to which the person has material nonpublic information, or those that prevent such individuals from becoming aware of such information.
Effective: July 22, 2010

United States Code Annotated Currentness
Title 15. Commerce and Trade
   Chapter 2B. Securities Exchanges (Refs & Annos)
   § 78cc. Validity of contracts

(a) Waiver provisions

Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule of a self-regulatory organization, shall be void.

(b) Contract provisions in violation of chapter

Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: Provided, (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) or (2) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation. The Commission may, in a rule or regulation prescribed pursuant to such paragraph (2) of such section 78o(c) of this title, designate such rule or regulation, or portion thereof, as a rule or regulation, or portion thereof, a contract in violation of which shall not be void by reason of this subsection.

(c) Validity of loans, extensions of credit, and creation of liens; actual knowledge of violation

Nothing in this chapter shall be construed (1) to affect the validity of any loan or extension of credit (or any extension or renewal thereof) made or of any lien created prior or subsequent to the enactment of this chapter, unless at the time of the making of such loan or extension of credit (or extension or renewal thereof) or the
creating of such lien, the person making such loan or extension of credit (or extension or renewal thereof) or acquiring such lien shall have actual knowledge of facts by reason of which the making of such loan or extension of credit (or extension or renewal thereof) or the acquisition of such lien is a violation of the provisions of this chapter or any rule or regulation thereunder, or (2) to afford a defense to the collection of any debt or obligation or the enforcement of any lien by any person who shall have acquired such debt, obligation, or lien in good faith for value and without actual knowledge of the violation of any provision of this chapter or any rule or regulation thereunder affecting the legality of such debt, obligation, or lien.

CREDIT(S)


HISTORICAL AND STATUTORY NOTES

Revision Notes and Legislative Reports


References in Text

This chapter, referred to in text, in the original read “this title”. See References in Text note under § 78a of this title.

Amendments


1990 Amendments. Subsec. (b). Pub.L. 101-429 substituted in cl. (A) “paragraph (3)” for “paragraph (2) of (3)” and in cl. (B) “paragraph (1) of (2)” for “paragraph (1)” and inserted provision that the Commission may, in a rule or regulation prescribed pursuant to such paragraph (2) of such section 78o(c) of this title, designate such rule or regulation, or portion thereof, as a rule or regulation, or portion thereof, a contract in violation of which shall not be void by reason of this subsection.


Effective and Applicability Provisions
IV.

CONCLUSION
For the reasons discussed above, we will vacate the order of the District Court transferring Olabode's § 2255 motion to this court for authorization to file it pursuant to § 2244 and remand for further proceedings.

AES CORP., Appellant
v.
The Dow Chemical Company; Dynegy Power Corporation f/k/a Destec Energy Inc.
No. 01–3373.
United States Court of Appeals,
Third Circuit.
Argued May 23, 2002.
Filed April 14, 2003.

Buyer of corporation brought securities fraud action against majority shareholder of parent of acquired corporation, alleging misrepresentations concerning value of acquired corporation, and asserting various state-law claims. The United States District Court for the District of Delaware, 157 F.Supp.2d 346, Joseph J. Farnan, J., granted majority shareholder's summary judgment motion, and buyer appealed. The Court of Appeals, Stapleton, Circuit Judge, held that: (1) federal law governed issue of whether buyer had antici-patorily waived federal securities fraud claims, and (2) non-reliance clauses in confidentiality and asset purchase agreements could not be enforced so as to bar as a matter of law buyer's securities fraud claims.

Reversed and remanded.

Wallace, Senior Circuit Judge, filed concurring and dissenting opinion.

1. Securities Regulation 60.18
To state a valid claim under Rule 10b-5, plaintiff must show that defendant: (1) made misstatement or omission of material fact; (2) with scienter; (3) in connection with purchase or sale of security; (4) upon which plaintiff reasonably relied; and (5) that plaintiff's reliance was proximate cause of his or her injury. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.

2. Securities Regulation 60.48(1)
"Reasonable reliance" element of Rule 10b-5 claim requires showing of causal nexus between misrepresentation and plaintiff's injury, as well as demonstration that plaintiff exercised diligence that reasonable person under the circumstances would have exercised to protect his own interests. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.

3. Securities Regulation 60.48(1)
Factors in determination of whether securities fraud plaintiff's reliance on alleged misrepresentations was reasonable include: (1) whether fiduciary relationship existed between parties; (2) whether plaintiff had opportunity to detect fraud; (3) sophistication of plaintiff; (4) existence of was, at most, dictum. Barnes, 324 F.3d 135, 2003 WL 1467580, at *2. The issue we raised in that case was our jurisdiction. We do not regard the court's passing statement as binding precedent in a case where the issue is not squarely raised.
long standing business or personal relationships; and (5) plaintiff's access to relevant information. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.

4. Securities Regulation ⇑60.48(1)

What constitutes reasonable reliance in context of Rule 10b-5 claim is governed by federal law, although terms of any agreement between parties may be among circumstances relevant to reliance and material dispute about what parties agreed to may be resolved by state contract law. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.

5. Securities Regulation ⇑60.49

Federal rather than state law governed issues of whether buyer of corporation had anticipatorily waived federal securities fraud claim against seller and whether purported anticipatory waiver was enforceable. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.

6. Securities Regulation ⇑60.48(1), 60.49

Under Securities Exchange Act provision prohibiting waiver of substantive obligations imposed by Act, non-reliance clauses in confidentiality and asset purchase agreements between buyer of corporation and seller, whereby seller disclaimed any representations not contained in definitive agreements, could not be enforced so as to bar as a matter of law buyer's Rule 10b-5 securities fraud claims against seller arising from alleged misrepresentations concerning value of acquired corporation; rather, clauses were among circumstances to be considered in determining reasonableness of any reliance upon alleged misrepresentations. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. §240.10b–5.


Herbert L. Zarov, Michele L. Odorizzi (Argued), Daniel J. Delaney, Mayer, Brown, Rowe & Maw, Chicago, and David C. McBride, John W. Shaw, Young, Conway, Stargatt & Taylor, Wilmington, for Appellee.

Before McKEE, STAPLETON and WALLACE,* Circuit Judges.

CLIFFORD, Senior Circuit Judge, concurring and dissenting.

OPINION OF THE COURT

STAPLETON, Circuit Judge.

I. Introduction

The AES Corporation ("AES") operates power facilities. AES alleges that Dow Chemical Company ("Dow") and its subsidiary, Destec Energy, Inc. ("Destec"),1 violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act") in connection with a transaction in which AES purchased the stock of one of Destec's subsidiaries, Destec Engineering, Inc. ("DEI"). DEI's sole asset was a contract to design and construct a power plant in The Netherlands (the "Els-
ta Plant"). According to AES, Dow and Destec conspired to sell DEI at an artificially inflated price by making misrepresentations material to an evaluation of DEI.

During the pendency of this case in the District Court, AES and Destec entered into a settlement agreement. Thus, only the claims against Dow remain. There has been no discovery. Dow moved for summary judgment, relying solely on documents relating to the transactions in which AES acquired DEI's stock. In response, AES filed a Rule 56(f) affidavit requesting discovery in identified areas. The District Court nevertheless granted Dow's summary judgment motion. The District Court held that certain clauses in the transaction documents rendered AES's reliance on the alleged misrepresentations unreasonable as a matter of law.

II. Background

Dow formed Destec to build and run power plants that would supply power to Dow Chemical facilities and third-party users. In 1996, after determining that it could not profitably run Destec as its subsidiary, Dow retained Morgan Stanley to perform a valuation of Destec in order to initiate a public sale.

Morgan Stanley issued a Confidential Offering Memorandum on behalf of Destec. As a precondition to receiving the Offering Memorandum, AES signed a Confidentiality Agreement that provided in part:

We [AES] acknowledge that neither you [Destec], nor Morgan Stanley [Destec's Investment Banker] or its affiliates, nor your other Representatives, nor any of your or their respective officers, directors, employees, agents or controlling persons within the meaning of section 20 of the Securities Exchange Act of 1934, as amended, make any express or implied representation or warranty as to the accuracy or completeness of the Information, and we agree that no such person will have any liability relating to the Information or for any errors therein or omissions therefrom. We further agree that we are not entitled to rely on the accuracy or completeness of the Information and that we will be entitled to rely solely on any representations and warranties as may be made to us in any definitive agreement with respect to the Transaction, subject to such limitations and restrictions as may be contained therein.

App. at 197, ¶ 5. Dow was not a party to the Confidentiality Agreement but is alleged to have been a "controlling person" of Destec within the meaning of § 20(a) of the Exchange Act.

The Offering Memorandum included projections and estimates about the future performance of Destec's businesses, including DEI and the Elsta Plant. Like the Confidentiality Agreement, the Offering Memorandum warned readers that they were not to rely on the accuracy or completeness of information contained therein. It further stated:

[O]nly those particular representations and warranties which may be made to a purchaser in a definitive agreement, when, as, and if executed, and subject to such limitations and restrictions as may be specified in such definitive agreement, shall have any legal effect.

App. at 7 (alteration in original).

Dow and Destec provided information about Destec to potential bidders in several other ways. First, Destec officers gave a presentation to potential bidders, which AES representatives attended. Dow and Destec also sent certain documents to potential bidders and made others available in a room at a Destec facility in Houston,
Texas. Further, Dow and Destec gave potential bidders a computer model to value the Destec assets. This model included assumptions about the expenses and revenues of the Elsta Plant. Lastly, Dow and Destec allowed AES, as part of its due diligence, to visit the Elsta Plant.

AES contacted Dow about the possibility of purchasing the international assets of Destec. Dow responded that it would prefer to sell all of Destec, rather than dispose of it piecemeal. As a result, AES approached NGC Corporation ("NGC") to propose submitting a joint bid for all of Destec, and a joint bid was subsequently made.

The AES/NGC joint bid was accepted by Dow. The transaction took place in two steps. First, NGC acquired all of the stock of Destec pursuant to an Agreement and Plan of Merger (the "Merger Agreement") entered into by Dow, Destec, and NGC. Second, AES purchased all of the international assets of Destec, including all of DEI’s outstanding stock, pursuant to an Asset Purchase Agreement between AES and NGC.

Section 4.6 of the Merger Agreement, to which AES was not a party, provided as follows:

Except for the representations and warranties contained in this Article IV, neither Dow nor any other person makes any other express or implied representation or warranty with respect to the Elsta Plant.

Similarly, Section 3.4 of the Asset Purchase Agreement, signed by NGC and AES, states that "except for the representations and warranties contained in this Article III, neither NGC nor any other person (as defined in the Merger Agreement) makes any other express or implied representation or warranty on behalf of NGC." App. at 280–81, Section 3.4. The Merger Agreement defines "Person" to "mean an individual, partnership, joint venture, trust, corporation, limited liability company or other legal entity or Governmental Entity." App. at 216. Article III of the Asset Purchase Agreement contains limited representations and warranties by NGC very similar to those made by Dow in the Merger Agreement.

The Merger Agreement provided that "[t]his Agreement and the Confidentiality Agreement, and certain other agreements executed by the parties hereto as of the date of this Agreement, constitute the entire agreement, and supersedes (sic) all prior agreements and understandings (written and oral), among the parties with respect to the subject matter hereof." App. at 265, Section 9.9.

According to AES, shortly after purchasing DEI and Destec's other international assets, it realized that the Elsta Plant would cost far more to complete than its due diligence investigation had indicated and would open for operation much later than Dow and Destec had represented it would. Instead of providing the predicted $31 million in profit, the project ultimately occasioned a $70 million loss. AES contends that Dow knew specific facts about the Elsta Plant that contradicted the representations it had made prior to and during due diligence. Its complaint
alleges fourteen affirmative misrepresentations and eight material omissions upon which it relied. Some involved profit and cost projections, but others involved currently existing facts. Further, AES contends that, as part of the scheme to defraud, Dow concealed the true state of the Elsta Plant and frustrated its due diligence efforts by causing Destec and its employees to provide false and misleading information to AES.

The District Court’s opinion refers to all of the above quoted provisions of the transaction documentation and “concludes that the ‘no representation/non-reliance’ clauses in the agreements between Dow and AES are enforceable.” App. at 15. The reference to “agreements between Dow and AES” is not clear to us, but we assume for present purposes that AES’s commitment in the Confidentiality Agreement was made for the benefit of Dow and, if enforceable, is enforceable by it. In that document, AES “acknowledge[d]” that no “express or implied representations or warranty as to the accuracy or completeness of the Information” had been made and agreed (1) that Destec and Dow would not have “any liability relating to the Information” and (2) that AES would be entitled to rely solely on the representations and warranties it would be able to secure in “any definitive agreement.” App. at 197, ¶ 5. In order to avoid further repetition of this acknowledgment and agreement, we will refer to them hereafter as the “non-reliance” clause.

III. Analysis

A. The Federal Law

[1] Section 10(b) of the Exchange Act prohibits the “use or employ, in connection with the purchase or sale of any security[,] . . . [o]f any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe.” 15 U.S.C. § 78j(b). Rule 10b–5, which was promulgated to implement Section 10(b), makes it unlawful for anyone engaged in the purchase or sale of a security to:

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which the were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person[.]

17 C.F.R. § 240.10b–5. “To state a valid claim under Rule 10b–5, a plaintiff must show that the defendant ‘made a misstatement or an omission of a material fact (2) with scienter (3) in connection with the purchase or the sale of a security (4) upon which the plaintiff reasonably relied and (5) that the plaintiff’s reliance was the proximate cause of his or her injury.’” Semerenko v. Cendant Corp., 223 F.3d 165, 174 (3d Cir.2000).

[2,3] The “reasonable reliance” element of a Rule 10b–5 claim requires a showing of a causal nexus between the misrepresentation and the plaintiff’s injury, as well as a demonstration that the plaintiff exercised the diligence that a reasonable person under all of the circumstances would have exercised to protect his own interests. Straub v. Vaisman and Co., Inc., 540 F.2d 591, 597–98 (3d Cir. 1976). In Straub, we identified a non-exclusive set of factors to aid in determining whether a party’s reliance was reasonable under all of the circumstances. We noted that courts may consider (1) whether a fiduciary relationship existed between the parties; (2) whether the plaintiff had
the opportunity to detect the fraud; (3) the sophistication of the plaintiff; (4) the existence of long standing business or personal relationships; and (5) the plaintiff's access to the relevant information. See id. at 598.

The District Court held that as a result of AES's contractual commitment not to rely on any representations other than those incorporated in the final agreements, its alleged reliance was unreasonable as a matter of law. AES insists that this holding is incorrect in light of Section 29(a) of the Exchange Act, 15 U.S.C. § 78cc(a). Section 29(a) provides: "Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void." 15 U.S.C. § 78cc(a). That is, by its terms, Section 29(a) "prohibits waiver of the substantive obligations imposed by the Exchange Act." Shearson/American Express, Inc. v. McMahon, 482 U.S. 220, 228, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987). The underlying concern of this section is "whether the [challenged] agreement weakens [the] ability to recover under the Exchange Act." Id. at 230, 107 S.Ct. 2332 (quotation omitted).

B. The Applicable Law

[4] AES emphasizes that the Merger and Asset Purchase agreements stipulated that Delaware law would govern their interpretation and insists that we must look to that law to determine the effect to be given the non-reliance clause. While we will not rule out the possibility that state law may play a role in some situations involving a Rule 10b–5 claim, we conclude that it has no role here. Reasonable reliance is an element of a federal law claim and what constitutes such reliance is a matter of federal law. Federal law calls for the determination of reasonableness to be made on a case-by-case basis based on all of the surrounding circumstances. The terms of any agreement between the parties may be among these relevant circumstances and, if there is a material dispute about what the parties agreed to, reliance on state contract law may be appropriate to resolve that dispute.

[5] The Delaware cases relied upon by AES, however, do not involve rules of contract interpretation. Primary reliance, for example, is placed upon Norton v. Poplos, 443 A.2d 1 (Del.1982), which involved a contract to sell commercial real estate in which the parties had represented that they "do not rely on any written or oral representations not expressly written in the contract." Id. at 6. The Delaware Supreme Court held that Delaware law will not enforce such a clause to bar a common law rescission claim based on fraudulent, or "innocent but material[,] misrepresentation by a seller." Id. AES and Dow dispute whether this is an across-the-board rule of Delaware law or whether its application is limited to non-negotiated contracts between unsophisticated parties.\(^2\) We need not resolve that issue; the issues of what constitutes an anticipatory waiver of a federal securities claim and whether a purported anticipatory waiver of such a claim is enforceable are matters of federal law. See Newton v. Rumery, 480 U.S. 386, 107 S.Ct. 1187, 94 L.Ed.2d 405 (1987) ("the agreement purported to waive a right to sue conferred by a federal statute. The question whether the policies underlying that statute may in same circumstance
render that waiver unenforceable is a question of federal law.

C. The Role of the Non–Reliance Clause

[6] This brings us back to Section 29(a) of the Exchange Act which forecloses anticipatory waivers of compliance with the duties imposed by Rule 10b–5. We believe the conclusion inescapable that enforcement of the non-reliance clauses to bar AES’s fraud claims as a matter of law would be inconsistent with Section 29(a).

As we have noted, reliance is an essential element of a Rule 10b–5 claim. It necessarily follows that, if a party commits itself never to claim that it relied on representations of the other party to its contract, it purports anticipatorily to waive any future claim based on the fraudulent misrepresentations of that party. The same is true if the commitment is more limited, e.g., a promise not to claim reliance on any representation not set forth in the agreement. The scope of the anticipatory waiver is more limited, but it is nevertheless an anticipatory waiver of potential future claims under Rule 10b–5.

We, thus, find ourselves in agreement with the conclusion of the Court of Appeals for the First Circuit in Rogen v. Ilikon, 361 F.2d 260 (1st Cir.1966). There, a stockholder and former officer and director of the defendant company brought suit alleging that during negotiations for the sale of his stock after his separation from the company, officers and directors of the defendant corporation failed to disclose material information about the possibility of new prospects for the company. In the agreement to sell his stock, plaintiff represented that he was familiar with the business of the company and that he was not relying on any representations of the purchaser or its agents. In addressing the propriety of this type of contractual provision under the Exchange Act, the Court concluded:

This [type of contract clause] is not, in its terms, a “condition, stipulation, or provision binding . . . [plaintiff] to waive compliance” with the Securities Act of 1934 as set forth in Section 29(a) of the Act, (15 U.S.C. § 78cc(a)). But, on analysis, we see no fundamental difference between saying, for example, “I waive any rights I might have because of your representations or obligations to make full disclosure” and “I am not relying on your representations or obligations to make full disclosure.” Were we to hold that the existence of this provision constituted the basis (or a substantial part of the basis) for finding non-reliance as a matter of law, we would have gone far toward eviscerating Section 29(a).

361 F.2d at 268 (alterations in original).

As the Rogen court noted, this is not to say that a plaintiff’s declaration in a contract of an intent not to rely may not be evidence that he or she did not rely on representations of the defendants. That declaration, alone or in conjunction with other evidence of non-reliance, may establish an absence of reliance and, when unrebutted, may even provide a basis for summary judgment in the defendant’s favor. Thus, in this case, the non-reliance clauses are some evidence of an absence of reliance. However, the District Court did not find that the evidence of non-reliance was unrebutted. Indeed, Dow does not contend that the information provided by it and its associates played no material role in AES’s decision to enter the agreement.

Dow does contend, and we understand the District Court to have held, that the non-reliance clauses establish as a matter of law that any reliance of AES was unreasonable reliance. We find the same tension between Section 29(a) and this argument, however, as we have found between
Section 29(a) and the argument that the non-reliance clauses foreclose an assertion by AES that it relied. If all of the evidence bearing on the reasonableness of AES’s reliance does not entitle Dow to summary judgment under traditional summary judgment principles, it would offend Section 29(a) to bar its claim based solely on a contractual commitment not to claim reliance.

IV. The Issue for Decision on Remand

This leaves for resolution the issue of whether, viewing all of the relevant circumstances and applying the reasonable reliance standard set forth in Straub, a reasonable trier of fact could only conclude that AES failed to exercise ordinary care in protecting its own interest. We decline to address that issue, however, because we conclude that it is premature to do so.

Dow did not argue to the District Court that it was entitled to summary judgment because an application of the principles of Straub to all of the relevant circumstances of this case could lead only to one conclusion. It candidly acknowledged that the record was undeveloped with respect to AES’s investigation and its failure to discover the facts it learned after settlement. It insisted, however, that the record had established the only fact necessary to require summary judgment in its favor – the existence of the non-reliance clause. Stated otherwise, Dow’s argument is that it is impossible for a buyer to show reasonable reliance in any case where there is a non-reliance clause. Faced with this argument, AES understandably did not file affidavits or verify its complaint, although it did file a Rule 56(a) affidavit pointing out the need for discovery.

The non-reliance clauses are, of course, among the circumstances to be considered in determining the reasonableness of any reliance here. Importantly, they reflect the fact that the seller was unwilling to vouch for the accuracy of the information it was providing and the fact that the buyer was willing to undertake to verify the accuracy of that data for itself. Clearly, in such circumstances, a buyer who relies on seller-provided information without seeking to verify it has not acted reasonably. Clearly, a buyer in a non-reliance clause case will have to show more to justify its reliance than would a buyer in the absence of such a contractual provision. For this reason, cases involving a non-reliance clause in a negotiated contract between sophisticated parties will often be appropriate candidates for resolution at the summary judgment stage. We are unwilling, however, to hold that the extraction of a non-reliance clause, even from a sophisticated buyer, will always provide immunity from Rule 10b–5 fraud liability.

AES’s complaint alleges that Dow and its subsidiaries were in exclusive control of the information necessary to accurately evaluate the Elsta Plant. It further alleges that, as a part of its fraudulent scheme to sell DEI to someone at a price far above its worth, Dow controlled release of the relevant information to AES both initially as well as during the period that it was conducting its investigation to determine the accuracy of the information initially disclosed. Much of that information involved projections and other “soft” data that a seller dealing in good faith would understandably be unwilling to guarantee. According to AES, it conducted a diligent investigation that was reasonably calculated to determine the reliability of Dow’s representations but revealed no reason to suspect that Dow was intentionally misleading it. Dow allegedly saw to it that all information received by AES would reassure it of the reliability of the earlier supplied data; Dow allegedly also prevented...
AES from securing the data in Dow’s and Destec’s files that would have disclosed the fraud.

In its Rule 56(e) affidavit, AES seeks discovery of information in the exclusive possession of Dow to support AES’s claim that Dow and Destec intentionally concealed their fraudulent conduct, restricted its access to truthful information, and accelerated the transaction to prevent AES from discovering the true status of the construction at the Elsta Plant.

With this as background, AES points to our observation in Straub:

[A] sophisticated investor is not barred [from] reliance upon the honesty of those with whom he deals in the absence of knowledge that the trust is misplaced. Integrity is still the mainstay of commerce and makes it possible for an almost limitless number of transactions to take place without resort to the courts. Straub, 540 F.2d at 598 (citations omitted).

AES argues that a reasonable investor, in its position, trusting in the integrity of the seller, would have understood the seller’s unwillingness to guarantee the truth of the supplied data as something other than a warning that it was unreliable 3 and would have been willing to rely upon an unimpeded investigation of its own.

While AES may have an uphill battle here and summary judgment for the defendants may be appropriate at some point, we decline to give controlling significance to the existence of a non-reliance clause in a vacuum. We fully appreciate that the avoidance of costly discovery is one of the objectives of negotiating such clauses. Nevertheless, to hold that a buyer is barred from relief under Rule 10b–5 solely by virtue of his contractual commitment not to rely would be fundamentally inconsistent with Section 29(a). Given this legislative directive, parties in Dow’s position will have to rely upon discovery management and the summary judgment process to ameliorate the discovery burden.

In reaching this conclusion, we have not been unmindful of the decision of the Court of Appeals for the Second Circuit in Harsco Corp. v. Segui, 91 F.3d 337 (2d Cir.1996). The court there affirmed the dismissal of a Rule 10b–5 security fraud claim based on a stipulation in the stock purchase agreement that the sellers were “not [to] be deemed to have made . . . any representation or warranty other than as expressly made by” the sellers in the agreement. Id. at 342. The Harsco court rejected the purchaser’s argument that the District Court’s dismissal had violated Section 29(a). Although acknowledging that “the underlying concern of § 29(a) is ‘whether the agreement weakens the ability to recover under the Exchange Act’ ” and that the agreement before it could accurately be described as doing precisely that, the Court nevertheless found the “no other representation” clause enforceable:

Thus, the Agreement can be described as weakening Harsco’s ability to recover

3. In Semerenko, 223 F.3d at 181, we upheld the dismissal of some of the plaintiffs’ Rule 10b–5 claims against the accounting firm of Ernst & Young on the ground that the plaintiffs could not reasonably have relied upon its audit opinions after the company publicly announced the discovery of accounting irregularities and warned investors not to rely on its prior financial statements and audit reports. Dow cites Semerenko for the proposition that there is no need here to consider all of the circumstances in determining the reasonableness of plaintiff’s reliance. The cases are not analogous, however. Dow was not saying to potential investors that it was supplying unreliable data that should not be relied upon. Rather, it was communicating only that it was not willing to absorb the risk of guaranteeing the data it was tendering to potential investors for use in evaluating DEI without having been paid for doing so as part of the contract price.
under § 10(b) of the Exchange Act. We think, however, that in the circumstances of this case such a "weakening" does not constitute a forbidden waiver of compliance. Here there is a detailed writing developed via negotiations among sophisticated business entities and their advisors. That writing, we conclude, defines the boundaries of the transaction. Harsco brings this suit principally alleging conduct that falls outside those boundaries.

* * * * * *

Harsco bought Section 2.04's fourteen pages of representations. Unlike a contractual provision which prohibits a party from suing at all, the contract here reflects in detail the reasons why Harsco bought Multi–Serv—in essence, Harsco bought the representations and, according to Sections 2.05 and 7.02, nothing else. This means that there are fourteen pages of representations, any of which, if fraudulent, can be the basis of a fraud action against the sellers. But Harsco specifically agreed that representations not made in those fourteen pages were not made. Thus, it is not fair to characterize Sections 2.05 and 7.02 as having prevented Harsco from protecting its substantive rights. Harsco rigorously defined those rights in Section 2.04.

This analysis becomes a question of degree and context. Harsco has not waived its rights to bring any suit resulting from this deal. Each representation in Section 2.04 is a tooth which adds to the bite of Sections 2.05 and 7.02. In different circumstances (e.g., if there were but one vague seller's representation) a "no other representations" clause might be toothless and run afoul of § 29(a). But not here.

Id. at 343, 344.

We find Harsco's reasoning unpersuasive. Section 29(a) is not intended to protect substantive rights created by contract. It is designed to protect rights created by the Exchange Act, and it expressly forecloses contracting parties from "defin[ing] the boundaries of the[ir] transaction" in a way that relieves a party of the duties imposed by that Act. We do not dispute that there may be economic efficiency in allowing private parties the freedom to fashion their own bargains. But Congress has made a decision to limit that freedom when it comes to anticipatory waivers of Exchange Act claims. Accordingly, we conclude that we must side with the First Circuit Court of Appeals in Rogen rather than with the Harsco court.4

In addition to Harsco, Dow relies on One–O–One Enters., Inc. v. Caruso, 848 F.2d 1283 (D.C.Cir.1988), Jackvony v. RIHT Finan. Corp., 873 F.2d 411 (1st Cir.1989), and Rissman v. Rissman, 213 F.3d 381 (7th Cir.2000). None of these cases address § 29(a). Moreover, as we read them, each provides some support for the approach we hold that the District Court should have taken here—treat the existence of the non-reliance clause as one of the circumstances to be taken into account in determining whether the plaintiff's reliance was reasonable. See the analysis of these decisions in Rissman, 213 F.3d at 387–389 (Rovner, J., concurring). As the District of Columbia Court of Appeals has observed in commenting on One–O–One, a contrary reading "would leave swindlers free to extinguish their victims'
remedies simply by sticking in a bit of boilerplate.” *Id.* at 388.

**V. Conclusion**

The judgment of the District Court will be reversed and this matter will be remanded for further proceedings consistent with this opinion.

CLIFFORD, Senior Circuit Judge.

I agree the case should be reversed, but disagree on the evidentiary use of the stipulations and waivers on remand.

Section 29(a), 15 U.S.C. § 78cc(a), states, “Any ... stipulation ... binding any person to waive compliance with [the Securities Exchange Act] ... shall be void.” AES and Dow’s stipulations are waivers of compliance, and under the express terms of section 29, they are “void.” The majority holds that the void stipulation can nonetheless be evidence of the reasonableness of AES’s reliance. I write separately because I cannot join in the majority’s interpretation of the word “void.”

A void clause is “of no effect whatsoever.” BLACK’S LAW DICTIONARY 1568 (7th ed.1999). It is “an absolute nullity.” Id. It is “ineffective,” “useless,” “having no legal force or validity.” THE AMERICAN HERITAGE DICTIONARY 911 (4th ed.2001). If we permit the void stipulation to have evidentiary value, it is no longer a nullity, ineffective, or useless. Instead, it becomes a very potent weapon in the 10b–5 defendant’s arsenal. This is precisely what section 29(a) prohibits.

At its core, section 29 seeks to prevent parties from contractually avoiding the requirements of Rule 10b–5. If the void stipulation may be evidence in a later Rule 10b–5 claim, how likely is it that the seller of securities will lose the 10b–5 claim? Imagine the mountains of evidence the 10b–5 plaintiff will need to compete with the evidence of the stipulation. Realistically, how will a plaintiff convince a reasonable juror that he reasonably relied on a representation when he signed a provision that stated otherwise? To permit the void stipulation to serve as evidence of a lack of reasonable reliance would be to take the teeth out of section 29. It would make a 10b–5 claim logically possible, but essentially hopeless. Congress meant more when it enacted section 29(a).

Derek J. OATWAY Appellant  
v.  
AMERICAN INTERNATIONAL GROUP, INC., Plan Administrator of Stock Option Plan; American International Group, Inc., a Delaware Corporation; 1987 Employee Stock Option Plan, an employee welfare benefit plan.  
No. 02–1699.  
United States Court of Appeals, Third Circuit.  
Submitted pursuant to Third Circuit LAR 34.1(a) Nov. 4, 2002.  
Filed April 14, 2003.

Former employee brought action against employer as administrator of employee stock option plan, alleging violation of the Employee Income Retirement Security Act (ERISA) based on employer’s refusal to allow employee to exercise stock options. The United States District Court for the District of Delaware, Gregory
DDJ Mgt., LLC v Rhone Group L.L.C.
15 N.Y.3d 147, 905 N.Y.S.2d 118
NY,2010.

15 N.Y.3d 147, 931 N.E.2d 87, 905 N.Y.S.2d 118,

DDJ Management, LLC, et al., Appellants
v
Rhone Group L.L.C. et al., Respondents, et al.,
Defendants.
Court of Appeals of New York

Argued June 2, 2010
Decided June 24, 2010

CITE TITLE AS: DDJ Mgt., LLC v Rhone Group L.L.C.

HEADNOTES

Fraud
Reliance
Written Representations and Warranties Regarding
Accuracy of Financial Statements

(1) In a fraud action brought by plaintiff lenders
after defendant remanufacturer and its affiliated
companies failed to repay the loan plaintiffs made
to them, plaintiffs alleged facts from which a jury
could find that plaintiffs were justified in relying on
the misrepresentations defendants made to them.
Plaintiffs alleged that the remanufacturer's financial
statements presented by defendants were designed
to inflate the accuracy of the remanufacturer's
earnings before interest, taxes, depreciation and
amortization. Although the statements contained
some features that might have aroused concern in a
skeptical reader who examined them carefully, the
remanufacturer, at plaintiffs' insistence, represented
and warranted in the loan agreement that the
financial statements were accurate. Where a
plaintiff has taken reasonable steps to protect itself
against deception, it should not be denied recovery
merely because hindsight suggests that it might
have been possible to detect the fraud when it
occurred. In particular, 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. Here, plaintiffs made a significant
effort to protect themselves against *148 the
possibility of false financial statements: they
obtained representations and warranties to the
effect that nothing in the financials was materially
misleading. Whether plaintiffs were required to do
more—either to conduct their own audit or to
subject the preparers of the financial statements to
detailed questioning—was a question to be resolved
by the trier of fact.

Fraud in Inducement
Liability of Companies Affiliated with Company Providing False Financial Statements

(2) In a fraud action brought by plaintiff lenders after defendant remanufacturer failed to repay a loan, plaintiffs stated a fraud cause of action against the defendants who owned and controlled the remanufacturer based upon written representations and warranties by the remanufacturer in the loan agreement regarding certain financial statements. Although plaintiffs could not recover against those defendants as a contractual matter if plaintiffs proved only that the warranties were false, recovery would be possible under a claim for fraud if plaintiffs proved that those defendants knew that the financial statements gave an untrue picture of the remanufacturer's financial condition. It could be inferred from the allegations of the complaint that plaintiffs believed those defendants would not knowingly cause a company they controlled to make false representations in a loan agreement as to the accuracy of financial statements. It cannot be said as a matter of law that this was an unjustifiable belief.

RESEARCH REFERENCES

Am Jur 2d, Fraud and Deceit §§ 2, 23, 26, 239, 245, 248, 263, 279, 468.

NY Jur 2d, Fraud and Deceit §§ 87, 147, 156, 232–235.


ANNOTATION REFERENCE

See ALR Index under Fraud and Deceit.

FIND SIMILAR CASES ON WESTLAW

Database: NY-ORCS

Query: fraud /s justifi! /3 reliance rely! & financial /2 statement /p represent! /s warrant!

POINTS OF COUNSEL

Law Offices of Arnold M. Weiner (Arnold M. Weiner of the Maryland bar, admitted pro hac vice, and Barry L. Gogel of counsel), Epstein Becker & Green, P.C., New York City (Barry A. Cozier and Ralph A. Berman of counsel), and Whiteford, Taylor & Preston, L.L.P., Baltimore, Maryland (William F. Ryan, Jr., Edward M. Buxbaum and Dwight W. Stone, II, of counsel), for appellants.

I. The Appellate Division erred in performing its *149 review of the sufficiency of the complaint on motions to dismiss under CPLR 3211 (a). (Knight Sec. v Fiduciary Trust Co., 5 AD3d 172; Sokoloff v Harriman Estates Dev. Corp., 96 NY2d 409; Nonnon v City of New York, 9 NY3d 825.) II. There is no support in existing New York case law for the Appellate Division's harsh bright-line rule. (Metropolitan Coal Co. v Howard, 155 F2d 780; CBS Inc. v Ziff-Davis Publ. Co., 75 NY2d 496; National Conversion Corp. v Cedar Bldg. Corp., 23 NY2d 621; Jo Ann Homes at Bellmore v Dworetz, 25 NY2d 112; Merrill Lynch & Co. Inc. v Allegheny Energy, Inc., 500 F3d 171; Faller Group, Inc. v Jaffe, 564 F Supp 117; Emergent Capital Inv. Mgt., LLC v Stonepath Group, Inc., 343 F3d 189; Lazard Freres & Co. v Protective Life Ins. Co., 108 F3d 1531; Turkish v Kasenetz, 27 F3d 23; Spyder Enters., Inc. v Ward, 872 F Supp 8.) III. The decision of the First Department threatens to have a chilling effect upon commercial lending and is therefore inconsistent with sound public policy. (Abu Dhabi Commercial Bank v Morgan Stanley & Co., 651 F Supp 2d 155.)

Wachtell, Lipton, Rosen & Katz, New York City (Herbert M. Wachtell, Ben M. Germana, Emil A. Kleinhaus and Adam P. Schleifer of counsel), and Sullivan & Cromwell LLP (Brian T. Frawley and Naomi D. Johnson of counsel) for Rhone Group L.L.C. and others, respondents.

I. The complaint fails to allege facts showing reasonable reliance. (Global Mins. & Metals Corp. v Holme, 35 AD3d 93, 8 NY3d 804; Abrahami v UPC Constr. Co., 224 AD2d 231; Schumaker v
Mather, 133 NY 590; Danann Realty Corp. v Harris, 5 NY2d 317; Sylvester v Bernstein, 283 App Div 333, 307 NY 778; Lanzi v Brooks, 54 AD2d 1057, 43 NY2d 778; Dragon Inv. Co. II LLC v Shanahan, 49 AD3d 403; Valassis Communications v Weimer, 304 AD2d 448; UST Private Equity Inv. Fund v Salomon Smith Barney, 288 AD2d 87; Orlando v Kukielka, 40 AD3d 829. III. Appellants' and amici's "public policy" arguments are meritless. (CBS Inc. v Ziff-Davis Publ. Co., 75 NY2d 496.)

Nixon Peabody LLP, New York City (Christopher M. Mason and Leah R. Threatte of counsel), for Quilvest S.A. and others, respondents.

I. Plaintiffs did not plead or offer facts showing reasonable reliance as to Quilvest S.A., Quilvest Services Ltd., and Quilvest American Equity Ltd. (Global Mins. & Metals Corp. v Holme, 35 AD3d 93, 8 NY3d 804; Wendel v Wendel, 30 App Div 447; Daly v Kochanowicz, 67 AD3d 1164; Dragon Inv. Co. II LLC v Shanahan, 49 AD3d 403; Lusins v Cohen, 49 AD3d 1015; Orlando v Kukielka, 40 AD3d 829; Permasteelisa, S.p.A. v Lincolnshire Mgt., Inc., 16 AD3d 352; Barrett v Huff, 6 AD3d 351; Valassis Communications v Weimer, 304 AD2d 448; UST Private Equity Inv. Fund v Salomon Smith Barney, 288 AD2d 87.) III. Public policy does not favor allowing a lender to conclude a large financial transaction without conducting appropriate due diligence.

Dorsey & Whitney LLP (Juan C. Basombrio, of the California bar, admitted pro hac vice) and Dorsey & Whitney LLP, New York City (Marc S. Reiner of counsel), for Scott Duncan, respondent.

The claim against Scott Duncan fails for the reasons set forth in the briefs submitted by the other defendants-respondents. (Walton v New York State Dept. of Correctional Servs., 8 NY3d 186; Schiavone v City of New York, 92 NY2d 308; Ziecker v Town of Orchard Park, 75 NY2d 761; McCain v Koch, 70 NY2d 109.) III. The First Department's proposed rule is contrary to long-standing public policy governing commercial transactions. (Credit Francais Intl. v Sociedad Fin. de Comercio, 128 Misc 2d 564; Metropolitan Coal Co. v Howard, 155 F2d 780; CBS Inc. v Ziff-Davis Publ. Co., 75 NY2d 496; Pramco III, LLC v Partners Trust Bank, 16 Misc 3d 351; Merrill Lynch & Co. Inc. v Allegheny Energy, Inc., 500 F3d 171.) III. The First Department's harsh bright-line rule is not supported by its prior cases and conflicts with persuasive Second Circuit case law. (UST Private Equity Inv. Fund v Salomon Smith Barney, 288 AD2d 87; Global Mins. & Metals Corp. v Holme, 35 AD3d 93, 8 NY3d 804; Abrahami v UPC Constr. Co., 224 AD2d 231; Permasteelisa, S.p.A. v Lincolnshire Mgt., Inc., 16 AD3d 352; Merrill Lynch & Co. Inc. v Allegheny Energy, Inc., 500 F3d 171; Metropolitan Coal Co. v Howard, 155 F2d 780; Mallis v Bankers Trust Co., 615 F2d 68.)

OPINION OF THE COURT

Smith, J.

We hold that plaintiffs in this action for fraud have alleged facts from which a jury could find that they were justified in relying on the representations defendants made to them.**2
Plaintiffs are four companies that loaned a total of $40 million in March of 2005 to American Remanufacturers Holdings, Inc. and affiliated companies (ARI). ARI was a remanufacturer of automobile parts; it purchased used parts, broke them down into their components, and used the components to make new parts. ARI's stock was owned 45% by entities affiliated with Rhone Group L.L.C., and 55% by entities affiliated with Quilvest S.A.

After ARI failed to repay the loan, plaintiffs brought a number of claims against Rhone, Quilvest, companies and individuals associated with them, members of ARI management, and ARI's outside accountants. Only the first claim is in issue here. It asserts in essence that Rhone and Quilvest, their corporate affiliates and individuals acting on their behalf (hereafter defendants) defrauded plaintiffs into making the loans.

Plaintiffs allege, among other things, that defendants presented them with ARI financial statements that were false and misleading. More specifically, they allege that the financial statements were designed to inflate the number with which plaintiffs were most concerned—ARI's earnings before interest, taxes, depreciation and amortization (EBITDA). The allegations on this subject are lengthy, and include some striking details. An e-mail sent to one of the defendants by an ARI executive about two months before the loan closing says: “I understand the financial reason to manipulate earnings.” Another e-mail, sent some three weeks later by the same officer to the same recipient says: “I realize we needed to make EBITDA for banks but we should understand . . . what our true EBITDA is.”

We need not describe defendants' alleged misconduct fully; we may assume, for purposes of this appeal, that the complaint adequately alleges that defendants made material misrepresentations. The question for us is whether, if the complaint's allegations are true, a jury could find that plaintiffs justifiably relied on those misrepresentations. Defendants argue that plaintiffs failed to make a reasonable inquiry into the truth of what defendants said, and we will describe in more detail the alleged facts that are relevant to that argument.

The complaint alleges that plaintiffs were first solicited to loan money to ARI in July 2004, and that over the next several months they received a number of written presentations by ARI's investment banker, containing financial and other information that later proved to be false or misleading. At the time of the solicitation—and indeed until the day the loan closed—ARI's outside auditors had not completed their audit for the year ending December 31, 2003, and it was part of the original proposal that the loans would be “conditioned upon, and made after, the borrower had provided the lenders” with audited financial statements for 2003. It was later agreed that unaudited financial statements for 2004 would also be provided.

During the months before those financial statements were completed, plaintiffs had several conversations with ARI representatives in which they were given reassuring information, and made two calls to participants in the industry to get information about ARI's management, which was also reassuring. In December 2004 and January 2005, plaintiffs were sent drafts of the audit report for 2003, and on March 2, 2005 they were sent the unaudited financial statements for 2004. The final version of the 2003 audit report was provided on March 22, 2005, and the loan closed on the same day.

ARI's unaudited 2004 statements, plaintiffs allege, grossly inflated EBITDA, in significant part through a manipulation of ARI's inventory reserves. Plaintiffs say that they could not have detected this, but, as defendants point out, the 2004 statements contained some features that might have aroused concern in a skeptical reader who examined them.
carefully. They showed a significant increase in the value of ARI's inventory over the previous year; a modest amount of cash on hand, equal to the amount of ARI's bank overdraft; and a remarkable increase in the company's apparent profitability in the last month of the year. Though December 2004 revenues were below the year's monthly average, gross profit was higher than average, and gross margin was shown as 17.9% for the month, compared to 13.5% for the year as a whole.

The complaint does not allege that plaintiffs asked questions about these or other aspects of the financial statements, or that they asked to look at ARI's underlying records. Plaintiffs did, however, insist that ARI represent and warrant, in substance, that the financial statements were accurate. Specifically, ARI represented and warranted in the loan agreement (as summarized in the complaint) that the 2004 financial statements “present fairly in all material respects the financial position of ARI as at December 31, 2004 and the results of ARI's operations and cash flows for the period then ended”; that the statements were prepared in accordance with generally accepted accounting principles; that “between December 31, 2003 and March 22, 2005 [the closing date], no event has occurred, which alone or together with other events, could reasonably be expected to have a Material Adverse Effect” on ARI's business, assets, operations or prospects or its ability to repay the loans; and that “no information contained in the loan agreement, the other loan documents or the financial statements being furnished to the Plaintiffs contains any untrue statement of a material fact or omits to state a material fact necessary to make the statements contained therein not misleading in light of the circumstances under which they were made.” All of these representations and warranties, plaintiffs say, later proved to be false.

The rule defendants rely on was stated more than a century ago in 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.” (See also Danann Realty Corp. v Harris, 5 NY2d 317, 322 [1959].)

This rule has been frequently applied in recent years where the plaintiff is a sophisticated business person or entity that claims to have been taken in. In some cases, the rule serves to rid the courts of cases in which the claim of reliance is likely to be hypocritical. Thus in Global Mins. & Metals Corp. v Holme (35 AD3d 93 [1st Dept 2006]), the plaintiff had fired an officer whom it found to be untrustworthy, and given him a general release.
Later, it claimed to have trusted, without verifying, the officer's assurances as to the innocent nature of a particular transaction. The Appellate Division held such trust to be unjustified. In other cases, the rule rejects the claims of plaintiffs who have been so lax in protecting themselves that they cannot fairly ask for the law's protection. In Lampert v Mahoney, Cohen & Co. (218 AD2d 580, 582 [1st Dept 1995]), the Appellate Division dismissed the claim of a plaintiff who said “that he loaned some $3 million to a corporate entity and its principal without ever investigating the financial condition of the business beyond obtaining some vague verbal assurances from its accountant.” In cases like Global Minerals and Lampert, the plaintiff “may truly be said to have willingly assumed the business risk that the facts may not be as represented” (Rodas v Manitaras, 159 AD2d 341, 343 [1st Dept 1990]).

Where, however, a plaintiff has taken reasonable steps to protect itself against deception, it should not be denied recovery merely because hindsight suggests that it might have been possible to detect the fraud when it occurred. In particular, 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. Indeed, there are many cases in which the plaintiff’s failure to obtain a specific, written representation is given as a reason for finding reliance to be unjustified (see e.g. Curran, Cooney, Penney v Young & Koomans, 183 AD2d 742, 743-744*155 [2d Dept 1992]; Rodas v Manitaras, 159 AD2d at 343; Emergent Capital Inv. Mgt., LLC v Stonepath Group, Inc., 343 F3d 189, 196 [2d Cir 2003] [applying New York law]). It is harder to find cases holding that a plaintiff who did obtain such a representation could not justifiably rely on it; one such case is Ponzini v Gatz (155 AD2d 590 [2d Dept 1989]), in which the plaintiff’s attorney actually knew that the warranty in question was false. In National Conversion Corp. v Cedar Bldg. Corp. (23 NY2d 621 [1969]) —a case admittedly much different in its facts from this one—we held that it was reasonable for the plaintiff to rely on a written representation as a substitute for making an investigation of the facts represented.

“The question of what constitutes reasonable reliance is always nettlesome because it is so fact-intensive” (Schlaifer Nance & Co. v Estate of Warhol, 119 F3d 91, 98 [2d Cir 1997]). No two cases are alike in all relevant ways. However, several federal cases applying New York law bear a noticeable resemblance to this one—and all of them hold that the plaintiffs’ claims of justifiable reliance were legally sufficient (Merrill Lynch & Co. Inc. v Allegheny Energy, Inc., 500 F3d 171, 181-182 [2d Cir 2007]; Barron Partners, LP v Lab123, Inc., 2008 WL 2902187, 2008 US Dist LEXIS 56899 [SD NY 2008]; JP Morgan Chase Bank v Winnick, 350 F Supp 2d 393 [SD NY 2004]; Faller Group, Inc. v Jaffe, 564 F Supp 1177 [SD NY 1983]).

JP Morgan is perhaps the case most similar to ours. Plaintiffs there were banks that had extended credit to Global Crossing, Ltd. (GC). After it became insolvent, the banks sued GC’s officers, directors and employees for fraud. The District Court denied defendants’ motion for summary judgment on the fraud claims, rejecting the argument “that the plaintiffs cannot demonstrate reliance on the alleged misrepresentations” (350 F Supp 2d at 404). The court emphasized that plaintiffs had bargained for a provision in their credit agreement with GC to the effect that “each loan request was ‘deemed’ a representation and warranty” by GC that no ‘event of default’ had occurred” (id. at 396). Examining the facts of several state and federal cases applying New York law, the court concluded that they “do not support the interpretation that a duty to inquire is necessarily triggered as soon as a plaintiff has the slightest ‘hints’ of any ‘possibility’ of falsehood” (id. at 408). The court said:

“It is undisputed that the Banks expressly bargained *156 not only for the right to examine GC’s books and records, but also for the provision of the Agreement deeming each borrowing request to be a
representation that GC remained in compliance with its debt covenants at the time the request was made. Under these circumstances, it cannot be argued that the Banks failed to bargain for adequate safeguards to establish, at least initially, the basis for their reliance on the defendants' representations” (id. at 409).

Noting the defendants' argument “that GC's financial statements were so transparently false—or at least, that the assumptions on which they were based were so apparently questionable—that no reasonable banker would have lent GC a penny without conducting further inquiry into their accuracy” (id.), the court found that the question it presented was for the jury. The court was unable to say as a matter of law that “a reasonable lender of equivalent experience should have inquired further” into GC's financial statements (id. at 411).

(1) We reach a similar conclusion here. It is fair to say that there were hints from which plaintiffs might have been put on their guard in this transaction. Some aspects of the 2004 financial statements—particularly the sudden improvement in profitability in the last month of the year—might have seemed too good to be true; the fact that it took an auditor until March of 2005 to complete an examination of the 2003 financial statements was hardly encouraging; and the high interest rate itself demonstrates that plaintiffs knew the transaction carried considerable risk. But plaintiffs made a significant effort to protect themselves against the possibility of false financial statements: they obtained representations and warranties to the effect that nothing in the financials was materially misleading. We decline to hold as a matter of law that plaintiffs were required to do more—either to conduct their own audit or to subject the preparers of the financial statements to detailed questioning. 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.

(2) Defendants emphasize that the warranties were given only by ARI, and suggest that they cannot support a claim against Rhone, Quilvest and others. But this argument blurs the distinction between claims for breach of warranty and claims for fraud. It is true that, as a contractual matter, the only rights plaintiffs acquired under the warranties were against ARI. If plaintiffs prove only that the warranties were false, they cannot recover against Rhone and Quilvest. But if they can prove that Rhone and Quilvest knew the facts represented and warranted were false—in other words, that Rhone and Quilvest knew the financial statements gave an untrue picture of ARI's financial condition—the case is different. It can be inferred from the allegations of the complaint that plaintiffs believed Rhone and Quilvest would not knowingly cause a company they controlled to make false representations in a loan agreement as to the accuracy of financial statements. We cannot say as a matter of law that this was an unjustifiable belief.

Accordingly, the order of the Appellate Division, insofar as appealed from, should be reversed with costs, and the case remitted to the Appellate Division for consideration of questions raised but not determined on the appeal to that court.

Chief Judge Lippman and Judges Ciparick, Graffeo, Read, Pigott and Jones concur.

Order, insofar as appealed from, reversed, with costs, and case remitted to the Appellate Division, First Department, for consideration of issues raised but not determined on the appeal to that court.

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NY,2010.
86 A.D.3d 435, 927 N.Y.S.2d 52
NY, 2011.


China Development Industrial Bank, Respondent v
Morgan Stanley & Co. Incorporated et al.,
Appellants, et al., Defendants.

Supreme Court, Appellate Division, First
Department, New York

July 7, 2011


HEADNOTES

Pleading
Sufficiency of Pleading
Fraud—Scienter

Pleading
Sufficiency of Pleading
Fraudulent Inducement

Pleading
Sufficiency of Pleading
Fraudulent Concealment

Davis Polk & Wardwell LLP, New York (James P. Rouhandeh of counsel), for appellants.
Robbins Geller Rudman & Dowd LLP, Melville (Jason C. Davis of counsel), for respondent.

Order, Supreme Court, New York County (Melvin L. Schweitzer, J.), entered February 28, 2011, which, to the extent appealed from, denied the Morgan Stanley defendants' (collect *436 ively, Morgan) motion to dismiss the complaint pursuant to CPLR 3211 (a) (1) and (7) and 3016 (b), and denied that branch of the motion seeking to strike plaintiff's demand for a jury trial in connection with plaintiff's fraudulent inducement cause of action, unanimously affirmed, with costs.

In this action alleging common-law fraud, fraud in the inducement and fraudulent concealment in the sale of an investment product (credit default swaps), plaintiff purchaser (China) alleges that defendant seller Morgan falsely promoted collateral debt obligations as having specified credit ratings, which Morgan knew to be overstated and misleading. Specifically, the ratings were allegedly generated with grandfathered models and protocols and assumptions that were no longer applicable. Such ratings for Morgan's products were allegedly procured by way of Morgan's financial influence over the rating agencies. We recognize that a sophisticated business entity, like China, that alleges it was fraudulently induced to enter a contract because of false representations as to a product's quality, may nonetheless be precluded by contractual disclaimers from pursuing such a claim (see MBIA Ins. Corp. v Merrill Lynch, 81 AD3d 419 [2011]). Nevertheless, such rule is not determinative in this case. China has sufficiently alleged that Morgan possessed peculiar knowledge of the facts underlying the fraud, and the circumstances present would preclude any investigation by China conducted with due diligence (see generally Jana L. v West 129th St. Realty Corp., 22 AD3d 274 [2005]). The element of scienter can be reasonably inferred from the facts alleged (see Pluedeman v Northern Leasing Sys., Inc., 10 NY3d 486, 492-493 [2008]), including e-mails, which support a motive by Morgan, at the time of the subject transaction, to quickly dispose of troubled collateral (i.e., predominately residential mortgage-backed securities) which it owned at the time.

China also adequately alleged facts in support of its fraudulent concealment claim to indicate that Morgan had a duty to disclose, inasmuch as
Morgan allegedly had peculiar knowledge of the application of grandfathered ratings, the unstable collateral which was sold, and its misstatements regarding the investment risks involved (see generally King County, Washington v IKB Deutsche Industriebank AG, 751 F Supp 2d 652 [SD NY 2010]).

China’s allegations were sufficiently particularized to support a claim for fraudulent inducement. As the validity of the parties’ 2007 investment transaction is challenged by the allegations, the motion court properly concluded that the jury waiver provision in the agreement was inapplicable to the fraudulent inducement cause of action (see generally Wells Fargo Bank, N.A. v Stargate Films, Inc., 18 AD3d 264 [2005]).

Morgan argues that China ratified the parties’ 2007 transaction agreement when, in May 2009, it executed an amendment to the 2007 agreement. Morgan claims that at such time, China should have been on inquiry notice of the alleged fraudulent conduct. However, because China claimed it signed the amendment under economic duress, and damage attributable to the fraud may already have accrued (see e.g. Braddock v Braddock, 60 AD3d 84, 94-95 [2009]), there are issues of fact which preclude judgment for Morgan. Concur—Mazzarelli, J.P., Catterson, DeGrasse, Abdus-Salaam and Román, JJ.

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NY,2011.

END OF DOCUMENT
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CASE SUMMARY:

OVERVIEW: HOLDINGS: [1]-A trial court properly denied a finance company's motion to compel arbitration because there was a substantial question as to whether the parties agreed to arbitrate and it was shown that the buying fund never signed the document containing the mandatory arbitration clause; [2]-The court held that the motion court properly declined to dismiss the fraud claims since the disclaimers and disclosures in the offering circulars did not preclude, as a matter of law, the buying fund's claim of justifiable reliance; [3]-The motion court should have dismissed the negligent representation claim because there was no allegation of a relationship of trust and confidence between the parties, the unjust enrichment claim since the transactions were governed by written agreements, and the rescission claim because the complaint failed to allege the absence of an adequate remedy at law.

OUTCOME: Order modified to the extent of granting that part of the motion seeking to dismiss the causes of action for negligent misrepresentation, unjust enrichment and rescission; otherwise, the order was affirmed.

LexisNexis(R) Headnotes

Civil Procedure > Alternative Dispute Resolution > arbitrations > Arbitrability
Civil Procedure > Alternative Dispute Resolution > Validity of ADR Methods
Contracts Law > Contract Conditions & Provisions > Arbitration Clauses

[HN1] A party will not be compelled to arbitrate absent evidence which affirmatively establishes that the parties expressly agreed to arbitrate their disputes. The agreement must be clear, explicit and unequivocal. An arbitration clause in an unsigned agreement may be enforceable but only when it is evident that the parties intended to be bound by the contract.
The contention that a court is limited to the pleadings, when reviewing a motion to dismiss pursuant to CPLR 3211(a)(7), is not a completely accurate statement of the law. What the New York Court of Appeals has consistently said is that evidence in an affidavit used by a defendant to attack the sufficiency of a pleading will seldom if ever warrant the relief the defendant seeks unless such evidence conclusively establishes that plaintiff has no cause of action. A CPLR 3211(a)(7) motion may be used by a defendant to test the facial sufficiency of a pleading in two different ways. On the one hand, the motion may be used to dispose of an action in which the plaintiff has not stated a claim cognizable at law. On the other hand, the motion may be used to dispose of an action in which the plaintiff identified a cognizable cause of action but failed to assert a material allegation necessary to support the cause of action. As to the latter, the Court of Appeals has made clear that a defendant can submit evidence in support of the motion attacking a well-pleaded cognizable claim.

When documentary evidence is submitted by a defendant, the standard morphs from whether the plaintiff has stated a cause of action to whether it has one. CPLR 3211(A)(7). If the defendant's evidence establishes that the plaintiff has no cause of action, for example, that a well-pleaded cognizable claim is flatly rejected by the documentary evidence, dismissal would be appropriate.

To make a prima facie claim of fraud, a complaint must allege misrepresentation or concealment of a material fact, falsity, scienter on the part of the wrongdoer, justifiable reliance and resulting injury. Even in the absence of any affirmative misrepresentation or any fiduciary obligation, a party may be liable for nondisclosure where it has special knowledge or information not attainable by the plaintiff, or when it has made a misleading partial disclosure.

The law is abundantly clear in New York that a buyer's disclaimer of reliance cannot preclude a claim of justifiable reliance on the seller's misrepresentations or omissions unless (1) the disclaimer is made sufficiently specific to the particular type of fact misrepresented or undisclosed; and (2) the alleged misrepresentations or omissions did not concern facts peculiarly within the seller's knowledge. Accordingly, only where a written contract contains a specific disclaimer of responsibility for extraneous representations, that is, a provision that the parties are not bound by or relying upon representations or omissions as to the specific matter, is a plaintiff precluded from later claiming fraud on the ground of a prior misrepresentation as to the specific matter. In other words, in view of the disclaimer, no representations exist and that being so, there can be no reliance.

Even if the disclaimers and disclosures were to be viewed as sufficiently specific, a purchaser may not be precluded from claiming reliance on misrepresentations of facts peculiarly within the seller's knowledge.

The theory of unjust enrichment is one created in law in the absence of any agreement.

COUNSEL: [*1] Boies, Schiller & Flexner LLP, New York (Philip M. Bowman, Jonathan D. Schiller and Thomas Ling of counsel), for appellants.
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Lewis and Courtney L. Weiner of counsel), for respondent.


OPINION BY: RENWICK

DEFENDANTS APPEAL FROM THE ORDER OF THE Supreme Court, New York County (Shirley Werner Kornreich, J.), entered October 19, 2012, which, insofar as appealed from, denied their motion to compel arbitration or, in the alternative, to dismiss the causes of action for fraud, fraudulent inducement, fraudulent concealment, negligent misrepresentation, unjust enrichment, and rescission.

RENWICK J. [**2]

This is a case of a Wall Street firm (Goldman Sachs) being accused of selling mortgage-backed securities it knew to be "junk" and then betting against the same securities as the 2007 financial crisis unfolded. Specifically, plaintiff, Basis Yield Alpha Fund (Basis), a fund managed by an Australian hedge fund, Basis Capital Fund Management, commenced this action against several Goldman Sachs-related entities over investments in subprime mortgage-linked securities that [**2] contributed to the fund's demise. The transactions took place on April 17 and June 13, 2007, with the sale of a security issued by a collateralized debt obligation (CDO) known as Point Pleasant 2007-1, Ltd., as well as Basis's entry into two credit default swaps that referenced securities from a similar CDO known as Timberwolf 2007-1, Ltd. Basis, which financed these transactions with loans from Goldman, reportedly lost $67 million when the bank began making margin calls on the products shortly after selling them to Basis. The margin calls quickly forced Basis into insolvency.

1 Plaintiff brings this action against defendants Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs International and Goldman Sachs & Partners Australia Pty. Ltd. (collectively referred to as Goldman).

Initially, in 2010, Basis commenced an action for federal securities fraud and common law fraud against Goldman in the U.S. District Court for the Southern District of New York. In an order dated July 21, 2011, the court dismissed the case on the ground that the underlying transactions were not domestic securities transactions and, therefore, are not subject to federal securities laws. The District Court [**3] declined to exercise supplemental jurisdiction over the remaining state law claims and dismissed the case without prejudice. In late 2011, Basis commenced this action against Goldman for: (1) common law fraud; (2) fraudulent inducement; (3) fraudulent concealment; (4) breach of contract; (5) negligent misrepresentation; (6) breach of the implied covenant of good faith and fair dealing; (7) unjust enrichment; and (8) rescission. The factual allegations in the complaint are similar to those made in the federal action.

In lieu of answering the complaint, Goldman moved for an order compelling arbitration pursuant to the New York Convention and CPLR 7503(a) or, in the alternative, dismissing the complaint for failure to state a cause of action (CPLR 3211[a][7]). Supreme Court denied the motion to compel arbitration, as well as the motion to dismiss with respect to the causes of actions alleging fraud, negligent misrepresentation, unjust enrichment and rescission.2

2 The court granted that portion of defendants' motion seeking to dismiss the claims of breach of contract and breach of the implied covenant of good faith and fair dealing, which are not at issue on this appeal.

As a threshold consideration, [**4] we examine Goldman's contention that the motion court improperly denied its motion to compel arbitration. Goldman does not challenge the motion [**3] court's refusal to compel arbitration pursuant to the New York Convention. We note, however, that the motion court properly held that the purported document containing an arbitration clause did not meet the writing requirements of the New York Convention, which defines an "agreement in writing" to include "an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams (see New York Convention, Article II[2]). The document, which was attached to an e-mail, was never signed by Basis, nor referred to in any exchange of correspondence between the parties.

3 The New York Convention is formally known as the 1958 United Nations Convention on the Recognition and Enforcement of Foreign Arbitral

Goldman also fails to satisfy the heavy burden of demonstrating that arbitration should [*5] be compelled pursuant to CPLR Article 75. As the Court of Appeals has stated, [HN1] "[A] party will not be compelled to arbitrate . . . absent evidence which affirmatively establishes that the parties expressly agreed to arbitrate their disputes. The agreement must be clear, explicit and unequivocal" (Matter of Waldron (Goddess), 61 NY2d 181, 183, 461 N.E.2d 273, 473 N.Y.S.2d 136 [1984] [internal quotation marks and citations omitted]). An arbitration clause in an unsigned agreement may be enforceable but only "when it is evident that the parties intended to be bound by the contract" (God's Battalion of Prayer Pentecostal Church, Inc. v Miele Assoc., LLP, 6 NY3d 371, 373, 845 N.E.2d 1265, 812 N.Y.S.2d 435 [2006]).

Here, there is a substantial question as to whether the parties agreed to arbitrate. In support of its motion to compel arbitration, Goldman relied on a mandatory arbitration clause set forth in a document entitled "General Terms and Conditions" that was attached to a November 10, 2006 email. Goldman claims to have sent the email to Basis in connection with the latter's opening of a trading account with Goldman. It is, however, undisputed that the document was never signed by anyone from Basis. More importantly, the director of Basis's managing entity [*6] swore in an affidavit that Basis never entered into the arbitration agreement Goldman proffers.

Since the record does not affirmatively establish a valid obligation to arbitrate the issues raised herein, we must examine Goldman's alternative argument seeking dismissal of the action. With regard to the fraud allegations, Goldman argues that plaintiff failed to state a cause of action because the element of reasonable reliance is precluded as a matter of law by the disclaimer and disclosure in the offering circulars. We do not find that such argument is procedurally precluded by the fact that "Goldman's motion was made under CPLR 3211(a)(7)." The concurring opinion incorrectly maintains that Goldman cannot rely on documentary evidence (the disclaimer and disclosure in the offering circulars) because a CPLR 3211(a)(7) motion is limited to a review of the pleadings.

The motion court examined the purported documentary evidence, albeit over plaintiff's objections, but concluded that it did not bar the fraud claims. Plaintiff, however, has abandoned [**4] such procedural argument by failing to raise it on appeal (see Matter of Raqiyb v Fischer, 82 AD3d 1432, 1433, 919 N.Y.S.2d 543, n [3rd Dept 2011], citing Matter of Ifill v Fischer, 72 AD3d 1367, 901 N.Y.S.2d 723, [*7] n [3rd Dept 2010]). Instead, in its opening paragraph of the argument section opposing Goldman's motion to dismiss the fraud claims, plaintiff simply comments:

"Goldman's argument on appeal strays far beyond addressing the sufficiency of the allegations. Instead, Goldman seeks to play on a field of disputed issues of fact. But this provides no basis for dismissing this Complaint. That is particularly the case here when this Complaint is based not just on well-pleaded allegations, but on inculpatory Goldman documents disclosed in prior proceedings [emphasis added]."

Thus, on this appeal, plaintiff does not claim that this Court is "procedurally" precluded from examining the documentary evidence at issue because Goldman moved to dismiss under CPLR 3211(a)(7). Rather, plaintiff appears to be arguing that the documentary evidence simply raises "disputed issues of fact," which, as plaintiff correctly asserts, is not enough for a dismissal under CPLR 3211(a)(7).

In any event, [HN2] the concurrence's contention that this Court is limited to the pleadings, when reviewing a motion to dismiss pursuant to CPLR 3211(a)(7), is not a completely accurate statement of the law. What the Court of Appeals has [*8] consistently said is that evidence in an affidavit used by a defendant to attack the sufficiency of a pleading "will seldom if ever warrant the relief [the defendant] seeks unless [such evidence] conclusively establishes that plaintiff has no cause of action" (Rovello v Orofino Realty Co, Inc, 40 NY2d 633, 636, 357 N.E.2d 970, 389 N.Y.S.2d 314 [1976] [emphasis added]; see also Guggenheim v Ginzburg, 43 NY2d 268, 372 N.E.2d 17, 401 N.Y.S.2d 182 [1977]).
A CPLR 3211(a)(7) motion may be used by a defendant to test the facial sufficiency of a pleading in two different ways. On the one hand, the motion may be used to dispose of an action in which the plaintiff has not stated a claim cognizable at law. On the other hand, the motion may be used to dispose of an action in which the plaintiff identified a cognizable cause of action but failed to assert a material allegation necessary to support the cause of action. As to the latter, the Court of Appeals has made clear that a defendant can submit evidence in support of the motion attacking a well-pleaded cognizable claim (see Rovello, 40 NY2d 633, 357 N.E.2d 970, 389 N.Y.S.2d 314; Guggenheim, 43 NY2d 268, 372 N.E.2d 17, 401 N.Y.S.2d 182; see also Board of Managers of Fairways at N. Hills Condominiums v Fairways at N. Hills, 150 AD2d 32, 545 N.Y.S.2d 343 [2d Dept 1989]).

In his concurring opinion, [*9] Justice DeGrasse argues that factual allegations presumed to be true on a CPLR 3211(a)(7) motion may be properly negated by an affidavit but not by documentary evidence. This distinction makes no sense. On a motion, the only possible way that documentary evidence can be submitted to the court is by way of affidavit. Thus, an affidavit from an individual, even if the person has no personal knowledge of the facts, may properly serve as the vehicle for the submission of acceptable attachments which provide evidentiary proof in admissible form, like documentary evidence. In such situations, the affidavit itself is not considered evidence; it merely serves as a vehicle to introduce documentary evidence to the court. Our judgment as to the conclusive nature of the adduced evidence should not depend on such an artificial distinction. The key should be whether the evidence adduced conclusively negates an element of the cause of action. Here, the documentary evidence defendants allege is dispositive was in fact submitted via affidavit. Thus, even under the concurrence's view, it was properly considered.

Thus, there is no procedural impediment to evaluating the merits of Goldman's motion to dismiss the fraud claims. [HN4] To make a prima facie claim of fraud, a complaint must allege misrepresentation or concealment of a material fact, falsity, scienter on the part of the wrongdoer, justifiable reliance and resulting injury (see Dembeck v 220 Cent. Park S., LLC, 33 AD3d 491, 492, 823 N.Y.S.2d 45 [1st Dept 2006]). Even in the absence [*11] of any affirmative misrepresentation or any fiduciary obligation, a party may be liable for nondisclosure where it has special knowledge or information not attainable by plaintiff, or when it has made a misleading partial disclosure (see Williams v Sidney Austin Brown & Wood, L.L.P., 38 AD3d 219, 220, 832 N.Y.S.2d 9 [1st Dept 2007]; L.K. Sta. Group, LLC v Quantek Media, LLC, 62 AD3d 487, 493, 879 N.Y.S.2d 112 [1st Dept 2009]).

In this case, plaintiff's theory of fraud does not rest upon a single decisive event which manifestly demonstrates Goldman's wrongdoing, but on a series of interrelated events which, viewed as whole, portray the alleged fraudulent scheme. In essence, plaintiff alleges that in 2007, the Point Pleasant and Timberwolf securities were designed primarily not just as instruments to earn returns for Goldman's clients but to solve a huge internal problem Goldman then faced: its enormous financial exposure to residential mortgage-backed securities (RMBS). Specifically, the complaint asserts:

"By no later than late 2006, based on its extensive involvement in and detailed knowledge of the subprime residential home mortgages market, Goldman, at its highest levels, had arrived at the informed
and firm view [*12] that the value of securities in this market would likely go into sharp decline in the near future. This situation presented both a problem and an opportunity for Goldman. The problem was that Goldman held a large portfolio of such securities, which would decline in value as the market fell, and Goldman needed to offload these securities onto third parties. The opportunity was the potential profit that Goldman could make by shorting such securities. Goldman devised a plan that both addressed its problem and took advantage of its opportunity. Putting profits before integrity and acting to the detriment of its own clients, Goldman constructed a number of new CDO offerings in early 2007 based on securities Goldman deliberately selected for their poor quality and likely failure -- many from its own inventory -- and marketed them aggressively to its clients while at the same time shorting the market in order to profit at its clients’ expense. Goldman used these new CDOs as one vehicle for shorting the market. The Point Pleasant and Timberwolf offerings were a key part of this Goldman strategy, and provided a vehicle for Goldman to unload its toxic inventory and to profit from the decline [*13] in value of the very securities it was recommending that its clients purchase."

On these facts, plaintiff claims that Goldman engaged in a fraudulent scheme. The fraud claims sufficiently detail the allegations relating to Goldman’s internal valuation of the securities and the independence of the underlying asset selection process. They also allege that Goldman’s interests were not really aligned with the fund’s interests. Goldman does not dispute that these allegations, as amplified in the thirty-page complaint, are sufficiently detailed to state a fraud cause of action. Goldman made several disclosures and disclaimers in the offering circulars for the Point Pleasant and Timberwolf securities.

[HN5] The law is abundantly clear in this state that a buyer’s disclaimer of reliance cannot preclude a claim of justifiable reliance on the seller’s misrepresentations or omissions unless (1) the disclaimer is made sufficiently specific to the particular type [*14] of fact misrepresented or undisclosed; and (2) the alleged misrepresentations or omissions did not concern facts peculiarly within the seller’s knowledge (Danann Realty Corp. v Harris, 5 NY2d 317, 323, 157 N.E.2d 597, 184 N.Y.S.2d 599 [1959]; MBIA Ins. Corp v Merryl Lynch, 81 AD3d 419, 916 N.Y.S.2d 54 [1st Dept 2011]; Capital Z Fin. Servs. Fund II, L.P. v Health Net, Inc., 43 AD3d 100, 111, 840 N.Y.S.2d 16 [1st Dept 2007]). Accordingly, only where a written contract contains a specific disclaimer of responsibility for extraneous representations, that is, a provision that the parties are not bound by or relying upon representations or omissions as to the specific matter, is a plaintiff precluded from later claiming fraud on the ground of a prior misrepresentation as to the specific matter (see e.g. Silver Oak Capital L.L.C. v UBS AG, 82 AD3d 666, 667, 920 N.Y.S.2d 325 [1st Dept 2012]; Steinhardt Group v Citicorp, 272 AD2d 255, 256, 708 N.Y.S.2d 91). In other words, in view of the disclaimer, no representations exist and that being so, there can be no reliance (HSH Nordbank AG v UBS AG, 95 AD3d 185, 201, 941 N.Y.S.2d 59 [1st Dept 2012]).

In this case, Goldman argues that the disclaimers and disclosures in the offering circulars are sufficiently specific and applicable to information that was either misrepresented [*15] or [**7] undisclosed. First, Goldman points out that the offering circulars required the purchaser to disclaim reliance on "any advice, counsel or representation "whether oral or written of [the sellers] . . . other than in this offering circular" and concomitantly advised the purchaser to "consider and assess for themselves the likely rate of default of the references obligations. . . ." Secondly, Goldman points out that the offering circulars disclose that "[a]ccording to recent reports, the residential mortgage in the United States has experienced a variety of difficulties and change in economic conditions that may adversely affect the performance and Market of RMBS." Thirdly, Goldman points out that the offering circulars disclosed that an affiliate "will act as the sole Synthetic Security counterparty," which would "create a conflict of interest," and that it would be purchasing credit protection from the CDOs.
These disclaimers and disclosures, in our view, fall well short of tracking the particular misrepresentations and omissions alleged by plaintiff. As indicated, plaintiff alleges that Goldman structured, marketed and sold the Point Pleasant and Timberwolf CDOs with the intent of reducing its long term exposure to subprime risk by betting against them. The complaint further alleges that Goldman not only knew that it was selling toxic assets (based upon Goldman's internal valuation of the securities and its involvement in the underlying asset selection process) to its clients and failed to disclose those sales to investors, but that Goldman also sought to profit from its own actions. Yet, the aforementioned disclosures simply provide boilerplate statements regarding the speculative and risky nature of investing in mortgaged-backed CDOs and the possibility of market turns. If plaintiff's allegations are accepted as true, there is a "vast gap" between the speculative picture Goldman presented to investors and the events Goldman knew had already occurred.

Nor did Goldman's disclosure that it was taking a "short" position in the securities (as indicated by the disclosure that an affiliate would be acting as a "CDO counterparty" and purchasing credit protection from the CDOs) remedy this "vast gap" of information. Undoubtedly, such disclosures would have been sufficient to alert a purchaser of mortgage-backed CDOs that the seller would attempt to earn a profit by exploring "arbitrage" positions in the market. Plaintiff, however, is alleging more than the fact that Goldman was a mere "contrarian" looking to capitalize on over-priced long RMBS bets that would be unprofitable when the housing prices collapsed, contrary to the general belief at the time that prices would continue to perpetually rise. Again, plaintiff claims that Goldman had more than a profit motive. As exhaustively explained in the complaint, plaintiff claims that Goldman not only structured, marketed and sold Point Pleasant and Timberwolf CDOs, but that it did so with the intent to rid itself of long term exposure to subprime mortgages, and to profit by selling them to its clients and betting against its own long term position.

In economics and finance, arbitrage is the practice of taking advantage of a price difference between two or more markets: striking a combination of matching deals that capitalize upon the imbalance, the profit being the difference between the market prices (see The Limits of Arbitrage, Andrei, Robert, Shleifer and Vishny, Journal of Finance 52: 35–55 [1977]; Convergence Trading with Wealth Effects, Wei and Xiong, The Journal of Financial Economics [*18] 62: 247--292 [2001]).

6 Short selling is a method of profiting when security prices fall. If you are "short" a security, it means that you expect the price to go down. Thus, in practical terms, going short can be considered the opposite of the conventional practice of "going long," whereby an investor profits from an increase in the price of the asset (see Larry Harris, Trading and Exchange: Market Microstructure for Practitioners, 41 [2012]).

[HN6] Even if the disclaimers and disclosures were to be viewed as sufficiently specific, "a purchaser may not be precluded from claiming reliance on misrepresentations of facts peculiarly within the seller's knowledge" (Steinhardt Group Inc., 272 AD2d at 256, citing Tahini Invs. v Bobrowsky, 99 AD2d 489, 490, 470 N.Y.S.2d 431 [2d Dept 1984]; see Danann, 5 NY2d at 322; China Dev. Indus. Bank v Morgan Stanley & Co., Inc., 86 AD3d 435, 436, 927 N.Y.S.2d 52 [1st Dept 2011]; Swersky v Dreyer & Traub, 219 AD2d 321, 328, 643 N.Y.S.2d 33 [1st Dept 1996]).

In this case, plaintiff alleges that because of what Goldman knew from its role as an underwriter and because of what the mortgage investigations conducted on its behalf (Clayton report) revealed, Goldman had access to nonpublic information regarding the deteriorating credit quality of subprime mortgages. These allegations are supported by quotes from Goldman-authored documents, complete with dates and names, expressing derogatory remarks about the CDOs. These allegations are more than adequate to allege the peculiar knowledge exception to the disclaimer bar. While evidence may ultimately demonstrate that Goldman did not have any special knowledge upon which it relied or which plaintiff could have ascertained by exercising reasonable diligence, "these are issues which are inappropriate to determine, as a matter of law, based solely on the allegations of the complaint" (P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V., 301 AD2d 373, 378, 754 N.Y.S.2d 245 [1st Dept 2003]; see MBIA Ins. Corp. v Merrill Lynch, 81 AD3d 419, 916 N.Y.S.2d 54 [1st Dept 2011]).

The principal case upon which Goldman relies in
support of its disclaimer bar argument, HSH Nordbank AG v UBS AG (95 AD3d 185, 941 N.Y.S.2d 59), does not mandate a different result. Nordbank involved a plaintiff, HSH, that entered into a credit default swap with the defendant, UBS, in which, like here, the plaintiff assumed the risk of losses on a $2 billion portfolio of mortgaged-backed securities related to the U.S. market.

Nordbank is inapposite [*20] here for two significant reasons. First, unlike here, in Nordbank the disclaimers and disclosures were sufficiently specific to the particular type of information allegedly misrepresented. In Nordbank "the core subject of the complained-of-representations was the reliability of the credit ratings used to define the permissible composition of the reference pool" (Nordbank, 95 AD3d at 196). Yet, the disclaimers and disclosures "relate directly or indirectly to the reliability of credit ratings in the relevant market" (id. at 199). In [***9] view of the disclaimer, this Court held that no representation existed, and thus, there could not have been any reliance (id.).

Secondly, in Nordbank, this Court found that the alleged misrepresentation did not concern facts peculiarly within the seller's knowledge. On the contrary, the reliability of the credit ratings could have been ascertained from reviewing market data or other publicly available information (id.). Indeed, the allegations of the complaint itself established that HSH could have uncovered any misrepresentation of the risk of the transaction through the exercise of reasonable due diligence within the means of a financial institution of [*21] its size and sophistication (id.).

Here, however, neither the complaint nor the documentary evidence establishes plaintiff's peculiar knowledge of the misrepresentations and omissions. In this regard, this case is more akin to China Dev. Indus. Bank v Morgan Stanley & Co., Inc. (86 AD3d 435, 927 N.Y.S.2d 52). There, the plaintiff's fraud claims were based on facts strikingly similar to those alleged here with regard to mortgage-backed securities. The plaintiff alleged that the seller of credit default swaps, Morgan Stanley, fraudulently disposed of "troubled collateral (i.e., predominantly residential mortgage-backed securities)" (China Dev., 86 AD3d at 436). This Court refused to dismiss the fraud claims based on certain disclaimers because, like here, the pleadings sufficiently alleged that the seller possessed peculiar knowledge of the facts underlying the fraud (id.; cf. MBIA Ins. Corp. v Countrywide Home Loans, Inc., 87 AD3d 287, 291-292, 928 N.Y.S.2d 229 [1st Dept 2011] [court sustained the sufficiency of a fraud claim based on alleged misrepresentations "concerning the origination and quality of the mortgage loans underlying" mortgage-backed securities]).

In sum, we find that the motion court properly declined [*22] to dismiss the fraud claims since the disclaimers and disclosures in the offering circulars do not preclude, as a matter of law, plaintiff's claim of justifiable reliance on Goldman's misrepresentations and omissions. Of course, discovery will flesh out whether Goldman's misrepresentations and omissions were the reasons plaintiff invested in Point Pleasant CDOs and Timberwolf credit default swaps, or instead whether plaintiff merely entered into a bad deal.

We find, however, that the remaining claims should have been dismissed. The negligent representation cause of action should have been dismissed because there is no allegation in the complaint of a relationship of trust and confidence between the parties (see Mandarin Trading Ltd. v Wildenstein, 16 NY3d 173, 180-181, 944 N.E.2d 1104, 919 N.Y.S.2d 465 [2011]). Likewise, the unjust enrichment cause of action should have been dismissed because the Point Pleasant and Timberwolf transactions were governed by written agreements. [HN7] The theory of unjust enrichment is one created in law in the absence of any agreement (see Goldman v Metropolitan Life Ins. Co., 5 NY3d 561, 572, 841 N.E.2d 742, 807 N.Y.S.2d 583 [2005]). Finally, the motion court should have also dismissed the rescission cause of action because [*23] the complaint fails to allege the absence of "a complete and adequate remedy at law" (see Rudman v Cowles Communications, 30 NY2d 1, 13, 280 N.E.2d 867, 330 N.Y.S.2d 33 [1972]).

Accordingly, the order of the Supreme Court, New York County (Shirley Werner Kornreich, J.), entered October 19, 2012, which, insofar as appealed from, denied defendants' motion to compel arbitration or, in the alternative, to dismiss the causes of action for fraud, fraudulent inducement, fraudulent concealment, negligent misrepresentation, unjust enrichment, and rescission, should be modified, on the law, to the extent of granting that part of the motion [**10] seeking to dismiss the causes of action for negligent misrepresentation, unjust enrichment and rescission, and otherwise affirmed, without costs.
All concur except DeGrasse, J. who concurs in a separate Opinion:

CONCUR BY: DEGRASSE

DEGRASSE, J. (concurring)

This appeal is from an order denying a dispositive motion by defendants Goldman Sachs Group, Inc., Goldman Sachs & Co., Goldman Sachs International, and Goldman Sachs & Partners Australia Pty. Ltd. (collectively referred to as Goldman). As relevant to this appeal, the motion was for an order compelling arbitration, or, in the alternative, dismissing the claims for fraud, negligent misrepresentation and unjust enrichment for failure to state a cause of action (CPLR 3211[a][7]). Although I have no quarrel with the result reached by the majority, I write separately primarily because, for reasons discussed later in this writing, the majority opinion employs an inapt analysis in its discussion of the facial sufficiency of the fraud cause of action.

Plaintiff, Basis Yield Alpha Fund (Master) (BYAFM), alleges that it was defrauded by Goldman's materially false statements and omissions in connection with an April 17, 2007 sale of a security issued by a collateralized debt obligation (CDO) known as Point Pleasant 2007-1, Ltd. as well as BYAFM's June 13, 2007 entry into two credit default swaps that referenced securities from a similar CDO known as Timberwolf 2007-1, Ltd. BYAFM claims to have lost approximately $10 million in the Point Pleasant transaction and $56 million in the Timberwolf credit default swaps as a result of Goldman's conduct.

Preliminarily, I agree that the motion court properly denied the application to compel arbitration pursuant to CPLR 7501. For reasons outlined by the majority, the record supports the conclusion that there was no written agreement to arbitrate within the contemplation of CPLR 7501. Goldman, as the party seeking arbitration, has the burden of establishing an agreement to arbitrate (see e.g. Siegel v 141 Bowery Corp., 51 AD2d 209, 212, 380 N.Y.S.2d 232 [1st Dept 1976]). As BYAFM argues, Goldman fails to lay a foundation for the "General Terms and Conditions (GTC)," the document which it proffered as an agreement to arbitrate. Goldman submitted the GTC as an exhibit to the affirmation of its counsel who did not have personal knowledge of the document, its source or its significance. Nor was the GTC qualified as a business record. As such, there is no evidentiary foundation for the GTC and, for that matter, any of the documents submitted in support of Goldman's motion. Therefore, the unsworn documents proffered by Goldman have no probative value given the absence of such an evidentiary foundation (cf. J.K. Tobin Constr. Co. Inc. v David J. Hardy Constr. Co., 64 AD3d 1206, 883 N.Y.S.2d 681 [4th Dept 2009]). Goldman correctly cites Olan v Farrell Lines (64 NY2d 1092, 479 N.E.2d 229, 489 N.Y.S.2d 884 [1985]), for the proposition that an attorney's affidavit may be used as a vehicle for submitting evidence. Such evidence, however, must be in admissible form (see Zuckerman v City of New York, 49 NY2d 557, 562, 404 N.E.2d 718, 427 N.Y.S.2d 595 [1980]). For example, the proof found sufficient in Olan consisted of "evidentiary proof in admissible form" that happened to be "placed before the court by way of an attorney's affidavit" (Olan, 64 NY2d at 1093). Contrary to Goldman's argument, a document lacking evidentiary foundation does not become admissible by mere attachment to an attorney's affirmation. Although the majority finds "a substantial question as to whether the parties agreed to arbitrate," I would go further by saying that Goldman failed to make a prima facie showing on this issue on the basis of the lack of an evidentiary foundation for the GTC.

I now turn to the motion to dismiss the fraud claim for failure to state a cause of action. In sustaining the complaint, the court held as follows:

"There are two categories of representations at issue: representations of fact and expressions of opinion. The representations of fact include Goldman's representations to BYAFM about its internal marks, the manner in which the reference securities were selected, and Goldman's position as a real counterparty. BYAFM has properly pled all elements of fraud as to these representations with substantial detail."

The thrust of Goldman's argument regarding the sufficiency of the fraud claim is based on our holding in HSH Nordbank AG v UBS AG (95 AD3d 185, 941 N.Y.S.2d 59 [1st Dept 2012]), a case cited or referenced 68 times in the briefs before us. In its opening brief,
Goldman argues:

"In HSH Nordbank, this Court, addressing substantively identical allegations, held that a CDO investor failed to state a claim because reasonable reliance was precluded as a matter of law by substantially identical express disclaimers of reliance and disclosures in the offering materials [emphasis added]. The trial court erred in failing to follow this binding precedent."

The disclaimers and disclosures referred to by Goldman are set forth in offering circulars that it claims were issued to BYAFM.

In HSH, we dismissed a fraud cause of action pursuant to CPLR 3211(a)(1) and (7), citing undisputed documentary evidence that the plaintiff in that case did not rely on the defendant's advice, asserted to inherent conflicts of interest and was warned of risks in the underlying transaction (HSH, 95 AD3d at 188). It should be noted that HSH involved a motion to dismiss the complaint on the basis of a defense founded upon documentary evidence (CPLR 3211[a][1]) and for failure [*28] to state a cause of action (CPLR 3211[a][7]; HSH, 95 AD3d at 192). In this case, Goldman's motion was made under CPLR 3211(a)(7) only. The difference is significant and should be dispositive of Goldman's challenge to the fraud causes of action.

CPLR 3211(a)(1) may be invoked where it is claimed that "documentary evidence utterly refutes plaintiff's factual allegations conclusively establishing a defense as a matter of law" (see Goshen v Mut. Life Ins. Co. of N.Y., 98 NY2d 314, 326, 774 N.E.2d 1190, 746 N.Y.S.2d 858 [2002] [citation omitted]). On the other hand, as recently stated by the Court of Appeals, a motion under CPLR 3211(a)(7) "limits us to an examination of the pleadings to determine whether they state a cause of action" (Miglino v John Doe 1, 73 AD3d 78, 85, 898 N.Y.S.2d 569 [2d Dept 2010]). As stated by the Court of Appeals:

"Under CPLR 3211(a)(1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law (see e.g. Heaney v Purdy, 29 NY2d 157, 272 N.E.2d 550, 324 N.Y.S.2d 47). In assessing a motion under CPLR 3211(a)(7), however, a court may freely consider affidavits submitted by the plaintiff to remedy any defects in the complaint (Rovello v Orfino Realty Co., supra, at 635) . . . (Leon v Martinez, 84 NY2d 83, 88, 638 N.E.2d 511, 614 N.Y.S.2d 972 [1994])."

1 It is unfortunate for stare decisis that this distinction, articulated by the Court of Appeals, "makes no sense" to the majority. Moreover, the majority's thesis that a CPLR 3211(a)(7) motion
may be supported by documentary evidence is unsupported, if not belied, by the cases it cites. For example, the underlying motions, like the motion in HSH, were made under CPLR 3211(a)(1) as well as (a)(7) in Constructamax, Inc. v Dodge Chamberlin Luzine Weber, Assoc. Architects, LLP (109 AD3d 574, 971 N.Y.S.2d 48 [2nd Dept 2013]), Rabos v R & R Bagels & Bakery (100 AD3d 849, 955 N.Y.S.2d 109 [2nd Dept 2012]) and Kliebert v McKoan (228 AD2d 232, 643 N.Y.S.2d 114 [1st Dept 1996], lv denied 89 NY2d 802, 675 N.E.2d 1232, 653 N.Y.S.2d 279 [1996]). Board of Managers of the Fairways of N. Hills Condominiums v Fairways at N. Hills (150 AD2d 32, 545 N.Y.S.2d 343 [2nd Dept 1989]) involves a motion for summary judgment. The motion in Skillgames, LLC v Brody (1 AD3d 247, 767 N.Y.S.2d 418 [1st Dept 2003]) was made on the basis of an affidavit as opposed to documentary evidence.

The majority also sidesteps a threshold issue regarding the purported Timberwolf offering circular that it has decided to consider with respect to the instant CPLR 3211(a)(7) motion. As stated in its brief, BYAFM categorically denies that it ever entered into any contract that references or incorporates the Timberwolf offering circular and it does not reference or rely upon the same in its complaint. Goldman, in no position to argue otherwise, does not touch upon BYAFM's assertion in its reply brief. Like the GTC submitted in support of the motion to compel arbitration, the offering circular lacks an evidentiary foundation because it is merely annexed to counsel's affirmation (cf. J.K. Tobin Constr. Co., Inc. v David J. Hardy Constr. Co., Inc., 64 AD3d at 1206, 1206). Nevertheless, without resolving the issue, the majority unnecessarily passes upon the legal effect of a document that lacks foundation in the [*32] record.

As the majority notes, BYAFM's objection to the use of documentary evidence was waived because it was not set forth in its respondent's brief. The discussion, however, does not end there. The issue is not beyond our review since it was briefed before the motion court.

"The fact that a party abandons or fails to urge a particular line of reasoning does not prevent an appellate court from sustaining such contention for that very reason. The appellate court is not required to reject a contention sound in its ultimate conclusion because the path followed in reaching it is different from the one marked out in the argument of counsel before it" (10A Carmody-Wait 2d § 70:490, citing Morris Plan Co. of New York v Globe Indem. Co., 253 NY 496, 171 N.E. 756 [1930]).

As we stated in Fenton v Consolidated Edison Co. of N.Y. (165 AD2d 121, 566 N.Y.S.2d 227 [1st Dept 1991], lv denied 78 NY2d 856, 580 N.E.2d 409, 574 N.Y.S.2d 937 [1991]), "[T]he fact that [the appellant] limited the scope of its appeal is of no moment since [the respondent] is entitled to have the determination affirmed on any ground he properly raised before the IAS court" (id. at 125). As BYAFM challenged Goldman's use of purported documentary evidence below, our review is not circumscribed [*33] by the arguments made in its respondent's brief. In this case, the better course would have been to disregard the proffered documentary evidence and construe CPLR 3211(a)(7) as narrowly as the Court did in Miglino. This is especially true because no foundation for the Timberwolf offering circular has been established (see Miglino, 20 NY3d at 351).

In my view, the complaint is sufficient to withstand Goldman's CPLR 3211(a)(7) motion insofar as it alleges a scheme devised and executed for the specific purpose of defrauding BYAFM by selling the Point Pleasant security and the Timberwolf credit default swaps for more than they were worth (see e.g. CPC Int'l Inc. v McKesson Corp., 70 NY2d 268, 286, 514 N.E.2d 116, 519 N.Y.S.2d 804 [1987]). The fraud cause of action is also sustainable to the extent that it is alleged that Goldman falsely stated that it had only one mark (opinion of value) for each of its securities in response to BYAFM's inquiry regarding same. Notwithstanding the arm's length nature of the transactions described in the complaint, such a false representation is actionable since Goldman, having assumed to respond to BYAFM's inquiry, was "under a duty to speak fully and truthfully" (see e.g. Atlantic Bank of N.Y. v Carnegie Hall Corp., 25 AD2d 301, 305, 268 N.Y.S.2d 941 [1st Dept 1966]). I am in accord with the dismissal of the negligent misrepresentation, unjust enrichment and rescission causes of [*14] action for the reasons given by the majority.

Order, Supreme Court, New York County (Shirley
Werner Kornreich, J.), entered October 19, 2012, modified, on the law, to the extent of granting that part of the motion seeking to dismiss the causes of action for negligent misrepresentation, unjust enrichment and rescission, and otherwise affirmed, without costs.

Opinion by Renwick, J. All concur except DeGrasse, J. who concurs in a separate Opinion.

Tom, J.P., Acosta, Renwick, DeGrasse, Richter, JJ.

THIS CONSTITUTES THE DECISION AND ORDER OF THE SUPREME COURT, APPELLATE DIVISION, FIRST DEPARTMENT.

ENTERED: JANUARY 30, 2014

Index No. 652991/12

SUPREME COURT OF NEW YORK, NEW YORK COUNTY

2013 N.Y. Misc. LEXIS 5531; 2013 NY Slip Op 33015(U)

November 26, 2013, Decided

NOTICE: THIS OPINION IS UNCORRECTED AND WILL NOT BE PUBLISHED IN THE PRINTED OFFICIAL REPORTS


OPINION BY: MELVIN L. SCHWEITZER

DECISION AND ORDER

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 [*2] 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 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.

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.

**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. 2013 N.Y. Misc. LEXIS 5531, *2; 2013 NY Slip Op 33015(U), **3

**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 U.S. Dist. LEXIS 19227, 2013 WL 535320, at *7 (D Mass 2013); In re Countrywide Fin Corp Mortgage-Backed Secs., 2012 U.S. Dist. LEXIS 59620, 2012 WL 1322884, at *4 (CD Cal 2012); Allstate Ins Co v Morgan Stanley, No. 651840/2011, 2013 N.Y. Misc. LEXIS 2238, 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 [*6] 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.


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 [*8] 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 [**7] 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 [*9] 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 N.Y. Misc. LEXIS 2238, 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, 910 N.E.2d 976, 883 N.Y.S.2d 147 (2009). Under CPLR 3016(b), these elements must be stated in detail. As discussed below, Nordbank [*10] 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

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

[**8] 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 [*11] 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 [**9] 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, 38 Misc. 3d 1214[A], 966 N.Y.S.2d 349, 2012 NY Slip Op 52433[U], 2012 WL 6929336, at *8 (NY Sup Ct Nov. 30, 2012).3 Accordingly, [*12] Nordbank's allegations of widespread abandonment of underwriting guidelines are sufficient to withstand a motion to dismiss.

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").
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 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.

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 U.S. Dist. LEXIS 140663, 2012 WL 4469101 (D. Mass. Sept. 28, 2012) [*14]; Bank Hapoalim BM v Bank of Am Corp, 12-CV-4316-MRP MANX, 2012 U.S. Dist. LEXIS 184540, 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 N.Y. Misc. LEXIS 3531, 2013 WL 4505139, at *13.

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

See Part II, sec. 2, infra ("Scienter").

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, 928 N.Y.S.2d 229 (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 U.S. Dist. LEXIS 184540, 2012

Allstate v Ace Sec Corp, 2013 N.Y. Misc. LEXIS 3531, 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, 2012 U.S. Dist. LEXIS 184429 (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, 891 N.Y.S.2d 578 (4th Dept 2009) (sustaining claim for fraudulent nondisclosure where complaint identified specific relevant information that was withheld from ratings agencies); Stichting, 2012 NY Slip Op 52433[U], 2012 WL 6929336, at *9 (same).

2. Nordbank has Adequately Pledged 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, 753 N.Y.S.2d 493 (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, 890 N.E.2d 184, 860 N.Y.S.2d 422 (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 NY Slip Op 52433[U], 2012 WL 6929336, *9.

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. 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.

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 n 15 (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.

[**14] These allegations [*21] 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 NY Slip Op 52433[U], 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., 39 Misc. 3d 1218[A], 2013 N.Y. Slip Op. 50653[U], 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 [*22] 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 NY Slip Op 52433[U], 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 [**15] 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 [*23] 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 AD3d 435, 436, 927 N.Y.S.2d 52 (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. The United States Senate's Permanent Subcommittee on Investigations (the [*24] [*16] "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 [*25] 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 U.S. Dist. LEXIS 165896, 2012 WL 5868300, at *2 (SDNY 2012), but the court is skeptical of this line of reasoning. See Phoenix Light, 2013 N.Y. Slip Op. 50653[U], 2013 WL 1788007, at *6 ("for a bank to contend that [*26] it did not act with scienter with [*17] 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 Pledged 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, 824 N.Y.S.2d 210 (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 [*27] 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, 931 N.E.2d 87, 905 N.Y.S.2d 118 (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 AD3d 172, 173, 774 N.Y.S.2d 488 (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, 39 Misc. 3d 1220[A], 2013 NY Slip Op 50677[A], 2013 WL 1845588, at *5 (NY Sup Ct Apr 29, 2013) ( [**18] "[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 [*28] 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 AD3d 437, 437, 966 N.Y.S.2d 369 (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 [*29] 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 [**19] 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 AD3d 185, 195, 941 N.Y.S.2d 59 (1st Dept 2012). [*30] 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

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 AD3d 494, 494, 967 N.Y.S.2d 1 (1st Dept 2013) ("plaintiff fails [*31] 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.")

[*20] 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 [*32] to defeat Goldman Sachs’ motion to dismiss on the grounds that Nordbank failed to conduct an adequate pre-purchase investigation.

4. Nordbank has Adequately Pleased 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, 745 N.Y.S.2d 534 (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 AD3d 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 N.Y. Misc. LEXIS 6827, 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 downturn is a question of fact for trial."); Allstate v Morgan Stanley, 2013 N.Y. Misc. LEXIS 2238, 2013 WL 2369953, at *12 (same). "Untangling [*33] 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 [*21] factual record." Dexia Holdings, Inc v Countrywide Fin Corp, 2012 U.S. Dist. LEXIS 71374, 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
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 foreclosures, and ultimately, a lower cash flow to Certificate-holders like Nordbank.

[*34] 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, 958 N.E.2d 77, 934 N.Y.S.2d 43 (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, 623 N.Y.S.2d 591 (1st Dept 1995) [**22] . 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 AD3d 287, 296 (1st Dept 2011); River Glen Assocs, Ltd v Merrill Lynch Credit Corp, 295 AD2d 274, 275, 743 N.Y.S.2d 870 (1st Dept 2002).

**Superior [**35]** 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, 30 Misc. 3d 856, 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 N.Y. Misc. LEXIS 2238, 2013 WL 2369953, at * 16; CIFG Assur N Am, Inc v Bank of Am, NA, 41 Misc. 3d 1203[A], 2013 NY Slip Op 51565[U], 2013 WL 5459468 [NY Sup Ct 2013]; Stichting, 2012 NY Slip Op 52433[U], 2012 WL 6929336, at *13; MBIA Ins Corp v Residential Funding Co, 26 Misc. 3d 1204[A], 906 N.Y.S.2d 781, 2009 NY Slip Op 52662[U], 2009 WL 5178337, at *6 [NY Sup Ct 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 [**36] 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."

[**23] 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, 489 N.E.2d 231, 498 N.Y.S.2d 344 (1986). A claim for mutual mistake must be pleaded with particularity pursuant to CPLR 3016(b). Simkin v Blank, 19 NY3d 46, 52, 968 N.E.2d 459, 945 N.Y.S.2d 222 (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, 23 Misc. 3d 1105(A), 881 NYS2d 364 (Sup Ct Erie Cnty 2009), affd as mod., 68 AD3d 1747, 891 N.Y.S.2d 578 (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 [**37] 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, 940 N.Y.S.2d 49 (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 (Il1 Cir Ct Cook Cnty Sept 19, 2012) ("Defendants' claim that the Offering Documents never said the notes would be validly transferred insinuates [**24] that Defendants wish the court to believe that investors bought securities knowing that the underlying [*38] 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

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)).

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 368, 33 N.W. 919 (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 [*39] 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 [**25] 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 [*40] 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 AD3d 1747, 891 N.Y.S.2d 578. 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:

/s/ Melvin L. Schweitzer

J.S.C.
the Indians in subsequent treaties. But the language in the Treaty of 1831 is distinct from and more specific than that addressed in *Mille Lacs*. Here, Article XVII states “the privileges of every description . . . shall forever cease and determine.” The omission and ambiguity of “whatever the nature the same may be” that was present in *Mille Lacs* is not present in this treaty. Plaintiff’s rights granted under the Treaty of Detroit and the Treaty of the Maumee Rapids, including the privilege to fish on Lake Erie, were terminated by the explicit language in the Treaty of 1831.

**CONCLUSION**

The hardship brought upon the Ottawa Tribe following their removal from Ohio was severe. Despite the Tribe’s identified hardships, the delay in asserting treaty rights to hunt and fish in Ohio is unreasonable. This delay in asserting hunting and inland fishing rights is also prejudicial to Defendant, and as such laches bars recovery of these claims. Plaintiff has, however, established a dispute of material facts surrounding the prejudice to Defendant of asserting treaty rights to fish in Lake Erie, specifically the impact of commercial fishing on current conservation levels. Nevertheless, after examining all treaties identified by the parties, the Treaty of 1831 extinguished any treaty-based right for the Ottawa Tribe to fish in Lake Erie. Therefore, Defendant’s Motion for Summary Judgement is granted and this case is dismissed.

IT IS SO ORDERED.

**In re NATIONAL CENTURY FINANCIAL ENTERPRISES, INC., INVESTMENT LITIGATION.**

No. 2:03-md-1565.

United States District Court, S.D. Ohio, Eastern Division.


**Background:** Institutional investors filed securities fraud actions against investment bank that underwrote bond issuances through securitization programs. After actions were consolidated, bank moved to dismiss.

**Holdings:** The District Court, James L. Graham, J., held that:

1. alleged misrepresentations in offering materials were attributable to bank;
2. complaints supported strong inference of scienter; and
3. disclaimers in offering materials and participation agreement did not preclude institutional investors from showing that they justifiably relied on bank’s alleged misrepresentations.

Motions granted in part and denied in part.

1. **Securities Regulation**
   
   To state securities fraud claim under § 10(b) and Rule 10b–5(b), plaintiffs must allege, in connection with purchase or sale of securities: (1) misstatement or omission, (2) of material fact, (3) made with scienter, (4) justifiably relied on by plaintiffs, and (5) proximately causing them injury. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

2. **Fraud**

   Elements of fraud claim are: (1) representation or, where there is duty to dis-
close, concealment of fact, (2) which is material to transaction at hand, (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred, (4) with intent of misleading another into relying upon it, (5) justifiable reliance upon representation or concealment, and (6) resulting injury proximately caused by reliance.

3. Federal Civil Procedure \(\Rightarrow 636\)

To comply with rule requiring that fraud be pled with particularity, plaintiff, at minimum, must allege time, place, and content of alleged misrepresentation on which he or she relied; fraudulent scheme; defendants’ fraudulent intent; and injury resulting from fraud. Fed.Rules Civ.Proc. Rule 9(b), 28 U.S.C.A.

4. Securities Regulation \(\Rightarrow 60.51\)


5. Securities Regulation \(\Rightarrow 60.40\)

Alleged misrepresentations in offering materials were attributable to initial purchaser of securities in question, despite language indicating that issuer prepared materials, where purchaser’s name was displayed on front page of all offering materials, which identified it as initial purchaser, and purchaser’s own internal papers showing that it helped draft and review offering materials. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

6. Fraud \(\Rightarrow 17\)

Party to business transaction has duty to disclose only when special relationship exists.

7. Securities Regulation \(\Rightarrow 60.27(1)\)

Party who chooses to speak in securities transaction assumes duty to speak truthfully and completely about matters on which he speaks. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

8. Securities Regulation \(\Rightarrow 60.28(2.1)\)

Even though party in securities transaction may not always be under independent duty to volunteer information, he assumes duty to provide complete and nonmisleading information with respect to subjects on which he undertakes to speak. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

9. Securities Regulation \(\Rightarrow 60.28(2.1)\)

Institutional investors’ allegations that bank undertook, through offering materials, sales presentations, and other written materials, to speak about material aspects of securitization programs were sufficient to impose duty on bank under federal securities laws to provide complete and nonmisleading information regarding all subjects on which bank spoke. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

10. Securities Regulation \(\Rightarrow 60.45(1)\)

To establish liability under § 10(b) and Rule 10b–5, plaintiff must prove that defendant acted with scienter, that is, mental state embracing intent to deceive, manipulate, or defraud. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

11. Securities Regulation \(\Rightarrow 60.45(1)\)

“Recklessness” required to establish scienter necessary to support securities fraud claim under § 10(b) is mental state falling somewhere between intent and negligence, and is characterized by highly

See publication Words and Phrases for other judicial constructions and definitions.

12. Securities Regulation ☞60.51

In analyzing whether securities fraud complaint sufficiently pleads scienter, court must: (1) accept all factual allegations in complaint as true; (2) consider complaint in its entirety; and (3) take into account plausible opposing inferences. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

13. Securities Regulation ☞60.51

Institutional investors’ complaints against investment bank that underwrote bond issuances through securitization programs supported strong inference of scienter required to state securities fraud claims under § 10(b), where complaints alleged that bank performed due diligence and received and reviewed information providing it with knowledge of material aspects of purported fraud, including specific red flags that would have alerted reasonable person in bank’s position of fraud, and that bank, having become deeply involved in fraudulent enterprise and with hundreds of millions of dollars of unsold notes on its hands, reduced its exposure by selling notes to unsuspecting investors. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

14. Securities Regulation ☞60.45(1)

If defendant did not know or recklessly disregard statement’s falsity at time it was made, then § 10(b) liability cannot be imposed even if statement turns out to be false in hindsight. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

15. Securities Regulation ☞60.45(1)

Mere access to information is not enough to establish scienter required to support securities fraud claim under § 10(b). Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b); 17 C.F.R. § 240.10b–5(b).

16. Securities Regulation ☞60.48(1)

General disclaimers in offering materials and participation agreement did not preclude institutional investors from showing that they justifiably relied on investment bank’s alleged misrepresentations about bond issuances that it underwrote, where investors knew that bank had helped devise note programs, helped draft offering materials, and had purchased hundreds of millions of dollars of notes in its role as initial purchaser, bank’s name appeared prominently on every page of private placement memorandum, and documents stated that bank was issuer’s authorized agent and that all inquiries by investors were to be directed to bank. Securities Exchange Act of 1934, §§ 10(b), 29(a), 15 U.S.C.A. §§ 78j(b), 78cc(a); 17 C.F.R. § 240.10b–5(b).

17. Limitation of Actions ☞95(1)

Under Arizona law, statute of limitations is subject to discovery rule whereby claim accrues when plaintiff knows, or by exercise of due diligence should know, of defendant’s wrongful conduct. A.R.S. §§ 12–542, 12–543.

18. Federal Civil Procedure ☞1831

Issue of when investors could have reasonably discovered investment bank’s wrongful conduct in connection with bond issuances that it underwrote involved fact questions that could not be resolved on motion to dismiss investors’ common law
fraud claims against bank on limitations grounds. A.R.S. §§ 12–542, 12–543.

19. Securities Regulation §242

Buyer's purchase of bond notes did not have sufficient nexus with New Jersey to assert claim under New Jersey's blue sky law against bond underwriter, where buyer was British public limited company with its principal place of business in England, underwriter was Delaware limited liability company with its principal place of business in New York, and broker-dealer that allegedly had role in note offering was incorporated in Delaware, with its principal place of business in Illinois. N.J.S.A. 49:3–51(a).

20. Limitation of Actions §58(1)

Securities Regulation §305

Under Ohio law, claim under blue sky law is subject to two-year statute of limitations, which may be tolled, and four-year statute of repose, which may not be tolled. Ohio R.C. § 1707.43(B).

21. Limitation of Actions §6(9)

Under Ohio law, amendment extending period of repose for bringing claims under blue sky law did not apply retroactively to revive claims that were time-barred at time complaint was filed. Ohio R.C. §§ 1.48, 1707.43(B).

22. Limitation of Actions §104.5

Under Nebraska law, statute of repose for bringing claims under blue sky law was not subject to equitable tolling. Neb.Rev.St. § 8–1118.

23. Action §3

Securities Regulation §291.1


24. Securities Regulation §269


25. Securities Regulation §269


26. Securities Regulation §300


27. Securities Regulation §246

Under Oregon law, amendment to blue sky law expanding primary liability to persons who solicited sale of security was not retroactively applicable to securities purchases before amendment. West's Or. Rev. Stat. Ann. § 59.115(1)(a).

28. Securities Regulation §302

Under Connecticut, Louisiana, Minnesota, Ohio, and Pennsylvania law, investment bank that drafted offering materials in connection with bond issuances was subject to primary liability under blue sky laws, despite bank's contention that it did not solicit sales of notes, where bank allegedly played key role in devising note programs and in soliciting investors nationwide, and it allegedly had financial interest in existence of strong and active secondary market for notes.

29. Securities Regulation §302

Under California, Connecticut, Louisiana, Ohio, and Oregon law, investment bank that drafted offering materials in connection with bond issuances was sub-

30. Torts ⇐133
Under Ohio law, elements of aiding and abetting claim are: (1) knowledge that primary party’s conduct is breach of duty, and (2) substantial assistance or encouragement to primary party in carrying out tortious act.

31. Torts ⇐133, 141
Under Ohio law, plaintiff asserting aiding and abetting claim need not allege that aider and abettor had actual knowledge of all details of primary party’s scheme; it is enough for aider and abettor to have general awareness of his role in other’s tortious conduct for liability to attach.

32. Federal Civil Procedure ⇐1831
Issue of whether investment bank that drafted offering materials in connection with bond issuances had actual knowledge of issuer’s fraud involved fact questions that could not be resolved on motion to dismiss investors’ aiding and abetting claims against bank.

33. Federal Civil Procedure ⇐1831
Issue of whether notes that investment bank delivered to buyers conformed to representations made in sales contracts involved fact questions that could not be resolved on motion to dismiss buyers’ breach of contract claims against bank.

34. Conspiracy ⇐1.1
Under Ohio law, “civil conspiracy” is malicious combination of two or more persons to injure another in person or property, in way not competent for one alone, resulting in actual damages.

See publication Words and Phrases for other judicial constructions and definitions.

35. Conspiracy ⇐1.1
Under Ohio law, elements of civil conspiracy claim are: (1) malicious combination; (2) two or more persons; (3) injury to person or property; and (4) existence of unlawful act independent from actual conspiracy.

36. Conspiracy ⇐2
Under Ohio law, malicious combination element of civil conspiracy claim does not require showing of express agreement between defendants, but only common understanding or design, even if tacit, to commit unlawful act.

37. Conspiracy ⇐2
Under Ohio law, plaintiff asserting civil conspiracy claim need not show that co-conspirators made agreement as to every detail of their plan; rather, plaintiff must show that co-conspirators shared in general conspiratorial objective.

38. Federal Civil Procedure ⇐1831
Issue of whether investment bank marketed and sold debt securities issued to finance purchase of accounts receivable from healthcare providers, knowing of issuer’s deepening insolvency and understanding that funds invested would be misappropriated by issuer and its principals involved fact questions that could not be resolved on motion to dismiss investors’ civil conspiracy claim against bank.

39. Antitrust and Trade Regulation ⇐131
In determining whether conduct occurred primarily and substantially in state, for purposes of Massachusetts’s unfair competition statute, court should consider: (1) where defendant engaged in unfair or unscrupulous conduct; (2) where plaintiff was on receiving end of unfair or unscrupulous conduct; and (3) situs of plaintiff’s losses due to unfair and unscrupulous conduct. Mass. Gen. Laws ch. 93A, § 11.
40. Antitrust and Trade Regulation

Investors sufficiently alleged that conduct occurred primarily and substantially in state, and thus warranted invocation of Massachusetts’s unfair competition statute in their action against investment bank, where investors claimed that their principal place of business was in Massachusetts, that representatives of bank and issuer of debt securities made sales presentations in their offices in Massachusetts, that they were provided with offering materials in Massachusetts, that they made decision to purchase notes in Massachusetts, and that they suffered losses in Massachusetts.

41. Damages

Under Ohio law, award of punitive damages in tort case may be made only upon finding of actual malice, fraud, oppression, or insult on defendant’s part.


OPINION AND ORDER ON CERTAIN MOTIONS TO DISMISS FILED BY LEAD UNDERWRITER CREDIT SUISSE FIRST BOSTON

JAMES L. GRAHAM, District Judge.

This matter is before the Court on motions filed by Credit Suisse First Boston LLC (now Credit Suisse Securities LLC) to dismiss the claims made against it in this multi-district litigation. Credit Suisse
served as lead underwriter of the NPF VI, Inc. and NPF XII, Inc. securitization programs. The Court finds that the complaints put Credit Suisse at the center of the alleged scheme to defraud National Century Financial Enterprise's investors, and, thus, Credit Suisse's motions to dismiss are largely denied.

I. BACKGROUND

A. Factual Allegations against Credit Suisse

This order concerns the complaints filed by the following plaintiffs: Metropolitan Life Insurance Company and Metropolitan Insurance and Annuity Company (collectively “MetLife”); Lloyds TSB Bank PLC; the State of Arizona, the City of Chandler, and Crown Cork & Seal Company (collectively the “Arizona Noteholders”); the New York City Pension Funds; and Pharos Capital Partners, L.P. Though the allegations vary somewhat from complaint to complaint, below is a summary of what the Plaintiffs allege against Credit Suisse.

Plaintiffs allege that Credit Suisse underwrote and managed the notes issued by National Century through the NPF VI and NPF XII securitization programs. Between 1998 and 2002, NPF VI made at least 10 bond issuances and NPF XII made at least 12 bond issuances. During this time, National Century issued approximately $3 billion of debt securities to finance the purchase of accounts receivable from healthcare providers.

The notes were sold to institutional investors who could invest millions, if not hundreds of millions, of dollars in notes. Credit Suisse was the initial purchaser and placement agent for each note issuance. Credit Suisse then created a secondary market for the notes by actively soliciting institutional investors, who were provided with various offerings materials and given sales presentations. Credit Suisse allegedly authored the offering materials in substantial part, and Credit Suisse’s representatives allegedly participated in the sales presentations.

Plaintiffs allege that Credit Suisse made numerous misrepresentations and material omissions in the offering materials and sales presentations. These misrepresentations went to the financial soundness of the note programs, the quality of the notes, and, hence, the security of Plaintiffs’ investments. According to Plaintiffs, Credit Suisse represented that NPF VI and NPF XII would use the note proceeds to purchase only high-quality accounts receivable, which would serve as collateral for the notes. Further, Credit Suisse represented that indenture trustees would maintain reserve accounts for NPF VI and NPF XII according to strict standards designed to offset the risks associated with buying receivables. Credit Suisse further represented that NPF VI and NPF XII would not engage in related-party transactions; that is, they would refrain from purchasing accounts receivable from healthcare providers in which National Century or its principals held a financial interest.

Plaintiffs contend that Credit Suisse’s representations were false and that the NPF VI and NPF XII note programs, though perhaps at one time legitimate, had become a sham by the time Plaintiffs invested in them. In a nutshell, the complaints allege that National Century used Plaintiffs’ money to purchase low-quality or even non-existent receivables from healthcare companies that National Century’s principals (Lance Poulsen, Donald Ayers, and Rebecca Parrett, collectively “the Founders”) controlled or had some financial interest in. These healthcare companies became overfunded because National Century paid them for receivables that had little or no value. The Founders allegedly used their control of the healthcare compa-
nies to gain access to the overfunded amounts. In time, the reserves at NPF VI and NPF XII became severely depleted, the alleged wrongdoing was uncovered, and National Century filed for bankruptcy in November 2002, with an alleged aggregate loss to investors of at least $2.6 billion.

The complaints put Credit Suisse alongside National Century's Founders as being at the center of a scheme to defraud investors. Beginning in 1995, National Century selected Credit Suisse to serve as its financial advisor at-large. The Arizona Noteholders' complaints characterize National Century and Credit Suisse as having a "close, broad, and multifaceted relationship" whereby Credit Suisse "continuously enjoyed extensive access to inside information regarding [National Century], its finances, and its operations." See State of Arizona Second Am. Compl., ¶ 96A. Credit Suisse allegedly conducted numerous examinations of National Century's finances and reviewed the results of due diligence investigations performed by third party professionals.

According to the complaints, Credit Suisse's relationship with National Century was lucrative. Credit Suisse allegedly received millions of dollars in investment banking and placement fees for its services. The complaints therefore allege that Credit Suisse had a strong financial incentive to promote NPF VI and NPF XII notes to institutional investors.

Plaintiffs allege that as early as January 1998 Credit Suisse had knowledge that the NPF VI and NPF XII note programs were not operating in the manner described by the offering materials. The details of how Credit Suisse allegedly gained this knowledge will be reviewed below in the Court's discussion of Credit Suisse's scienter, but Plaintiffs allege that Credit Suisse gained extensive knowledge of National Century's operations. The complaints allege that Credit Suisse knew in particular that National Century was purchasing ineligible accounts receivable, not properly maintaining reserve accounts, and engaging in related-party transactions.

Despite this knowledge, Credit Suisse allegedly proceeded to sell notes to Plaintiffs and other investors. When rumors or reports surfaced that there were problems with the NPF VI and NPF XII note programs, Credit Suisse is alleged to have acted swiftly to undermine the reports and reassure investors that their money was safe, even though Credit Suisse allegedly knew NPF VI and NPF XII were a fraud. The complaints allege that in order to preserve its lucrative position and protect the unsold notes it had on its hands, Credit Suisse went so far as to make unsecured loans to National Century when NPF VI's and NPF XII's reserves were depleted.

B. The Plaintiffs

1. MetLife and Lloyds


Lloyds is a British public limited company with its principal place of business in London, England. Lloyds purchased a total of $60 million of NPF XII notes in March 2001. It separately purchased $68 million of NPF XII notes in November 2002 under a Participation Agreement with Credit Suisse.

MetLife and Lloyds filed separate suits in New Jersey federal court but have filed joint briefs and motions since their actions
have been consolidated in this multi-district litigation.

MetLife asserts the following claims against Credit Suisse: violations of Section 10(b) of the Securities Exchange Act, violations of Ohio’s and New Jersey’s blue sky laws, fraud, negligent misrepresentation, and negligence.

Lloyds asserts those same claims against Credit Suisse in relation to its initial note purchase and to the Participation Agreement. Lloyds also asserts a breach of contract claim with respect to the Participation Agreement.

2. The Arizona Noteholders

The Arizona Noteholders are a large collection of investors who filed three separate lawsuits in Arizona state court. Some of the Arizona Noteholders lack any direct connection to Arizona, but they are included in the group because they joined in the lawsuits originally filed in Arizona. The Arizona Noteholders include governmental entities from Arizona and other states, as well as businesses incorporated in various states and foreign countries. The Arizona Noteholders collectively purchased about $1.4 billion of NPF VI and NPF XII notes between 1998 and 2002. Attached to their complaints are detailed lists of when and how much each Noteholder invested in NPF VI and NPF XII.

The Arizona Noteholders assert the following claims against Credit Suisse: violations of the blue sky laws of numerous states, unfair competition under Massachusetts state law, fraud, negligent misrepresentation, aiding and abetting fraud, aiding and abetting breach of fiduciary duty, conspiracy, unjust enrichment, and breach of contract.

3. The New York City Pension Funds

The New York City Pension Funds are a group of public pension funds in charge of managing the assets of various New York City employees and retirees. The New York Funds purchased $89 million of NPF XII notes in October 2000 and May 2002.

The New York Funds originally filed suit in New York federal court. They assert the following claims against Credit Suisse: violations of Section 10(b) of the Securities Exchange Act, fraud, aiding and abetting fraud, negligent misrepresentation, and negligence.

4. Pharos Capital Partners

Pharos is a limited partnership organized under the laws of Delaware. Pharos describes itself as being in the business of making equity investments on behalf of its limited partner investors. Pharos purchased $12 million worth of National Century preferred stock on July 8, 2002.

Pharos brought suit in the Southern District of Ohio and asserts the following claims against Credit Suisse: violations of Ohio’s blue sky law, fraud, negligent misrepresentation, aiding and abetting, and conspiracy.

Because the claims of Pharos, who purchased preferred stock in National Century, are slightly different than the claims of the noteholder Plaintiffs, Pharos’s claims will be discussed separately below.

II. MOTION TO DISMISS STANDARD OF REVIEW

When considering a motion to dismiss under Fed.R.Civ.P. 12(b)(6), a court must construe the complaint in the light most favorable to the plaintiff and accept all well-pleaded material allegations in the complaint as true. *Scheuer v. Rhodes*, 416 U.S. 232, 236, 94 S.Ct. 1683, 40 L.Ed.2d 90 (1974); *Roth Steel Prods. v. Sharon Steel Corp.*, 705 F.2d 134, 155 (6th Cir.1982). A complaint may be dismissed for failure to state a claim only where “it appears be-
Beyond a doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.” Conley v. Gibson, 355 U.S. 41, 45–46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957). A motion to dismiss under Rule 12(b)(6) will be granted if the complaint is without merit due to an absence of law to support a claim of the type made or of facts sufficient to make a valid claim, or where the face of the complaint reveals that there is an insurmountable bar to relief. Rauch v. Day & Night Mfg. Corp., 576 F.2d 697 (6th Cir.1978).

Because a motion under Rule 12(b)(6) is directed solely at the complaint itself, the court must focus on whether the claimant is entitled to offer evidence to support the claims, rather than whether the plaintiff will ultimately prevail. Scheuer, 416 U.S. at 236, 94 S.Ct. 1683; Roth Steel Prods., 705 F.2d at 155; see also Bell Atlantic Corp. v. Twombly, — U.S. —, 127 S.Ct. 1955, 165, 127 L.Ed.2d 929 (2007) (Rule 8 “does not impose a probability requirement at the pleading stage”). A complaint must contain either direct or inferential allegations with respect to all material elements necessary to sustain a recovery under some viable legal theory. Weiner v. Klais & Co., Inc., 108 F.3d 86, 88 (6th Cir.1997). The court is not required to accept as true unwarranted legal conclusions or factual inferences. Morgan v. Church’s Fried Chicken, 829 F.2d 10, 12 (6th Cir.1987). Though the complaint need not contain detailed factual allegations, the factual allegations must be enough to raise the claimed right to relief above the speculative level and to create a reasonable expectation that discovery will reveal evidence to support the claim. Bell Atlantic, 127 S.Ct. at 1964–65, 167 L.Ed.2d 929; Associated Gen. Contractors of Cal., Inc. v. Carpenters, 459 U.S. 519, 526, 103 S.Ct. 897, 74 L.Ed.2d 723 (1983). Plaintiff must provide more than labels and conclusions, or a formulaic recitation of the elements of a cause of action, Bell Atlantic, 127 S.Ct. at 1965, 127 S.Ct. 1955, and the court is not “bound to accept as true a legal conclusion couched as a factual allegation.” Papasan v. Allain, 478 U.S. 265, 286, 106 S.Ct. 2932, 92 L.Ed.2d 209 (1986); accord Morgan, 829 F.2d at 12.

III. THE NOTEHOLDERS’ SECTION 10(B), FRAUD, AND NEGLIGENT MISREPRESENTATION CLAIMS

A. Elements

1. Section 10(b)

[11] Plaintiff MetLife, Lloyds, and the New York Funds have brought claims against Credit Suisse for violating Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b–5(b) promulgated thereunder, 17 C.F.R. § 240.10b–5(b). Section 10(b) prohibits any person from making “fraudulent, material misstatements or omissions in connection with the sale or purchase of a security.” Morse v. McWhorter, 290 F.3d 795, 798 (6th Cir. 2002); see 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b–5(b). To state a claim under Section 10(b) and Rule 10b–5(b), plaintiffs must allege, in connection with the purchase or sale of securities: “(1) a misstatement or omission, (2) of a material fact, (3) made with scienter, (4) justifiably relied on by plaintiffs, and (5) proximately causing them injury.” Helwig v. Vencor, Inc., 251 F.3d 540, 554 (6th Cir.2001); see also In re Comshare, Inc. Sec. Litig., 183 F.3d 542, 548 (6th Cir.1999).

The Private Securities Litigation and Reform Act (“PSLRA”) requires complaints asserting a claim of federal securities fraud to “specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that
belief is formed.” 15 U.S.C. § 78u–4(b)(1). Moreover, “the complaint shall, with re-
spect to each act or omission alleged to
violate this chapter, state with particulari-
ty facts giving rise to a strong inference
that the defendant acted with the required

2. Fraud

Funds, and the Arizona Noteholders have
asserted claims for common law fraud
against Credit Suisse. The elements of a
fraud claim are: (1) a representation or,
where there is a duty to disclose, conceal-
ment of a fact, (2) which is material to the
transaction at hand, (3) made falsely, with
knowledge of its falsity, or with such utter
disregard and recklessness as to whether
it is true or false that knowledge may be
inferred, (4) with the intent of misleading
another into relying upon it, (5) justifiable
reliance upon the representation or con-
cealment, and (6) a resulting injury proximi-
tely caused by the reliance. Russ v.
TRW, Inc., 59 Ohio St.3d 42, 49, 570
N.E.2d 1076, 1083–84 (Ohio 1991).1

[3, 4] Under Rule 9(b), Fed.R.Civ.P.,
averments of fraud and the circumstances
constituting the fraud must be stated with
“particularity.” To comply with Rule 9(b),
“a plaintiff, at a minimum, must ‘allege the
time, place, and content of the alleged
misrepresentation on which he or she re-
lied; the fraudulent scheme; the fraudu-
lent intent of the defendants; and the
injury resulting from the fraud.’ ” Wal-
burn v. Lockheed Martin Corp., 431 F.3d
966, 972 (6th Cir.2005) (quoting Coffey v.
Foamex L.P., 2 F.3d 157, 161–62 (6th Cir.
1993)). Sciente may be averred generally
and inferred from circumstantial evidence.
See Fed.R.Civ.P. 9(b); S.E.C. v. Blackwell,

3. Negligent Misrepresentation

MetLife, Lloyds, the New York Funds,
and the Arizona Noteholders have also
brought claims against Credit Suisse for
negligent misrepresentation. The Ohio
Supreme Court has defined negligent mis-
representation as follows:

One who, in the course of his business,
profession or employment, or in any oth-
er transaction in which he has a pecuni-
ary interest, supplies false information
for the guidance of others in their busi-
ness transactions, is subject to liability
for pecuniary loss caused to them by
their justifiable reliance upon the infor-
mation, if he fails to exercise reasonable
care or competence in obtaining or com-
municating the information.

Delman v. Cleveland Hts., 41 Ohio St.3d
1, 4, 534 N.E.2d 835, 838 (Ohio 1989) (quoting
3 Restatement of the Law 2d, Torts (1965),
Section 552(1)).

4. Summary of Credit Suisse’s Arguments

Credit Suisse opposes the Section 10(b),
fraud, and negligent misrepresentation
claims on the same grounds. In its mo-
tions to dismiss, Credit Suisse first argues
that it made no misrepresentations to
Plaintiffs and owed no duty of disclosure.
Credit Suisse next argues that the com-
plaints fail to sufficiently plead scienter.
Finally, Credit Suisse contends that the
offering materials contained disclaimers
that precluded Plaintiffs from claiming
they justifiably relied on Credit Suisse’s
alleged misrepresentations.

B. The Alleged Misrepresentations

Plaintiffs allege that they received offer-
ing materials from Credit Suisse in con-
nection with their purchase of NPF VI and
ed, the parties and the Court look primarily to
Ohio law.

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1. The Court has refrained from making
choice-of-law determinations until the facts
are further developed. Unless otherwise not-

NPF XII notes. These materials included private placement memoranda, supplemental private placement memoranda, and the Master Indenture governing the NPF XII note program. MetLife and Lloyds allege that Credit Suisse, as initial purchaser and lead underwriter of the notes, was “intimately involved with the drafting” of the offering materials. See MetLife Fourth Am Compl., ¶ 34; Lloyds Fourth Am. Compl., ¶ 36. The New York Funds similarly allege that Credit Suisse, as primary seller of the notes and as National Century’s financial advisor, had “active involvement in drafting, editing and/or approving” the offering materials. See New York Funds Second Am. Compl., ¶ 143. The Arizona Noteholders make the same allegations that Credit Suisse played a significant role in drafting the offering materials.

Plaintiffs contend that the offering materials contained material misstatements and omissions regarding how NPF VI and NPF XII operated, including that the note programs:

- did not engage in related party transactions.

Plaintiffs contend that these misrepresentations were material because they went to assuring that National Century’s business model was financially sound and that the notes were a good investment.

Plaintiffs allege that Credit Suisse repeated many of the same misrepresentations during sales presentations given to Plaintiffs. For instance, MetLife alleges that Credit Suisse gave a sales presentation at MetLife’s offices on October 11, 2000. During this presentation, Credit Suisse allegedly misrepresented that the notes were of high quality and the note programs had strong credit controls and enhancements. The New York Funds allege that Credit Suisse made a sales presentation to them in October 2000 in which Credit Suisse made the same or similar misrepresentations as were contained in the offering materials. The Arizona Noteholders likewise allege that during sales presentations and telephone calls, representatives of Credit Suisse reiterated the misrepresentations made in the offering materials and made false assurances about the quality of the notes.

Plaintiffs further allege that Credit Suisse made material misrepresentations and omissions in other written materials. For instance, MetLife alleges that Credit Suisse sent it a “Salespoints” document on December 18, 2000. This Salespoints document allegedly made the same or similar misrepresentations as were contained in the offering materials, namely that NPF XII was operating in compliance with the material terms of the Master Indenture. In June 2001, Credit Suisse sent to MetLife an email misrepresenting that the reserve accounts were being properly maintained and that the accounts receivable being purchased were of high quality.
Lloyds similarly alleges that Credit Suisse sent it a document in January 2001 containing misrepresentations regarding the nature and quality of the receivables, the nature of the collateralization of the notes, and the maintenance of the reserve accounts. In July 2002, after the NPF XII notes were downgraded by ratings agency Fitch, Inc., Lloyds contacted Credit Suisse, who responded by sending a “Research Report” containing the same or similar misrepresentations.

The New York Funds likewise allege that Credit Suisse issued the July 2002 Research Report, which misrepresented that there were no problems with the NPF XII note program. And the Arizona Noteholders allege that Credit Suisse sent them a number of “Salespoints” documents that repeated the same misrepresentations as were made in the offering materials.

In the face of these allegations, Credit Suisse argues that it made no misrepresentations to Plaintiffs. Selectively quoting language from the offering materials stating that National Century prepared the materials, Credit Suisse contends that any misrepresentations in those materials belonged to National Century and not to Credit Suisse. This argument is unpersuasive. Credit Suisse’s name is displayed on the front page of all the offering materials, which identify Credit Suisse as the initial purchaser of the notes. The complaints allege that Credit Suisse drafted the materials and provided them to Plaintiffs when marketing the notes. Indeed, the complaints go so far as quoting Credit Suisse’s own internal papers showing that Credit Suisse helped draft and review the offering materials. See MetLife Compl., ¶ 34, Lloyds Compl., ¶ 36, New York Funds Compl., ¶ 148. In Gabriel Capital, L.P., v. NatWest Finance, Inc., 94 F.Supp.2d 491, 502 (S.D.N.Y.2000), the court rejected a similar argument made by two underwriters in a motion to dismiss:

“[T]he cover of the Offering Memorandum prominently lists both NatWest and McDonald as two of the four initial purchasers…. In addition, NatWest and McDonald gave the Offering Memorandum to plaintiffs as part of their sales pitch…. At this stage of the proceedings, that is a sufficient basis to conclude that the alleged misrepresentations were attributable to NatWest and McDonald.”

[6–9] Credit Suisse next argues that it owed no duty of disclosure to Plaintiffs. Generally, a party to a business transaction has a duty to disclose only when a special relationship exists, which Credit Suisse contends was not the case here. See Interim Healthcare of Northeast Ohio, Inc. v. Interim Services, Inc., 12 F.Supp.2d 703, 712 (N.D.Ohio 1998). However, a party who chooses to speak in a securities transaction assumes a duty to speak truthfully and completely about the matters on which he speaks. See Rubin v. Schottenstein, Zox & Dunn, 143 F.3d 263, 268 (6th Cir.1998) (en banc). Even though a party “in a securities transaction may not always be under an independent duty to volunteer information . . . he assumes a duty to provide complete and nonmisleading information with respect to subjects on which he undertakes to speak.” Rubin, 143 F.3d at 268. Here, the complaints adequately allege that Credit Suisse undertook, through the offering materials, sales presentations, and other written materials, to speak about the material aspects of the NPF VI and NPF XII note programs. These allegations are sufficient to impose a duty on Credit Suisse to provide complete and nonmisleading information regarding all the subjects on which Credit Suisse spoke.

Finally, Credit Suisse argues that the claims of the New York Funds and the Arizona Noteholders must be dismissed because the complaints fail to identify
which, if any, of the various plaintiffs who make up the New York Funds and Arizona Noteholders received and reviewed the offering materials. This argument too is without merit. The New York Funds specifically allege that they made investment decisions through their agents Citibank, N.A. and Lincoln Capital, LLC and that these agents received and reviewed the offering materials from Credit Suisse. Each of the Arizona Noteholders allege that Credit Suisse provided the offering materials either directly to them or to their investment advisors.

C. Scienter

1. Pleading Standard

The Sixth Circuit has described the PSLRA's provisions as “[a]dding to the Federal Rules of Civil Procedure 9(b) requirement that fraud must be stated with particularity.” In re Ford Motor Co. Secs. Litig., 381 F.3d 563, 567 (6th Cir.2004). “[N]ot only must the complaint make particular factual allegations, but the inference of scienter which those allegations generate must be strong.” PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 682 (6th Cir.2004).

[10, 11] To establish liability under Section 10(b) and Rule 10b–5, a plaintiff must prove that the defendant acted with scienter, “a mental state embracing intent to deceive, manipulate, or defraud.” Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193–94, n. 12, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976). In the Sixth Circuit, reckless behavior may suffice for liability under Section 10(b). Robert N. Clemens Trust v. Morgan Stanley DW, Inc., 485 F.3d 840, 847 (6th Cir.2007); Helwig v. Vencor, Inc., 251 F.3d 540, 548 (6th Cir.2001) (en banc). Recklessness is a mental state falling "somewhere between intent and negligence" and is characterized by “highly unreasonable conduct which is an extreme departure from the standards of ordinary care.” Mansbach v. Prescott, Ball & Turben, 598 F.2d 1017, 1025 (6th Cir.1979). “While the danger need not be known, it must at least be so obvious that any reasonable man would have known of it.” Id.

The United States Supreme Court recently discussed Section 10(b)'s scienter requirement in Tellabs, Inc. v. Makor Issues & Rights, Ltd., — U.S. —, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007). The Court was called on to interpret the PSLRA's requirement that the allegations give rise to a "strong inference that the defendant acted with the required state of mind."

In the case before us, the Court of Appeals for the Seventh Circuit held that the “strong inference” standard would be met if the complaint “allege[d] facts from which, if true, a reasonable person could infer that the defendant acted with the required intent.” 437 F.3d 588, 602 (2006). That formulation, we conclude, does not capture the stricter demand Congress sought to convey in § 21D(b)(2) [of the PSLRA]. It does not suffice that a reasonable factfinder plausibly could infer from the complaint's allegations the requisite state of mind. Rather, to determine whether a complaint's scienter allegations can survive threshold inspection for sufficiency, a court governed by § 21D(b)(2) must engage in a comparative evaluation; it must consider, not only inferences urged by the plaintiff, as the Seventh Circuit did, but also competing inferences rationally drawn from the facts alleged. An inference of fraudulent intent may be plausible, yet less cogent than other, nonculpable explanations for the defendant's conduct. To qualify as “strong” within the intendment of § 21D(b)(2), we hold, an inference of scienter must be more than merely plausible or reasonable—it must be cogent and at least as
compelling as any opposing inference of nonfraudulent intent.

127 S.Ct. at 2504–05.

[12] The Supreme Court set the following guidelines for analyzing whether a complaint sufficiently pleads scienter. “First, faced with a Rule 12(b)(6) motion to dismiss a § 10(b) action, courts must, as with any motion to dismiss for failure to plead a claim on which relief can be granted, accept all factual allegations in the complaint as true.” 127 S.Ct. at 2509. “Second, courts must consider the complaint in its entirety. . . . The inquiry, as several Courts of Appeals have recognized, is whether all of the facts alleged, taken collectively, give rise to a strong inference of scienter, not whether any individual allegation, scrutinized in isolation, meets that standard.” Id. (citing cases). “Third, in determining whether the pleaded facts give rise to a ‘strong’ inference of scienter, the court must take into account plausible opposing inferences.” Id. With respect to this last point, the Court explained:

The strength of an inference cannot be decided in a vacuum. The inquiry is inherently comparative: How likely is it that one conclusion, as compared to others, follows from the underlying facts? To determine whether the plaintiff has alleged facts that give rise to the requisite “strong inference” of scienter, a court must consider plausible nonculpable explanations for the defendant's conduct, as well as inferences favoring the plaintiff. The inference that the defendant acted with scienter need not be irrefutable. . . . Yet the inference of scienter must be more than merely “reasonable” or “permissible”—it must be cogent and compelling, thus strong in light of other explanations. A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged.

Id. at 2510.

2. Plaintiffs' Allegations of Scienter

Plaintiffs allege at length that Credit Suisse knew that its representations concerning the note programs were false. Below is a summary of the numerous allegations of Credit Suisse’s scienter.

MetLife and Lloyds allege that Credit Suisse became aware of the fraud at National Century no later than 1999 when Credit Suisse performed a due diligence review of National Century's operations. Credit Suisse performed the review as a part of National Century’s ultimately unsuccessful efforts to arrange an initial public stock offering, which Credit Suisse was set to underwrite. During the due diligence, Credit Suisse allegedly reviewed, or at least had access to, documents informing it that National Century's operations were fraudulent. For instance, Credit Suisse had access to draft audit reports dating back to 1995. These reports directly stated that National Century had not complied with the Master Indenture's requirements for purchasing accounts receivable because it had purchased receivables that were “significantly aged” and “deemed uncollectible.” Moreover, Credit Suisse allegedly had access to a June 25, 1999 document authored by PriceWaterhouseCoopers LLP reporting that National Century had improperly done the following: purchased receivables older than 180–day limit set by the Master Indenture; listed ineligible receivables as collateral; and commingled or transferred funds between note programs. MetLife and Lloyds further allege that Credit Suisse received and reviewed an April 27, 1999 document authored by Kaye, Scholer, Fierman, Hays & Handler stating that National Century had not complied with cer-
tain documentary and reporting provisions of the Master Indenture.

MetLife and Lloyds allege that Credit Suisse continued to receive information informing it of problems at National Century. For instance, they allege that in July 2000 representatives from Credit Suisse and Fitch met to discuss Fitch’s concerns about the note programs. Fitch allegedly told Credit Suisse that it had found evidence of a surprising amount of related party transactions, meaning that National Century was purchasing receivables from healthcare providers in which National Century or its Founders held a financial interest. MetLife and Lloyds further allege that Credit Suisse received documents from April and May 2001 indicating that National Century was over-advancing money to healthcare providers and that the reserve accounts had dropped below the required levels. Credit Suisse allegedly received a March 7, 2002 letter from Lance Poulsen, one of National Century’s Founders, indicating that National Century was kiting funds between note programs in order to create the appearance that the reserve level requirements were being met. Further, an October 15, 2002 internal memorandum written by Poulsen allegedly stated that he had met with Credit Suisse about artificially boosting the reserve accounts.

The New York Funds and the Arizona Noteholders also make extensive allegations of scienter. They allege that, as part of the due diligence, Credit Suisse reviewed a draft registration statement stating that National Century had engaged in related party transactions. The draft identified by name several of the healthcare providers in which National Century or its Founders held interests, and it stated that related party transactions accounted for 36.3% of National Century’s gross revenues in 1998. These Plaintiffs further allege that in 1998 one of Credit Suisse’s financial clients, Freenius, contacted Credit Suisse about selling a healthcare business, NMC Homecare, to National Century. Credit Suisse helped arrange the sale of NMC Homecare and its receivables to National Century. In the process, Credit Suisse allegedly learned that National Century was buying NMC Homecare’s receivables even though they did not meet the eligibility standards described in the offering materials and Master Indenture.

The New York Funds and the Arizona Noteholders additionally allege that Credit Suisse knew of large shortfalls in the reserve accounts. In September 2000, Credit Suisse allegedly loaned $300 million to National Century for the specific purpose of using the money to hide the shortfalls in the reserve accounts of NPF VI and NPF XII. The New York Funds and the Arizona Noteholders also cite a July 15, 2002 report issued by Credit Suisse in which it admitted that it knew for several years that the note programs had violated the concentration limits set forth in the Master Indenture. Those concentration limits were supposed to restrict the note programs from purchasing too many of the same class of receivables and from purchasing too many receivables from any one provider.

The complaints also contain numerous indirect allegations of scienter. According to Plaintiffs, the alleged fraud at National Century was so great in magnitude, with losses between $2 and $3 billion, that insiders like Credit Suisse had to have known of the fraud. The complaints further allege the existence of many “red flags” that should have alerted Credit Suisse to the alleged fraud. Some of the red flags included: (1) Credit Suisse’s receipt of anonymous letters raising specific concerns about the operation of the note programs; (2) Deutsche Bank, which at one time served as an underwriter, abruptly termi-
nating its relationship with National Century in 2000; (3) PriceWaterhouseCoopers, which served as National Century’s auditor, abruptly terminating its relationship with National Century in 1999; (4) unexplained delays in the issuing of audits; (5) Deloitte & Touche, which replaced PriceWaterhouse as auditor, failing to complete its audit in 2001 and stating that there were concerns about the quality of the receivables; and (6) Fitch downgrading its rating of the NPF VI and NPF XII notes.

Each of the Plaintiffs further allege that Credit Suisse had financial motives for continuing to market the notes and misrepresent their quality, despite knowing that the note programs had repeatedly committed material violations of the Master Indenture. Plaintiffs allege that Credit Suisse collected significant investment banking and placement fees in its role as placement agent. In addition, Plaintiffs allege that Credit Suisse stood to lose millions of dollars if it, the initial purchaser of the notes, could not transfer the notes to the secondary market before National Century’s alleged fraud was exposed.

3. Discussion

Credit Suisse offers four main reasons for why Plaintiffs’ allegations of scienter are insufficient. First, Credit Suisse interprets the allegations as showing that it discovered the fraud after the fact—after it had already sold the notes to Plaintiffs. Second, Credit Suisse contends that the complaints allege that it merely had access to information. Third, Credit Suisse argues that the allegations concerning due diligence support nothing more than an inference that Credit Suisse performed the due diligence review negligently. Finally, Credit Suisse argues that the allegations of motive are nonsensical because Credit Suisse would not have increased its exposure to National Century after having learned of the alleged fraud.

Upon review of the complaints, the Court finds that each complaint supports a strong inference of scienter that is more compelling than the competing inferences suggested by Credit Suisse. Credit Suisse contends that scienter cannot be established through allegations of “fraud by hindsight.” As a legal principle, this is true. If a defendant did not know or recklessly disregard the falsity of the statement at the time it was made, then Section 10(b) liability cannot be imposed even if the statement turns out to be false in hindsight. See Sinay v. Lawson & Sessions Co., 948 F.2d 1037, 1042 (6th Cir. 1991) (holding that allegations of fraud by hindsight are insufficient to withstand a motion to dismiss). But Credit Suisse confuses how this principle applies here. It does not matter, as Credit Suisse seems to believe it does, that the complaints are unable to trace Credit Suisse’s alleged knowledge of the fraud to the time the alleged scheme to defraud investors was conceived. What matters for purposes of Section 10(b) liability is that Credit Suisse is alleged to have known of the fraudulent scheme by the time it made misrepresentations to Plaintiffs. See Sinay, 948 F.2d at 1040 (the issue is “whether the statement was false when made”). The complaints here thoroughly allege that Credit Suisse knew of the material aspects of the fraud—including the purchase of ineligible receivables, the related-party transactions, and the depletion and manipulation of reserve accounts—before it solicited and sold notes to Plaintiffs.

In an argument directed particularly at MetLife and Lloyds, Credit Suisse argues that the complaints allege only that Credit Suisse had access to information. For instance, MetLife and Lloyds allege that Credit Suisse had access to draft audit reports and a PriceWaterhouseCoopers document when it performed the due dili-
gence review. Credit Suisse correctly notes that mere access to information is not enough to establish scienter. See Fidel v. Farley, 392 F.3d 220, 229–30 (6th Cir.2004); PR Diamonds, Inc. v. Chandler, 364 F.3d 671, 688 (6th Cir.2004). In Fidel and PR Diamonds, the complaints alleged in conclusory fashion that the defendants, because of their positions with the companies committing the fraud, had access to information that would have given them knowledge of the fraud. The complaints failed to allege what documents in particular the defendants had access to or what information they would have learned from reviewing the documents.

In contrast to the plaintiffs in Fidel and PR Diamonds, MetLife and Lloyds describe exactly what documents Credit Suisse had access to, why Credit Suisse likely would have reviewed them, and what Credit Suisse would have learned by reviewing them. More importantly, as discussed in Part III.C.2 above, the complaints of MetLife and Lloyds go beyond allegations of mere access and describe what information Credit Suisse did review and know. The complaints allege that Credit Suisse knew—based on the Kaye Scholer memo, information from the meeting with Fitch, documents dated from April and May 2001, and correspondence with Lance Poulsen—that National Century was purchasing ineligible receivables, making related-party transactions, and manipulating its depleted reserve accounts. Thus, even putting aside the allegations of access, the complaints sufficiently allege that Credit Suisse reviewed information giving it knowledge of the alleged fraud.

Credit Suisse next contends that the complaints portray its performance of the due diligence review as negligent at best, and negligence is not sufficient to impose Section 10(b) liability. See Ernst & Ernst v. Hockfelder, 425 U.S. 185, 210, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976) (holding that Section 10(b) "cannot be extended, consistently with the intent of Congress, to actions premised on negligent wrongdoing"). But the thrust of the complaints is not that Credit Suisse negligently performed the due diligence. Rather, it is that Credit Suisse did perform the due diligence and did receive and review information providing it with knowledge of the material aspects of the alleged fraud. The Arizona Noteholders, for instance, quote Credit Suisse's own statement to investors that it had done "lots of due diligence." See, e.g., State of Arizona's Second Am. Compl., ¶ 108. Even if the allegations about the due diligence review, standing alone, do not create a strong inference of scienter, the Court must consider each complaint as a whole. Each complaint contains additional allegations of post-due diligence information Credit Suisse actually received and knew, as well as specific allegations of numerous red flags that would have alerted a reasonable person in Credit Suisse's position of the fraud. See PR Diamonds, 364 F.3d at 686 ("Specific factual allegations that a defendant ignored red flags, or warning signs that would have revealed the accounting errors prior to their inclusion in public statements, may support a strong inference of scienter."). All of these allegations, when combined with the due diligence allegations, create a strong inference of scienter.

Finally, Credit Suisse attacks the allegations of motive as being nonsensical. Credit Suisse questions why it would continue to serve as the initial purchaser of the notes if it knew of the fraud. No reasonable business, according to Credit Suisse, would expose itself to such a high risk of loss. Though Credit Suisse may ultimately be able prove this to be the case, the Court at this stage must accept the allegations in the complaints as true. The complaints allege that Credit Suisse
continued its involvement in National Century because that was the best way for Credit Suisse to reduce its exposure. Plaintiffs allege that Credit Suisse, having become deeply involved in the fraudulent enterprise and with hundreds of millions of dollars of unsold notes on its hands, reduced its exposure by selling the notes to unsuspecting investors. And by selling the notes, Credit Suisse generated enough funds to keep the note programs going awhile longer.

In summary, the Court finds that each complaint alleges facts that, when taken as true and considered collectively, give rise to a strong inference of scienter. Credit Suisse has challenged isolated portions of the complaints but does not offer any competing explanations of the pleaded facts that are as plausible as Plaintiffs’ explanations. The complaints portray Credit Suisse as an insider to the scheme to defraud. They describe a complete picture of Credit Suisse’s participation, knowledge, and motivation regarding National Century’s alleged scheme to defraud investors—a fraud so great in magnitude that the most plausible inference is that Credit Suisse almost surely had to know of it. See PR Diamonds, 364 F.3d at 684–85 (finding that fraud of great magnitude, in combination with other factors, may support a strong inference of fraud).

D. Reliance

Credit Suisse next argues that Plaintiffs could not have justifiably relied on the alleged misrepresentations. Credit Suisse points to several disclaimers contained in the offering materials, including that: (1) Credit Suisse did not do “any independent investigation” of the statements in the offering materials; (2) Credit Suisse made no “representations or warranties as to the accuracy or completeness of the information” contained in the offering materials; (3) prospective purchasers “must rely on their own examination” of the issuer and note offering; and (4) no person, apart from those “specifically designated,” was “authorized to give any information or to make any representations other than those contained in [the memoranda].” See Private Placement Memoranda and Supplemental Private Placement Memoranda, pp. 3–4. Credit Suisse argues that no reasonable investor could have relied on any misrepresentations in the offering materials after seeing the disclaimers.

Credit Suisse contends that the Participation Agreement between it and Lloyds contained similar disclaimers to the ones in the offering materials. The Agreement stated that Credit Suisse had not made any representations or warranties to Lloyds and that Lloyds was responsible for conducting its own examination of the NPF XII note program. See Participation Agr., § 12.

[16] The Court finds that the disclaimers in the offering materials and Participation Agreement do not preclude Plaintiffs from showing that they justifiably relied on Credit Suisse’s alleged misrepresentations. The reasons why this is so are fully explained in Plaintiffs’ briefs, and the Court will discuss them only briefly. The issue of whether a party’s reliance was justifiable is largely a question of fact inappropriate for resolution on a motion to dismiss. See Bass v. Janney Montgomery Scott, Inc., 210 F.3d 577, 590 (6th Cir.2000) (“[T]he question of whether [plaintiff’s] reliance was reasonable is beyond doubt a question of fact for a jury to decide, and not a fit subject for judgment as a matter of law.”). This is particularly true here because the purported disclaimers were undermined or contradicted by other information allegedly available to potential investors. For instance, the disclaimer stating that Credit Suisse had done no independent investigation would seem beyond credulity to po-
potential investors who knew that Credit Suisse, a major financial institution, had helped devise the note programs, helped draft the offering materials, and had purchased hundreds of millions of dollars of notes in its role as initial purchaser.

Other disclaimers stated that Credit Suisse was not making any representations of accuracy and that potential investors should rely on their own examinations. But those disclaimers were contradicted by a statement on the second page of the offering materials telling potential investors, “You should rely only on the information contained in this document.” The very documents that Credit Suisse put into the hands of investors told them to rely on the statements made in those documents.

The last disclaimer—the one in the offering materials stating that no person, apart from those “specifically designated,” was authorized to make representations other than those in the private placement memorandum—on its face did not apply to representations made in the offering materials. Moreover, the offering materials nowhere made a specific designation of who was authorized to make representations. In the absence of a specific designation otherwise, investors dealing with Credit Suisse, who served as placement agent for the notes and whose name appeared prominently on the front page of the offering materials, certainly had reason to believe that Credit Suisse was authorized to make representations.

Courts have long held that general disclaimers of accuracy do not shield sellers who knowingly make false statements. “[I]f a deliberate fraud may be shielded by a clause in a contract that the writing contains every representation made by way of inducement, or that utterances shown to be untrue were not an inducement to the agreement, sellers of bogus securities may defraud the public with impunity, through the simple expedient of placing such a clause in the prospectus which they put out, or in the contracts which their dupes are asked to sign.” Arnold v. Nat’l Aniline & Chemical Co., 20 F.2d 364, 369 (2d Cir.1927). As Plaintiffs argue, it would defeat the securities laws if parties could escape liability for their own deliberate misrepresentations by inserting boilerplate disclaimers into offering materials. See Milman v. Box Hill Systems Corp., 72 F.Supp.2d 220, 231 (S.D.N.Y. 1999) (“No degree of cautionary language will protect material misrepresentations or omissions where defendants knew their statements were false when made.”); Jadoff v. Gleason, 140 F.R.D. 330, 335 (M.D.N.C.1991) (“[U]pholding such disclaimers of reliance would give a 10b–5 defendant license to make any representations he desired with impunity.”).

Indeed, Section 29(a) of the Securities Exchange Act prohibits the waiver of the substantive obligations of the Act. It provides, “Any condition, stipulation, or provision binding any person to waive compliance with any provision of this title or of any rule or regulation thereunder, or of any rule of an exchange required thereby shall be void.” 15 U.S.C. § 78cc(a); see AES Corp. v. Dow Chemical Co., 325 F.3d 174, 179 (3d Cir.2003). “[A] party cannot disclaim liability for fraudulent misrepresentations by placing a disclaimer to that effect in a contract . . . . This is especially true of fraud in securities transactions. 15 U.S.C. § 78cc voids any contract which purports to release an individual from obligations under the federal securities laws, or to waive any claims under those statutes before those claims accrue.” Katz v. First of Mich., No. K87–264 CA4, 1989 WL 62196, at * 10 (W.D.Mich. March 13, 1989). Thus, the Court finds that Credit Suisse’s purported disclaimers do not preclude Plaintiffs from pleading justifiable reliance.
E. Statute of Limitations Challenge to Arizona Noteholders’ Fraud Claims

Credit Suisse argues that a significant number of the Arizona Noteholders filed their fraud claims, as well as the rest of their common law claims, after Arizona’s statute of limitations had run. The Arizona Noteholders filed two of their lawsuits on May 23, 2003 and the third suit on August 9, 2003. Credit Suisse argues that the common law claims accrued upon the purchase of the notes, some of which had purchase dates in 1998, 1999, and early 2000. Arizona law has a three-year statute of limitations for fraud-based claims and a two-year statute of limitations for other common law claims. See Ariz.Rev. Stat. Ann. §§ 12–542, 12–543.

[17, 18] The Court must reject Credit Suisse’s argument. The Arizona Noteholders have alleged at length that Credit Suisse concealed its conduct. They contend that the offering materials did not disclose the fraudulent nature of National Century’s operations, and when they approached Credit Suisse with concerns, Credit Suisse allegedly issued false assurances about the health of the NPF VI and NPF XII programs. The statute of limitations is subject to a discovery rule whereby a claim accrues when a plaintiff knows, or by the exercise of due diligence should know, of the defendant’s wrongful conduct. See Taylor v. State Farm Mut. Auto. Ins., Co., 913 P.2d 1092, 1095, 185 Ariz. 174, 177 (Ariz.1996); Gust, Rosenfeld & Henderson v. Prudential Ins. Co. of Am., 898 P.2d 964, 966–67, 182 Ariz. 586, 588–89 (Ariz. 1995). The complaints sufficiently allege that the Arizona Noteholders could not have reasonably discovered the wrongful conduct until the time of National Century’s collapse in October 2002.

F. Summary

For the reasons discussed above, the Court finds that the complaints of MetLife, Lloyds, and the New York Funds satisfy the pleading standard of the PSLRA and sufficiently state claims against Credit Suisse under Section 10(b). Those same complaints, as well as the complaints of the Arizona Noteholders, satisfy the standard of Rule 9(b) in stating claims for fraud and negligent misrepresentation.

IV. STATE BLUE SKY LAW CLAIMS

MetLife, Lloyds, and the Arizona Noteholders have asserted claims under the blue sky laws of various states. These laws prohibit the use of misrepresentations and material omissions in connection with the sale of securities. Typically, a state’s blue sky law will have provisions imposing primary liability on sellers or solicitors who make untrue statements in connection with a sale, and it will have provisions imposing secondary liability on persons who materially aid the seller and on persons who control the seller. See e.g., Ohio Rev.Code § 1707.41(A) (primary liability), § 1707.43(A) (secondary liability).

Credit Suisse opposes the blue sky law claims for the same reasons that it opposed the Section 10(b) and fraud claims. It contends that it made no misrepresentations, did not have a duty to disclose, did not act with the requisite scienter, and that the disclaimers precluded reasonable reliance by Plaintiffs. As discussed in Part III above, those arguments are not persuasive.

Credit Suisse additionally argues that the blue sky law claims fail for the following reasons: (1) certain plaintiffs have not alleged any nexus to the particular states whose blue sky laws they invoke; (2) the claims of certain Arizona Noteholders are time-barred; (3) the Arizona Noteholders who are governmental entities lack stand-
ing to assert a claim; (4) there is no private right of action under the blue sky laws of New Jersey and Oregon; (5) the laws of several states do not apply to private placements; (6) the laws do not protect certain Arizona Noteholders who purchased notes from Credit Suisse in the aftermarket; (7) Credit Suisse did not sell or solicit the sale of notes to certain Arizona Noteholders who purchased notes from someone other than Credit Suisse; and (8) Credit Suisse did not materially assist or aid the sale of notes to those Arizona Noteholders who purchased notes from someone other than Credit Suisse.

A. Nexus with Certain States

1. Lloyds

[19] Credit Suisse first contends that Lloyds has not alleged a sufficient nexus with New Jersey to assert a claim under the blue sky law of that state. This is correct. In its May 7, 2007 Opinion concerning the Outside Directors, the Court found:

The complaint of Lloyds (a British public limited company with its principal place of business in London, England), makes no allegations about where it was offered, or where it accepted an offer, to purchase notes. The complaint alleges that Credit Suisse First Boston LLC served as lead underwriter for the notes. According to the complaint, Credit Suisse First Boston LLC is a Delaware limited liability company, with its principal place of business in New York. Banc One Capital Markets, a broker-dealer that allegedly had a role in the note offering, is incorporated in Delaware, with its principal place of business in Illinois.

The Court finds that the complaint of Lloyds fails to contain any allegations that would bring the Outside Directors’ alleged conduct within the scope of New Jersey’s Blue Sky law. On the face of the complaint, there is no connection between New Jersey and the Outside Directors’ actionable conduct. Lloyds has amended its complaint four times, and despite the Outside Directors raising this issue from the outset, the complaint fails to allege any connection to New Jersey. Accordingly, Lloyds’s claim under New Jersey’s Blue Sky law is dismissed.

May 7, 2007 Opinion, p. 35. Lloyds’s complaint likewise fails to allege any connection between New Jersey and Credit Suisse’s actionable conduct, and, thus, Lloyds’s claim under New Jersey’s blue sky law is dismissed.

2. Certain Arizona Noteholders

Credit Suisse next argues that four of the Arizona Noteholders have not alleged a sufficient nexus with the state whose blue sky law they invoke. Those plaintiffs and states are: the State of Indiana Public Employees’ Retirement Fund (Indiana); Mellon Investor Services LLC (New Jersey); Crown, Cork & Seal Company Master Retirement Trust (Pennsylvania); and the Metropolitan Government of Nashville and Davidson County (Tennessee). Each of these plaintiffs reside in the state whose law they invoke. Credit Suisse argues that residency is not enough; rather, there must be a purchase or an offer to buy or sell in a particular state before that state’s blue sky law may be invoked.

According to the complaints, the State of Indiana Public Employees’ Retirement Fund and the Metropolitan Government of Nashville and Davidson County acted through an investment advisor in Illinois. The Crown, Cork & Seal Company Master Retirement Trust acted through an investment advisor in Minnesota. Each of these plaintiffs reside in the state whose law they invoke. Credit Suisse argues that residency is not enough; rather, there must be a purchase or an offer to buy or sell in a particular state before that state’s blue sky law may be invoked.

According to the complaints, the State of Indiana Public Employees’ Retirement Fund and the Metropolitan Government of Nashville and Davidson County acted through an investment advisor in Illinois. The Crown, Cork & Seal Company Master Retirement Trust acted through an investment advisor in Minnesota. The complaint is not entirely clear about Mellon Investor Services, but it groups Mellon with other plaintiffs from New York in a way suggesting that it acted through an advisor in
New York. Credit Suisse does not challenge the claims these plaintiffs make under the laws of the states where their investment advisors were located or under the law of Ohio, where National Century was headquartered. It challenges only the residency-based claims.

Each of the blue sky laws at issue apply to the “offer, sale, or purchase” of a security in that state. See Ind.Code § 23–2–1–12; N.J. Stat. Ann. § 49:3–51(a); 70 Pa. Cons.Stat. § 1–401; Tenn.Code Ann. § 48–2–121(a). Credit Suisse argues that the sales here occurred in the state where the plaintiff’s agent was located, not where plaintiff resided. Plaintiffs counter that each state has an interest in protecting its residents and that the blue sky laws may validly be applied to protect residents who have been defrauded in purchasing securities.

The Court finds that these blue sky law claims should survive the motion to dismiss. Typically, a defrauded buyer of a security may assert a blue sky claim under the law of his own state. In A.S. Goldman & Co., Inc. v. New Jersey Bureau of Securities, 163 F.3d 780, 787 (3d Cir.1999), the Third Circuit recognized that securities transactions often are not confined to one state. Courts should look to where the “elements of the transaction have occurred.” Id. Thus, a “contract between [a seller] in New Jersey and a buyer in New York does not occur ‘wholly outside’ New Jersey, just as it does not occur ‘wholly outside’ New York. Rather, elements of the transaction occur in each state, and each state has an interest in regulating the aspect of the transaction that occurs within its boundaries.” Id. Here, the plaintiffs assert claims under the laws of their own state, the state of the seller, and the state where their investment advisors were located. At this early stage, the Court cannot say that the laws of the states where plaintiffs resided do not apply.

B. Statute of Limitations

Credit Suisse argues that the claims of certain Arizona Noteholders are barred by the applicable statutes of limitations. The Arizona Noteholders filed two of their lawsuits on May 23, 2003 and the third suit on August 9, 2003. The complaints allege that notes were purchased in 1998 and early 1999 by the Asset Allocation & Management Plaintiffs, Bayerische Landesbank, Mutual of New York, SanPaolo IMI, and United of Omaha Insurance Company. Credit Suisse argues the Ohio blue sky law claims being asserted on those notes are time-barred under the applicable two-year statute of limitations. Credit Suisse also argues that United of Omaha’s Nebraska law claim is barred by Nebraska’s three-year statute of limitations. See Neb.Rev. Stat. § 8–1118(4).

The Noteholders argue that the statute of limitations should be tolled because Credit Suisse fraudulently concealed its conduct until October 2002. The Court agrees that the complaints amply allege that Credit Suisse concealed the fraud; however, Ohio law sets a cut-off of four years for bringing a blue sky claim. At the time the Noteholders filed suit, Ohio’s blue sky law provided that no action could be brought “more than two years after the plaintiff knew, or had reason to know, of the facts by reason of which the actions of the person or director were unlawful, or more than four years from the date of such sale or contract for sale, whichever is the shorter period.” Ohio Rev.Code § 1707.43(B) (2003). Thus, § 1707.43(B) has a two-year statute of limitations, which may be tolled, and a four-year statute of repose, which may not be tolled. See Wyster–Pratte Mgmt. Co., Inc. v. Telxon Corp., 413 F.3d 553, 561 n. 7 (6th Cir.2005); Cain v. Mid–Ohio Sees., Inc., No. 06CA008933, 2007 WL 2080553, at *2 (Ohio Ct.App. July 23, 2007). Claims must be brought within
two years after the discovery of facts constituting the violation or within four years from the date of the sale or contract for sale, “whichever is the shorter period.” Cf. Bovee v. Coopers & Lybrand, 216 F.R.D. 596, 603–04 (S.D.Ohio 2003) (discussing similar language in 15 U.S.C. § 78i(e) and noting that actions brought under Section 10(b) “are subject to a one-year statute of limitations and a three-year statute of repose .... Securities fraud claims must be brought within one year after the discovery of the facts constituting the violation and within three years after the violation.”). Four years will be the shorter period where, as alleged here, the fraud was concealed for more than two years. The claims based on the 1998 and early 1999 note purchases were not asserted within four years of sale or contract for sale.

[21] On September 16, 2003, an amendment became effective that changed the four-year period of repose to five years. Ohio Rev.Code § 1707.43(B) (2004). The Noteholders argue that their claims should be covered by the amended, five-year period, which went into effect shortly after they filed suit. The issue presented is whether claims that were time-barred when filed can be revived by a later extension of the limitations period. The general rule, including in Ohio, is that laws do not have retroactive effect absent express legislative directive otherwise. See Ohio Rev.Code § 1.48 (“A statute is presumed to be prospective in its operation unless expressly made retrospective.”); Van Fossen v. Babcock & Wilcox Co., 36 Ohio St.3d 100, 105, 522 N.E.2d 489, 495 (Ohio 1988). In the securities context, courts have refused to apply lengthened statutes of limitations retroactively unless the legislature says otherwise. See In re Wright Enterprises, 76 Fed.Appx. 717, 723, 2003 WL 22232919, at *5 (6th Cir.2003) (holding that lengthened limitations period for Kentucky blue sky law claim did not apply retroactively); Aetna Life Ins. Co. v. Enter. Mortgage Acceptance Co., 391 F.3d 401, 409–11 (2d Cir. 2004) (holding that Sarbanes–Oxley did not revive federal securities claim already time-barred prior to the effective date of the amendment). Here, there is no language in § 1707.43 expressing a legislative intent for the five-year period to apply retroactively. Accordingly, the Ohio blue sky law claims based on note purchases made in 1998 and early 1999 are time-barred. This means that the Asset Allocation & Management Plaintiffs and SanPolo IMI, who made all of their note purchases in 1998 and early 1999, have no claims remaining under Ohio’s blue sky law. Bayerische Landesbank, Mutual of New York, and United of Omaha made other note purchases in 2000, 2001, and 2002, and they still may pursue claims under Ohio’s blue sky law for those later transactions.

[22] Turning to Nebraska’s blue sky law, the result is the same for United of Omaha. Section 8–1118 provides that “[n]o person may sue under this section more than three years after the contract of sale or the rendering of investment advice.” Neb.Rev.Stat. § 8–1118(4). Though case law is scarce, courts have held that “equitable tolling principles are no part of section 8–1118.” Farr v. Designer Phosphate and Premix Intern., Inc., 804 F.Supp. 1190, 1199 (D.Neb.1992); see also DeSciose v. Chiles, Heider & Co., Inc., 239 Neb. 195, 207, 476 N.W.2d 200, 207 (Neb.1991). Thus, United of Omaha’s Nebraska law claim for its 1998 note purchase is time-barred. United of Omaha may still pursue claims based on its note purchases in 2001 and 2002.

C. Standing

Credit Suisse next argues that the Arizona Noteholders who are governmental
entities lack standing to assert a claim. In this litigation, there are 110 local governmental entities who are part of an investment pool managed by the treasurer of the State of Arizona. Under Arizona law, “the state treasurer may maintain one or more pooled investment funds for the collective investment of monies in this state.” Ariz. Rev.Stat. Ann. § 35–326.A. The treasurer directs how the investment pool is invested, regularly accounts for the funds in the pool, ensures that records are audited, disburses or reinvests mature securities, and allocates pooled income earnings on a pro rata basis. Ariz.Rev.Stat. Ann. § 35–327.

Credit Suisse argues that the individual governmental entities never purchased notes; only the treasurer purchased notes, and only the treasurer, as trustee of the investment pool, has standing to sue on behalf of the investment pool.

The Court finds that the standing issue raised by Credit Suisse is moot. Credit Suisse acknowledges that a trustee of a trust generally has the authority to pursue a cause of action for injury to the trust property. In the complaint captioned State of Arizona, et al., v. Credit Suisse First Boston, et al., Case No. CIV03–1618–PHX (D.Ariz.), the first plaintiff listed is the State of Arizona, ex rel. Treasurer David A. Peterson, in his official capacity on behalf of the local government investment pool. Even if Credit Suisse is right that the individual governmental entities do not have standing, the state treasurer does and he is named as a plaintiff.

D. Private Right of Action


E. Private Placements

Credit Suisse next contends that the blue sky laws of six states do not apply to private placements. Those states are the ones whom Credit Suisse claims have modeled their laws after Section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77l (a)(2): Arizona, California, Massachusetts, Nebraska, New Jersey, and Ohio. Credit Suisse argues that the blue sky laws of these states should be interpreted the same as courts have interpreted Section 12(2). In Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 569–70, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995), the United States Supreme Court held that Section 12(2) applies to public offerings of securities and
not to private agreements to sell securities. Credit Suisse believes that the state laws should also not apply to private sales, such as the ones to MetLife, Lloyds, and the Arizona Noteholders.

The Court rejected this argument when it was raised by the Outside Directors in the context of Ohio’s blue sky law. See May 7, 2007 Opinion, pp. 27–29. Section 12(2) imposes liability for misstatements in a “prospectus” or an oral communication related to a prospectus. 15 U.S.C. § 77l (a)(2). In Gustafson, the Supreme Court held that a prospectus “is confined to documents related to public offerings by an issuer or its controlling shareholders.” 513 U.S. at 568–71, 575–76.


F. Aftermarket

A limited number of the Arizona Noteholders purchased notes several months or years after the initial offering date. For example, in May 2002 Mellon Investor Services purchased from Credit Suisse securities that were issued in March 1999. The other Noteholders who made aftermarket purchases from Credit Suisse are: the AmerUs Plaintiffs, Bristol CDO I Ltd., the Dreyfus Plaintiffs, the GMO Plaintiffs, Mutual of New York Life Insurance Company, Oregon Insurance Guaranty Association, and Phoenix Life Insurance Company.

Credit Suisse challenges the claims being asserted by these aftermarket Noteholders under the laws of Connecticut, Massachusetts, New Jersey, and Ohio. Credit Suisse raises the same argument
that it made about private placements. It argues that under Gustafson’s interpretation of the word “prospectus,” courts have limited the application of Section 12(2) of the Securities Act of 1933 to initial public securities offerings. See First Union Discount Brokerage Services, Inc. v. Milos, 997 F.2d 835, 843 (11th Cir.1993); In re FirstEnergy Corp. Sec. Litig., 316 F.Supp.2d 581, 602 (N.D.Ohio 2004). According to Credit Suisse, the blue sky laws should also be limited to initial offerings.


G. Primary Liability as a Seller or Solicitor

A limited number of the Arizona Noteholders allege that they purchased all of their notes from someone other than Credit Suisse. These Noteholders and the blue sky law claims they assert are: Abu Dhabi Investment Company (Ohio), the Clifton Group Plaintiffs (Minnesota, Pennsylvania, Ohio), Louisiana Corporate Credit Union (Louisiana, Ohio), Oregon Insurance Guarantee Association (Oregon, Ohio), and select members of the Pacific Investment Management Company Plaintiffs (California, Ohio). Two other Noteholders—Bayerische Landesbank (Ohio) and Phoenix Life Insurance Company (Connecticut, Ohio)—purchased some, but not all, of their notes from someone other than Credit Suisse.

1. Privity

[26] Credit Suisse argues that the claims for primary liability under California and Oregon law must be dismissed because those laws require strict privity, such that liability does not extend to a party who solicits the sale of a security but does not pass title. The Court agrees that the claims for primary liability under California and Oregon law must be dismissed for lack of privity. California Corporations Code § 25501 limits primary liability to a person who “sells a security.” Cal. Corp.Code § 25501; see also Scognamillo v. Credit Suisse First Boston LLC, No. C03–2061 2005 WL 645446, at *11 (N.D.Cal. March 21, 2005); California Amplifier, Inc. v. RLI Ins. Co., 94 Cal. App.4th 102, 109, 113 Cal.Rptr.2d 915, 921 (Cal.Ct.App.2001). Privity is not alleged to have existed between Credit Suisse and select members of the Pacific Investment Management Company Plaintiffs; thus, their claims for primary liability under California’s blue sky law are dismissed.

[27] Oregon law also required privity at the time of the alleged actionable conduct. See Or.Rev.Stat. § 59.115(1)(a) (2002) (imposing liability on a person who “sells a security”). Only after the Arizona Noteholders filed their complaints was the

2. The members of the Pacific Investment Management Company Plaintiffs who did not purchase notes directly from Credit Suisse are listed in Exhibit 1 to the Arizona Noteholders’ complaints.
law amended to expand liability to persons who solicit the sale of a security. See Or.Rev.Stat. § 59.115(1)(a) (2004) (expanding liability but not indicating a retroactive effect). Privity is not alleged to have existed between Credit Suisse and the Oregon Insurance Guaranty Association when the note purchase was made in 2002; thus, the claim for primary liability under Oregon’s blue sky law is dismissed.

2. Solicitor Liability

The remainder of the blue sky laws at issue lack a privity requirement and thus extend liability to persons who solicit the sale of a security. The Noteholders allege that Credit Suisse is liable as a solicitor because it drafted the offering materials, which all of the Noteholders are alleged to have received. Credit Suisse counters that merely drafting the offering materials does not count as soliciting the sale of the notes.

In determining the scope of primary liability, state courts have looked to Pinter v. Dahl, 486 U.S. 622, 108 S.Ct. 2063, 100 L.Ed.2d 658 (1988), a case in which the United States Supreme Court interpreted Section 12(1) of the Securities Act. Section 12(1), like the blue sky laws here, applies to any person who sells or offers to sell a security. See 15 U.S.C. § 77l (a)(1). The Court held that primary liability can be imposed on the person who passes title and on “the person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner.” Pinter, 486 U.S. at 647, 108 S.Ct. 2063. “A natural reading of the statutory language would include in the statutory seller status at least some persons who urged the buyer to purchase.” Id. at 644, 108 S.Ct. 2063.

[28] The Court finds that the complaints sufficiently allege that Credit Suisse solicited the sale of the notes. Even where Credit Suisse was not the immediate seller, it is alleged to have participated in drafting and circulating the offering materials received by all of the Arizona Noteholders and their investment advisors. Credit Suisse allegedly played a key role in devising the NPF VI and NPF XII note programs and in soliciting investors nationwide, and it allegedly had a financial interest in the existence of a strong and active secondary market for the notes. As the Arizona Noteholders argue in their brief, courts have held that drafting, circulating, or presenting written sales material may, in the right circumstances, be enough to impose liability. See, e.g., Capri v. Murphy, 856 F.2d 473, 478 (2d Cir.1988) (finding liable a defendant who prepared and circulated a prospectus to plaintiffs); In re Prof’l Fin. Mgmt., Ltd., 692 F.Supp. 1057, 1064 (D.Minn.1988) (finding liable a defendant who was “the creator and principal proponent of the [securities] program nationally” and who “assisted with financial appraisals and helped draft a prospectus which was distributed to prospective buyers”).

H. Secondary Liability

[29] Finally, Credit Suisse challenges the secondary liability claims of the same Noteholders who purchased their notes from someone other than Credit Suisse. The blue sky laws at issue impose secondary liability on persons who participate in or materially assist or aid the fraudulent sale of securities. See, e.g., Cal. Corp. Code § 25504.1; Conn. Gen Stat. § 36b–29(a)(2); Ohio Rev.Code § 1707.43(A); Or. Rev.Stat. § 59.115(3). The Court finds that the complaints sufficiently allege that Credit Suisse participated in and materially assisted the sales to the Noteholders. The complaints allege that Credit Suisse played a material role in inducing the Noteholders to buy notes because it drafted and circulated the offering materials
that were received and relied on by the Noteholders when they decided to purchase notes. See Federated Mgmt. Co. v. Coopers & Lybrand, 137 Ohio App.3d 366, 391, 738 N.E.2d 842, 860 (Ohio Ct.App. 2000) (noting that liability extends to any person who participates in or aids the sale, including “inducing the purchaser to invest”).

V. NEGLIGENCE

MetLife, Lloyds, and the New York Funds assert claims for negligence. Credit Suisse argues that the negligence claims should be dismissed because they are indistinguishable from Plaintiffs’ negligent misrepresentation claims. Upon review of the complaints, the Court agrees that the negligence claims are indistinguishable from the claims for negligent misrepresentation. The complaints allege that Credit Suisse breached its duty of care by misrepresenting and failing to disclose material facts concerning the NPF VI and NPF XII note programs. This is the same conduct that forms the basis of the negligent misrepresentation claims. The Court will therefore will treat the negligence claims as claims for negligent misrepresentation.

VI. AIDING AND ABETTING

The Arizona Noteholders and the New York Funds have asserted claims for aiding and abetting fraud against Credit Suisse. The Arizona Noteholders additionally assert a claim for aiding and abetting breach of fiduciary duty. Though the case law is unclear about whether a cause of action exists in Ohio for civil aiding and abetting, see Pavlovich v. National City Bank, 435 F.3d 560, 570 (6th Cir.2006) (“It is unclear whether Ohio recognizes a common law cause of action for aiding and abetting tortious conduct.”), this Court has held in prior orders that it will decline to dismiss the aiding and abetting claims on a Rule 12(b)(6) motion, because it cannot be said conclusively that Ohio law does not recognize such a cause of action. See May 7, 2007 Opinion, p. 58; Oct. 3, 2006 Opinion, pp. 15–17.

Credit Suisse argues that the Arizona Noteholders and the New York Funds have failed to allege the elements of an aiding and abetting claim. Those elements are: “(1) knowledge that the primary party’s conduct is a breach of duty and (2) substantial assistance or encouragement to the primary party in carrying out the tortious act.” Andonian v. A.C. & S., Inc., 97 Ohio App.3d 572, 574–75, 647 N.E.2d 190, 191–92 (Ohio Ct.App.1994); see also Aetna Cas. and Sur. Co. v. Leacey Constr. Co., 219 F.3d 519, 533 (6th Cir. 2000). Courts have interpreted the first element as requiring actual knowledge of the underlying tortious conduct. See Aetna, 219 F.3d at 533; Javitch v. First Montauk Fin. Corp., 279 F.Supp.2d 931, 946 (N.D.Ohio 2003); see also In re Sharp Int’l Corp., 403 F.3d 43, 49 (2d Cir.2005). A plaintiff, however, need not allege that the aider and abettor had actual knowledge “of all of the details of the primary party’s scheme.” Aetna, 219 F.3d at 536. “[I]t is enough for the aider and abettor to have a general awareness of [his] role in the other’s tortious conduct for liability to attach.” Id. at 534 (citing Camp v. Dema, 948 F.2d
A plaintiff may use circumstantial evidence to support an inference of actual knowledge. *Id.* at 535.

[32] Credit Suisse argues the complaints do not allege that it had actual knowledge of the fraud. But as discussed above in relation to the scienter requirement of the Section 10(b) and fraud claims, the complaints of the Arizona Noteholders and the New York Funds allege at length that Credit Suisse had actual knowledge of the purchase of ineligible receivables, related-party transactions, the depletion and manipulation of reserve accounts, and violations of the Master Indenture. Suffice to say, the complaints support an inference that when Credit Suisse offered to sell the notes to potential investors, it had actual knowledge that the notes were not the high-quality investment Credit Suisse allegedly made them out to be.

With respect to the Arizona Noteholders’ claim for aiding and abetting breach of fiduciary duty, Credit Suisse similarly argues that it did not have actual knowledge of the Founders’ purported breaches. In an earlier order, the Court found that the Arizona Noteholders had stated a claim for breach of fiduciary duty against the Founders. *See* Feb. 27, 2006 Order, pp. 24–27. The Founders allegedly breached their duties to the company and to creditors by wasting corporate assets when National Century was insolvent. Here, the Court finds that the Arizona Noteholders sufficiently allege that Credit Suisse had actual knowledge of the Founders’ breaches. The complaints allege that Credit Suisse knew the Founders were wasting corporate assets by purchasing ineligible receivables and by purchasing receivables from related parties.

Credit Suisse next argues that the complaints fail to allege that it substantially assisted the tortious conduct. This argument is without merit, for the complaints plainly allege that Credit Suisse helped devise the note programs, helped draft and review the offering materials, and sold notes to investors.

VII. BREACH OF CONTRACT

The Arizona Noteholders and Lloyds assert claims for breach of contract. The Arizona Noteholders allege that they entered into sales contracts with Credit Suisse. The terms of the contracts allegedly were the same as the representations contained in the offering materials. They contend that Credit Suisse breached the sales contracts because the notes it delivered did not conform with the representations made in the offering materials.

Lloyds alleges that it entered into a Participation Agreement in which it purchased $68 million of NPF XII notes from Credit Suisse. Lloyds alleges that, in breach of the Agreement, Credit Suisse delivered notes that were not properly secured and were worth far less than what Lloyds paid.

Credit Suisse argues that the only obligation that it had under the sales contracts and Participation Agreement was to deliver the notes, which it did. It further argues that the complaints do not specify how the contracts were breached and that the contracts cannot be rewritten to incorporate the language of the offering materials.

[33] It is true that the exact nature of the breach of contract claims are not entirely clear. The Arizona Noteholders allege that the terms of the sales contracts were the same as those of the offering materials. Lloyds alleges that the Participation Agreement required the notes to be properly secured and of a certain worth. Nonetheless, applying the liberal standard of Fed. Rule Civ. P. 8(a), the complaints allege each element of a breach of contract claim: (1) the existence of a contract between the parties, (2) perform-
ance by the Plaintiffs, who paid the contract amounts for the notes; (3) a breach by Credit Suisse, who did not deliver notes of a certain type or quality, and (4) damages to the Plaintiffs. See Lawrence v. Lorain County Cnty. Cmty., 127 Ohio App.3d 546, 549, 713 N.E.2d 478, 480 (Ohio Ct.App.1998). These allegations are sufficient to survive a motion to dismiss.

Credit Suisse next argues that Plaintiffs cannot consistently assert their breach of contract claims and tort claims. "[T]he existence of a contract action generally excludes a cause of action based upon the same conduct sounding in tort." Hanlin v. Ohio Builders and Remodelers, Inc., 196 F.Supp.2d 572, 579 (S.D. Ohio 2001). Credit Suisse points out that the alleged breaches seem to be based on the same conduct on which the tort claims are based, namely, the misrepresentations in the offering materials. The Court finds that dismissing the tort claims for this reason would be premature. Under the rules of civil procedure, a party may assert inconsistent claims at the pleading stage. See Fed.R.Civ.P. 8(d)(3). Development of the facts will show whether pursuit of the contract claims would operate to exclude Plaintiffs' tort claims.

VIII. THE ARIZONA NOTEHOLDERS' OTHER CLAIMS

A. Conspiracy

[34, 35] The Arizona Noteholders allege that Credit Suisse conspired with National Century and the Founders to defraud investors. A civil conspiracy is "a malicious combination of two or more persons to injure another in person or property, in a way not competent for one alone, resulting in actual damages." Kenty v. Transamerica Premium Ins. Co., 72 Ohio St.3d 415, 419, 650 N.E.2d 863, 866 (Ohio 1995) (quoting LeFort v. Century 21-Mainland Realty Co., 32 Ohio St.3d 121, 126, 512 N.E.2d 640, 645 (Ohio 1987)). The elements of a civil conspiracy claim are: "(1) a malicious combination; (2) two or more persons; (3) injury to person or property; and (4) existence of an unlawful act independent from the actual conspiracy." Universal Coach, Inc. v. New York City Transit Auth., Inc., 90 Ohio App.3d 284, 292, 629 N.E.2d 28, 33 (Ohio Ct.App. 1993).

[36, 37] Credit Suisse argues that the complaints fail to allege that it entered into an agreement with another party. The element of a malicious combination "does not require a showing of an express agreement between defendants, but only a common understanding or design, even if tacit, to commit an unlawful act." Gosden v. Louis, 116 Ohio App.3d 195, 219, 687 N.E.2d 481, 496 (Ohio Ct.App.1996). Because "conspirators seldom make records of their illegal agreements," United States v. Short, 671 F.2d 178, 182 (6th Cir.1982), the existence of an agreement is often "provable only through circumstantial evidence." Aetna Cas. and Sur. Co. v. Leahy Constr. Co., 219 F.3d 519, 538 (6th Cir.2000) (discussing a conspiracy claim under Ohio law). A plaintiff need not show that co-conspirators made an agreement as to every detail of the plan; rather, plaintiff must show that the co-conspirators "'shared in the general conspiratorial objective.'" Id. (quoting Hooks v. Hooks, 771 F.2d 935, 944 (6th Cir.1985)); see also Swartz v. KPMG LLP, 476 F.3d 756, 764 (9th Cir.2007); Borden, Inc. v. Spoor Behrens Campbell & Young, Inc., 828 F.Supp. 216, 225 (S.D.N.Y.1993) ("[T]o demonstrate a conspiracy, plaintiffs need not show that each conspirator agreed to every detail of the conspiracy but only that each agreed on the 'essential nature of the plan.'").

Courts are not in unison as to whether Rule 8 or Rule 9 applies to pleading the existence of an agreement to commit fraud. Compare Southern Union Co. v.
Southwest Gas Corp., 165 F.Supp.2d 1010, 1020 (D.Ariz.2001) (requiring plaintiff to allege with particularity that defendants reached an understanding or agreement), with In re Methyl Tertiary Butyl Ether Prods. Liab. Litig., 175 F.Supp.2d 593, 634 (S.D.N.Y.2001) (applying Rule 8 and recognizing that, because conspiracies are by their nature often clandestine, it is typically difficult to plead with specificity the facts necessary to show the existence of an unlawful agreement). The Sixth Circuit has not addressed which pleading standard should be applied. Out of caution, this Court will apply Rule 8. Cf. Bell Atlantic Corp. v. Twombly, — U.S. ——, 127 S.Ct. 1955, 1964–65, 167 L.Ed.2d 929 (2007) (applying Rule 8 to conspiracy claim under § 1 of the Sherman Act and requiring that the complaint plead “plausible grounds to infer an agreement”).

The Court finds that the complaints adequately allege the existence of a common understanding between Credit Suisse and the Founders. The Arizona Noteholders allege that Credit Suisse and the Founders conspired to effect the fraudulent sale of NPF VI and NPF XII notes. Credit Suisse is alleged to have had a strong relationship with the Founders and National Century, beginning with the selection of Credit Suisse as National Century’s financial advisor. Representatives of Credit Suisse allegedly accompanied Lance Poulsen on sales presentations throughout the country. The complaints allege that Credit Suisse had access to National Century’s financial information and knew that National Century was purchasing ineligible receivables from healthcare providers in which the Founders had a financial interest. Further, Credit Suisse is alleged to have known that the reserves of the NPF VI and NPF XII note programs were dwindling and that more notes had to be issued and sold to keep the programs afloat. In sum, the complaints allege that Credit Suisse marketed and sold notes, knowing of National Century’s deepening insolvency and understanding that the funds invested would be misappropriated by National Century and the Founders. The Court finds that these allegations are sufficient to state a claim for conspiracy.

B. Unfair Competition

A group of the Arizona Noteholders named the GMO Plaintiffs assert a claim under Massachusetts’s unfair competition statute, which prohibits unfair methods of competition and deceptive practices occurring “primarily and substantially within the commonwealth.” Mass. Gen. Laws ch. 98A, § 11. Credit Suisse argues that this claim must be dismissed because the unfair conduct is not alleged to have occurred primarily and substantially within Massachusetts.

The Court finds that the complaint sufficiently invokes the unfair competition statute. “In determining whether the conduct occurred ‘primarily and substantially’ in Massachusetts, we will look to three factors: (1) where the defendant engaged in unfair or unscrupulous conduct; (2) where the plaintiff was on the receiving end of the unfair or unscrupulous conduct; and (3) the situs of plaintiff’s losses due to the unfair and unscrupulous conduct.” KPS & Associates, Inc. v. Designs By FMC, Inc., 318 F.3d 1, 24 (1st Cir.2003) (citing cases). The GMO Plaintiffs have their principal place of business in Boston, Massachusetts. They allege that representatives of National Century and Credit Suisse made sales presentations at GMO’s offices in Boston in May 2001. They further allege that Massachusetts is where they were provided with offering materials, where they made the decision to purchase notes, and where they suffered losses. Thus, the GMO Plaintiffs have adequately alleged that the unfair
conduct occurred primarily and substantially in Massachusetts.

C. Unjust Enrichment

The Arizona Noteholders allege that Credit Suisse wrongly benefited from its role in the securities offerings, to the harm of the Noteholders. Though Credit Suisse argues that the complaints fail to allege how it was unjustly enriched, the Court finds that the complaints clearly allege that Credit Suisse unjustly received significant investment banking and placement fees in its role as lead underwriter.

D. Punitive Damages

The Arizona Noteholders' complaints contain a demand for punitive damages. Credit Suisse argues that the complaints do not allege the requisite mental state. "Under Ohio law, an award of punitive damages in a tort case may be made only upon a finding of actual malice, fraud, oppression, or insult on the part of the defendant." Estate of Schmidt v. Derenia, 158 Ohio App.3d 738, 740, 822 N.E.2d 401, 404 (Ohio Ct.App.2004). The Court finds that the Arizona Noteholders have stated a claim for fraud and are therefore entitled to an opportunity to pursue punitive damages.

IX. PHAROS

A. Background

Pharos is differently situated from the other Plaintiffs because it was not a noteholder in the NPF VI and NPF XII programs. Rather, it purchased $12 million worth of National Century preferred stock in 2002. As an investor, though, Pharos brings some of the same claims asserted by the noteholders: fraud, negligent misrepresentation, violations of Ohio's blue sky law, aiding and abetting, and conspiracy.

Pharos alleges that it was approached by Credit Suisse in early 2002 about possibly investing in National Century preferred stock. Credit Suisse provided Pharos with offering materials, including a private placement memorandum, financial statements, and audit reports. Credit Suisse allegedly arranged meetings and phone calls among Pharos, Credit Suisse, and National Century's management. Along the way, Credit Suisse allegedly made false assurances to Pharos about the financial soundness of National Century's operations. On July 8, 2002, Pharos entered into a Stock Purchase Agreement whereby it purchased $12 million of preferred stock.

Like the other Plaintiffs, Pharos alleges that National Century engaged in fraud and deliberately abandoned the business model described in the offering materials. Pharos alleges that National Century raised $3 billion from investors and used 70% of those funds to purchase receivables that failed to meet the eligibility standards established for the NPF VI and NPF XII programs. Pharos contends that most of the money went to healthcare providers in which the Founders held an undisclosed financial interest.

B. Fraud and Negligent Misrepresentation

According to the complaint, Credit Suisse prepared a private placement memorandum and provided it to Pharos. The memorandum allegedly contained material misrepresentations and omissions, including that National Century would purchase eligible receivables, would refrain from self-interested transactions, and would maintain certain levels of reserves as security for the notes. The complaint alleges that Pharos relied on those misrepresentations regarding the financial soundness of National Century’s operations when it decided to purchase stock.
Credit Suisse’s primary challenge to the claims for fraud and negligent misrepresentation is that the offering materials contained disclaimers precluding Pharos from justifiably relying on them. These disclaimers stated that Credit Suisse was not making any representations or warranties and that investors should not rely on statements made in the materials. For the reasons discussed in Part III.D above, this argument is not persuasive. Credit Suisse’s name appeared prominently on the first page, and indeed every page, of the private placement memorandum given to Pharos. Further, the memorandum stated that Credit Suisse was the authorized agent of National Century and that all inquiries by investors were to be directed to Credit Suisse.

Credit Suisse next contends that Pharos has failed to allege scienter with particularity. Importantly, Pharos is not asserting a Section 10(b) claim, for which the complaint must state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind. Pharos is asserting a common law fraud claim, and, though the circumstances constituting the fraud must be stated with particularity, “intent, knowledge, and other condition of mind of a person may be averred generally.” Fed. R.Civ.P. 9(b). Upon review of the complaint, the Court finds it adequately alleges that Credit Suisse knew or should have known that its representations were false.

C. Other Claims

Credit Suisse argues that the claim under Ohio’s blue sky law should be dismissed because the law does not apply to private placements. But, as discussed in Part IV.E above, the Court finds that Ohio’s blue sky law does apply to private placements. See Ohio Rev.Code § 1707.41(A); Arpadi v. First MSP Corp., 68 Ohio St.3d 453, 454, 628 N.E.2d 1335, 1336 (Ohio 1994).

As to the aiding and abetting claim, Credit Suisse contends that the complaint does not allege how Credit Suisse materially assisted the fraud. However, the complaint plainly alleges that Credit Suisse assisted National Century’s fraud by drafting the private placement memorandum, soliciting Pharos to purchase stock, and arranging meetings among the parties.

Finally, Credit Suisse argues that the allegations of a conspiracy are deficient. The Court agrees with this argument. The complaint alleges that the conspiracy existed among the named defendants. Neither National Century nor the Founders are named as defendants. The named defendants beside Credit Suisse are National Century’s legal counsel, accounting firm, and outside directors, as well as the entities allegedly controlling the outside directors. The complaint is devoid of any allegations that Credit Suisse had an agreement or tacit understanding with any of the other named defendants. Thus, Pharos’s claim for conspiracy is dismissed.

X. CONCLUSION

Credit Suisse’s motions to dismiss the complaints filed by MetLife, Lloyds, the Arizona Noteholders, the New York Funds, and Pharos (docs. 177, 242, 735, 743 in Case No. 03–md–1565; doc. 115 in Case No. 03–cv–362) are GRANTED IN PART and DENIED IN PART.

The motions to dismiss are GRANTED as to the following claims:

- Lloyds’s claim under New Jersey’s blue sky law (no nexus);
- the Ohio blue sky law claims based on note purchases made in 1998 and early 1999 by the Asset Allocation & Management Plaintiffs, Bayerische Landesbank, Mutual of New York, SanPaolo IMI, and United of Omaha (time-barred);
United of Omaha's Nebraska blue sky law claim based on its November 1998 note purchase (time-barred);

MetLife's claim under § 49:3–52 of New Jersey's blue sky law (no private right of action);

Oregon Insurance Guaranty Association's claim under § 59.135 of Oregon's blue sky law (no private right of action);

the Arizona Noteholders' claims under § 44–1998(A) of Arizona's blue sky law (does not apply to private placements);

Pacific Investment Management Company Plaintiffs' claims for primary liability under California's blue sky law (lack of privity);

Oregon Insurance Guaranty Association's claim for primary liability under Oregon's blue sky law (lack of privity);

MetLife's, Lloyds's, and the New York Funds' negligence claims (duplicative of their negligent misrepresentation claims); and

Pharos's claim of conspiracy (no alleged agreement or understanding).

The motions to dismiss are DENIED as to all other claims asserted against Credit Suisse by MetLife, Lloyds, the Arizona Noteholders, the New York Funds, and Pharos.

**Background:** Purchaser transportation company brought action against ship builder alleging breach of contract, negligence, and strict liability. Builder brought motion for summary judgment.

**Holdings:** The District Court, David H. Coar, J., held that:

1. Contractual clauses disclaiming liability with respect to all implied warranties, pump motor problems falling under warranties of third-party manufacturer, and problems caused by purchaser's specifications were valid and enforceable insofar as they limited ship builder's potential liability to problems related to installation;

2. Builder was liable for ensuring that installation of pump motors satisfied requirements of Institute of Electrical and Electronics Engineers (IEEE) Standard 45;

3. Contractual provision that effectively nullified ship builder's express and implied warranties with respect to “material or equipment specified and/or furnished by [purchaser] including, but not limited to, design, specifications, and/or installation” applied to design determination made by purchaser with regard to how pumps and motors were to be arranged and purchaser's choice of motors;
exception applies, through the Clerk’s Office. See E.D. Mich. LR 5.1. A copy of any objections is to be served upon this magistrate judge but this does not constitute filing. See E.D. Mich. LR 72.1(d)(2). Once an objection is filed, a response is due within fourteen (14) days of service, and a reply brief may be filed within seven (7) days of service of the response. E.D. Mich. LR 72.1(d)(3), (4).

In re NATIONAL CENTURY FINANCIAL ENTERPRISES, INC., INVESTMENT LITIGATION.

Pharos Capital Partners, L.P., Plaintiff,
United States District Court, S.D. Ohio, Eastern Division.

Background: Investor brought action against co-placement agent, for fraud, negligent misrepresentation, and violations of Ohio Securities Act, alleging that agent failed to tell investor that company in which investor purchased preferred stock was not operating its business in manner consistent with what was represented to investor. Agent moved for summary judgment.

Holdings: The District Court, James L. Graham, J., held that:

1. Fraud
   Under New York or Ohio law, justifiable reliance is an element of both a fraud and a negligent misrepresentation claim.

2. Fraud
   Under New York or Ohio law, in determining whether reliance is justifiable in a fraud or negligent misrepresentation, courts consider such factors as the sophistication of the parties, the nature of their relationship, their access to information, whether the plaintiff initiated the transaction or sought to expedite it, the nature of the alleged misrepresentation, and the content of any agreement they entered into.

3. Brokers
   Under New York or Ohio law, any reliance by investor on any misrepresentations of co-placement agent, concerning operation of company in which investors purchased preferred stock, was not justifiable, and agent thus was not liable for fraud or negligent misrepresentation, where inves-
tor was private equity fund with about $160 million in committed capital, it was
investor who first approached agent, investor told agent that it already knew “quite a
bit about the healthcare receivables business,” investor knew that an investment
bank had decided not to serve as lead investor, investor had signed letter agree-
ment, which was product of negotiations, indicating that investor was a “sophisticat-
ed institutional investor” who was “relying exclusively” on its own due diligence inves-
tigation, its own sources of information, and its own credit analysis.

4. Federal Civil Procedure ⇔2515

Fraud ⇔20

In fraud or negligent misrepresentation cases brought under New York or
Ohio law, the issue of reasonableness of reliance depends on context, but cases in-
volving a non-reliance clause in a negotiated contract between sophisticated parties
will often be appropriate candidates for resolution at the summary judgment stage.

5. Contracts ⇔95(1)

Under New York or Ohio law, to avoid
a contract on the basis of duress, a party
must prove coercion by the other party to
the contract; it is not enough to show that
one assented merely because of difficult
circumstances that are not the fault of the
other party.

6. Contracts ⇔95(1)

Under New York or Ohio law, exert-
ing financial or business pressures does
not constitute duress, warranting avoid-
ance of a contract.

7. Contracts ⇔95(1)

Under New York law, a defense of
duress cannot be sustained by a contracting
party who has simply been bested in
contract negotiations by the hard bargain-
ing of another contracting party, even
when the hard bargainer knowingly takes
advantage of his counterpart’s difficult fi-
nancial circumstances.

8. Securities Regulation ⇔278

Justifiable reliance is an element of a
claim under the Ohio Securities Act provi-
sion governing civil liability of a seller for

9. Securities Regulation ⇔278

Company in which investor purchased
preferred stock did not violate Ohio Secu-
rities Act provision governing civil liability
of a seller for fraud, for purposes of inves-
tor’s secondary liability claim against co-
placement agent, notwithstanding that
company committed massive fraud against
some investors, where there were no false
statements in private placement memoran-
dum (PPM) on which investor relied.  Ohio
R.C. §§ 1707.41, 1707.43.

10. Securities Regulation ⇔278

The Ohio Securities Act provision gov-
erning civil liability of a seller for fraud is
not violated unless there is reliance upon a
false statement in written offering materi-
als.  Ohio R.C. § 1707.41.

11. Federal Civil Procedure ⇔2552

On a motion for summary judgment,
the District Court has no duty to comb the
record for facts to support a claim.  Fed.

12. Federal Civil Procedure ⇔2554

A court is entitled to rely, in deter-
mining whether a genuine issue of material
fact exists on a particular issue, only upon
those portions of the verified pleadings,
depositions, answers to interrogatories and
admissions on file, together with any affi-
davits submitted, specifically called to its

13. Federal Civil Procedure ⇔2554

Investor could not withstand co-
placement agent’s motion for summary
judgment in investor’s Ohio Securities Act action by relying on legal theory that company in which investor purchased preferred stock violated provisions of Act prohibiting false representations in prospectuses, engaging in certain illegal practices, and publishing false statements about value of securities, for purposes of investor’s secondary liability claim against agent, even though investor had mentioned one such provision in responding to motion to dismiss, where investor’s complaint had identified Act’s provision governing civil liability of a seller for fraud as the provision the company had violated. Ohio R.C. §§ 1707.41, 1707.44(B)(4), (G); Fed.Rules Civ.Proc.Rule 56, 28 U.S.C.A.

14. Torts ⇔133

New York recognizes a cause of action for aiding and abetting tortious conduct.

15. Federal Courts ⇔157

Ohio’s choice-of-law rules applied to question of whether Ohio or New York law applied to investor’s claim against co-placement agent for aiding and abetting fraud, where investor’s action, though consolidated by Judicial Panel on Multidistrict Litigation, was originally filed in federal court in Ohio.

16. Torts ⇔103

Ohio has adopted the Restatement (Second) of Conflict of Laws in making choice-of-law determinations in tort actions.

17. Torts ⇔103

Under Ohio law, the primary inquiry in making a choice-of-law decision for a tort claim is which state has the most significant relationship to the occurrence and the parties, and factors to be considered are: (1) the place where the injury occurred; (2) the place where the conduct causing the injury occurred; (3) the domicile, residence, nationality, place of incorporation and place of business of the parties; and (4) the place where the relationship, if any, between the parties is centered. Restatement (Second) of Conflict of Laws § 145(1, 2).

18. Fraud ⇔1.5

Under Ohio law, in making a choice-of-law decision in the context of a fraud-based tort, the court may, in addition to other factors, consider: (1) the place, or places, where the plaintiff acted in reliance upon the defendant’s representations; (2) the place where the plaintiff received the representations; (3) the place where the defendant made the representations; (4) the domicil, residence, nationality, place of incorporation and place of business of the parties; (5) the place where a tangible thing which is the subject of the transaction between the parties was situated at the time, and (6) the place where the plaintiff is to render performance under a contract which he has been induced to enter by the false representations of the defendant. Restatement (Second) of Conflict of Laws § 148(2).


Under Ohio’s choice-of-law rules, Ohio law, not New York law, applied to investor’s claim against co-placement agent for aiding and abetting fraud, arising from investment in Ohio company, even though agent dealt with investor from agent’s New York office, where investor alleged that company made misrepresentations and deceived investor about nature of company and its operations, alleged deception included site visit by investor to Ohio, investor wired $12 million to company in Ohio, and agent’s alleged assistance in fraud came in its role as conduit for Ohio company to convey false information to investor. Restatement (Second) of Conflict of Laws §§ 145(1, 2), 148(2).
20. Torts ⇐133

A claim under the Restatement (Second) of Torts for aiding and abetting tortious conduct is not cognizable under Ohio law. Restatement (Second) of Torts § 876.


OPINION AND ORDER

JAMES L. GRAHAM, District Judge.

Plaintiff Pharos Capital Partners, L.P. brings this action against defendant Credit Suisse Securities LLC for fraud in connection with a failed $12 million equity investment. In 2002 Pharos purchased preferred stock in National Century Financial Enterprises, Inc. Credit Suisse acted as a co-placement agent on the stock offering, and, according to Pharos, should have told Pharos that National Century was not operating its business in a manner consistent with what was represented to Pharos.

Credit Suisse moves for summary judgment on the grounds that the parties entered into a Letter Agreement in which Pharos acknowledged that it was “a sophisticated institutional investor” who was “relying exclusively” on its own due diligence investigation and who would bear the risk of “an entire loss” of its investment. The Agreement further stated that any non-public information known by Credit Suisse about National Century “need not be provided” to Pharos.

Though Pharos offers many purported reasons for discounting the plain language of the Agreement, “what matters when litigation breaks out is what the parties actually signed.” Rissman v. Rissman, 213 F.3d 381, 385 (7th Cir.2000). The court finds as a matter of law that Pharos could not have justifiably relied on the alleged misrepresentations and omissions made by Credit Suisse and thus grants summary judgment to Credit Suisse.

I. BACKGROUND

Pharos is a limited partnership that makes private equity investments for its limited partner investors. In 2002 Pharos had four managing partners, whose unanimous consent was required for any proposed investment. Credit Suisse (“CS”) Ex. 73 at PHAROS00002030; Pharos (“Ph.”) Ex. 22, Crants Dep. at 49. Those managing partners were Bob Crants, Mike Devlin, Dale LeFebvre, and Kneeland Youngblood. Ph. Ex. 22, Crants Dep. at 49–50. Crants, a Princeton graduate, and Devlin, a Duke Law School graduate, first met while working at Goldman Sachs. Ph. Ex. 22, Crants Dep. at 49–50. Crants, a Princeton graduate, and Devlin, a Duke Law School graduate, first met while working at Goldman Sachs. Ph. Ex. 22, Crants Dep. at 20–22; Ph. Ex. 34, Devlin Dep. at 14–15. Before forming Pharos, they formed several other firms together. Ph. Ex. 22, Crants Dep. at 20–22. LeFebvre graduated from Harvard Law School and Harvard Business School, and worked for Morgan Stanley before joining Pharos. CS Ex. 73 at PHAROS00002022. Youngblood came to Pha-
ros with several years of private equity and capital markets experience. Id. at PHAROS00002021.

On February 25, 2002, Bob Crants sent the following email to Heather Nicolau of Credit Suisse,

We haven't seen any deals from you in a while and were wondering what you were working on and what is in the pipeline. Clearly, we are looking for healthcare primarily, but we would like to see anything that is over $10 MM in revenues. I look forward to hearing from you. Thanks. Bob

CS Ex. 76.

At the time of the email, Credit Suisse was acting as a co-placement agent for National Century in connection with a $190 million private placement of securities. Credit Suisse and National Century had entered into an Engagement Letter whereby Credit Suisse agreed to act as placement agent, along with the Shattan Group, LLC, and use reasonable efforts to arrange for the private placement of equity securities. CS Ex. 54.

Nicolau responded to Crants,

We are currently raising equity and mezzanine for a company called NCFE. It is a profitable healthcare receivables company. Would you be interested in participating in a transaction for this type of company? I can send you some information.

We are also working with a number of public companies. Do you invest in public companies in addition to private?

CS Ex. 76.

Crants explained to Nicolau that Pharos did not invest in public companies, and added,

[W]e actually know quite a bit about the healthcare receivables business & would love to take a look. I look forward to getting some materials on it.

Id. Nicolau then sent Pharos a private placement memorandum (“PPM”) for the preferred stock offering. CS Ex. 78, Nicolau Dep. at 115; Ph. Ex. 21.

After receiving the PPM, Pharos requested that Credit Suisse send any “easy to forward due diligence materials.” Ph. Ex. 292. A “data room” of due diligence materials was maintained for potential investors in the private placement offering. Ph. Ex. 299, Nicolau Dep. at 66. Credit Suisse directed the Shattan Group to send three boxes of the data room materials to Pharos on March 1, 2002. Ph. Exs. 52, 241. The materials included: yearly financial audits; unaudited financial data, including income statements and balance sheets; operational materials for National Century and its note-issuing entities, NPF VI and NPF XII; PPMs for note issuances by NPF VI and NPF XII; and debt information. CS Exs. 82–84.

Pharos reviewed the due diligence materials and had follow-up communications with Credit Suisse. Ph. Ex. 22, Crants Dep. at 104. Dale LeFebvre emailed Credit Suisse’s David Hurwitz on March 5, 2002 asking if the National Century deal was “all it’s cracked up to be.” CS Ex. 213. Hurwitz responded,

I do believe NCFE is what it is cracked up to be. It’s extremely profitable and has been for many years. They are the dominant player in the industry and still have great growth opportunities. I do not remember our group (and we’ve raised over $5 billion in equity) ever having worked with a company that generates as much cash flow as NCFE. I think there are some initiatives the company needs to undertake regarding systematizing their business, but I believe the company has already made some important steps forward in this regard.
Id. In Bob Crants’s view, Hurwitz projected a “positive, very bullish outlook on NCFE.” Ph. Ex. 22, Crants Dep. at 123.

Also in March 2002, Crants had a telephone conversation with Credit Suisse’s Todd Fasanella, who responded to several lines of inquiry. Crants asked about how the NPF reserve accounts worked; Fasanella gave an answer consistent with what the PPM described. Ph. Ex. 22, Crants Dep. at 124. Crants asked about the market for the NPF notes, and Fasanella said the market had “infinite depth” for AAA-rated notes. Id. at 125. Fasanella stated that “there would be a cost” if the notes were downgraded because there would be less demand for sub-AAA notes. Id. Crants confirmed with Fasanella that National Century itself was not rated and that the NPF trusts were bankruptcy remote. Id. at 125–27. When Crants asked about what would happen if one of National Century’s clients went bankrupt, Fasanella gave an “incomplete answer.” Id. at 126.

Pharos reported to Credit Suisse on March 12, 2002 that it had completed its due diligence investigation, and had three remaining items to attend to: (1) conducting a site visit at National Century’s offices in Columbus, Ohio; (2) obtaining a list from National Century of three customer references; and (3) reviewing the final terms of equity financing. Ph. Ex. 30. Pharos also stated that it would be able to close on the deal as early as the next week. Id.

At the request of Pharos, Credit Suisse helped arrange a site visit on March 19, 2002, see Ph. Ex. 30, and forwarded to National Century a list of questions for which Pharos wanted “to hear the responses directly from management.” CS Ex. 81. Three Pharos representatives met directly with three National Century representatives, including CEO Lance Poulsen, for two to three hours. CS Ex. 70, Devlin Dep. at 77–78. They toured National Century’s offices and were shown a PowerPoint presentation. No one from Credit Suisse was present, although David Hurwitz listened on the phone while the parties met in the conference room. Id.

The next day, Mike Devlin emailed David Hurwitz to say that Pharos “loved the company and the management team” and was ready to close the deal at quarter’s end. Ph. Ex. 251. Devlin also sent an email that day to Lance Poulsen saying that Pharos was “deeply impressed” with National Century, “want[ed] to be a part of it,” and would be ready to close by quarter’s end, pending review of closing documents. CS Ex. 112. On March 25, 2002, Crants informed Hurwitz that Pharos had completed its due diligence and was “enthusiastic about closing.” Ph. Ex. 252.

The deal between Pharos and National Century did not close as quickly as Pharos had anticipated. Investment bank Goldman Sachs had been considering since May 2001 whether to serve as lead investor on the private equity offering. Pharos was aware of Goldman’s potential involvement. CS Ex. 120. Indeed, co-investors typically rely on the presence of a lead investor in private equity transactions. CS Ex. 121, Expert Report of John A. Krasznekwicz at ¶ 68. After conducting due diligence, Goldman decided not to invest in the National Century offering. CS Ex. 122, DeLuise Dep. at 33, 41.

Pharos continued update its due diligence during April, May, and June of 2002. Ph. Ex. 22, Crants Dep. at 117. Pharos had direct contact with Lance Poulsen during this time. Poulsen emailed Mike Devlin on May 10, 2002 to explain that Goldman likely would pull out as an investor. CS Ex. 113. Devlin responded, “Notwithstanding Goldman, our commitment and enthusiasm towards NCFE remains un-
changed.” Id. A week later, Poulsen sent Devlin a letter enclosing National Century’s responses to a series of inquiries Goldman had posed about potential areas of concern it had with National Century. CS Ex. 110. Devlin emailed Poulsen on May 24:

Thanks for the material. The numbers look great, congratulations. Regarding Goldman’s questions, we’ve waded through all of that and just don’t see a material issue. Clearly there’s been some complex deals done with some current and former clients, but from our point of view, that’s somewhat to be expected, and certainly justifiable when the primary beneficiary is NCFE!

CS Ex. 111. Poulsen and Devlin had another email exchange in early June evidencing that the parties were preparing to close on the deal. CS Ex. 114; see also Ph. Exs. 37, 80, 129 (showing that Pharos and National Century were negotiating closing documents in late May and early June of 2002).

On June 12, 2012, Heather Nicolau of Credit Suisse emailed Mike Devlin a “standard letter” that she requested Pharos to sign. Ph. Ex. 294. The letter stated that Pharos was “relying exclusively” on its own due diligence and would bear the risk of an entire loss. Ph. Ex. 296. It also struck out the language stating that Credit Suisse had made no representations about National Century and owed no duty to disclose non-public information. Id.; see also Ph. Ex. 22, Crants Dep. at 178–85.

On July 8, 2002, Pharos signed a Letter Agreement that incorporated some of the revisions proposed by Pharos but retained the language regarding reliance, risk, representations, and disclosure. Ph. Ex. 293. The Agreement provided that in connection with the purchase of preferred stock in National Century, Pharos represented to and agreed with Credit Suisse (“the Agent”):

(a) that we are a sophisticated institutional investor and have such knowledge and experience in financial and business matters and expertise in assessing credit risk, that we are capable of evaluating the merits, risks and suitability of investing in the Securities, that we have conducted our own due diligence investigation and our own sources of information and credit analysis with respect to the Securities, that we have acquired, or during the term of the Securities may acquire, non-public information with respect to the Company,

(b) that (i) neither the Agent nor any Affiliate (as defined herein) has been requested to or has provided us with any information or advice with respect to the Securities nor is such information or advice necessary or desired, (ii) neither the Agent nor any Affiliate has made or makes any representation as to Company or the credit quality of the Securities, and (iii) the Agent and any Affiliate may have acquired, or during the term of the Securities may acquire, non-public information with respect to the Company,
which we agree need not be provided to us;

... 

(f) that, in connection with the issue and purchase of Securities, neither the Agent nor any of its Affiliates have acted as our financial advisor or fiduciary

Ph. Ex. 293.

Mike Devlin signed the Agreement for Pharos. He formerly had served as a transactional attorney at a Wall Street law firm and also a vice president of a business development group at Goldman Sachs. CS Ex. 70, Devlin Dep. at 13–15, 35–37. Devlin testified that he had reviewed the Agreement carefully before signing it and had worked with counsel in connection with the Agreement. Id. at 294. Despite believing the Agreement to be factually inaccurate, “we certainly decided to sign it... To do this transaction and to have an ongoing relationship with CSFB.” Id. at 303. Bob Crants testified that though Pharos “questioned quite considerably” whether to sign the Agreement, “the discussion about signing it stopped because we did want to close.” Ph. Ex. 22, Crants Dep. at 186.

National Century and Pharos entered into a Preferred Stock Purchase Agreement on July 8, 2002 whereby Pharos purchased $12 million worth of National Century Series B Convertible Preferred Stock. Ph. Ex. 304. Credit Suisse received a placement fee of $450,000 in connection with the Pharos investment. Ph. Ex. 297. It is undisputed that the stock fully lost its value when National Century filed for bankruptcy on November 18, 2002. It is further undisputed that National Century committed a massive fraud, as has been described in full detail in several court opinions. See, e.g., U.S. v. Poulsen, 655 F.3d 492, 498–99 (6th Cir.2011); U.S. v. Faulkenberry, 614 F.3d 573, 577–79 (6th Cir.2010); In re Nat’l Century Fin. Enter-
eses, Inc., Inv. Litig., No. 2:03-md–1565, 2006 WL 469468 at **1–6 (S.D.Ohio Feb. 27, 2006); In re Nat’l Century Fin. Enter-

Pharos originally filed suit against Credit Suisse and other defendants in March 2003 in this court. The Pharos action later became consolidated with many other cases as part of the National Century multidistrict investment litigation. Credit Suisse is the only defendant remaining in the Pharos action. Pharos alleges that Credit Suisse had knowledge of the material aspects of National Century’s fraud and misrepresented to Pharos how National Century ran its operations. These misrepresentations allegedly were made in offering materials Pharos received and in two communications Credit Suisse had with Pharos in March 2002 (the Hurwitch email and the Fasanella phone call). Pharos further alleges that Credit Suisse should have disclosed facts about National Century’s fraud when Pharos conducted its due diligence investigation. In an earlier order, the court dismissed the conspiracy claim brought by Pharos against Credit Suisse, but allowed the fraud-based claims and Ohio Securities Act claims to survive Credit Suisse’s motion to dismiss. See In re Nat’l Century Fin. Enter-

This matter is now before the court on Credit Suisse’s motion for summary judgment.

II. STANDARD OF REVIEW

Under Fed.R.Civ.P. 56(c), summary judgment is proper “if the pleadings, the discovery and disclosure materials on file,
and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law.” See Longaberger Co. v. Kolt, 586 F.3d 459, 465 (6th Cir.2009).

The moving party bears the burden of proving the absence of genuine issues of material fact and its entitlement to judgment as a matter of law, which may be accomplished by demonstrating that the nonmoving party lacks evidence to support an essential element of its case on which it would bear the burden of proof at trial. See Celotex Corp. v. Catrett, 477 U.S. 317, 322–23, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); Walton v. Ford Motor Co., 424 F.3d 481, 485 (6th Cir.2005).

The “mere existence of some alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247–48, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (emphasis in original); see also Longaberger, 586 F.3d at 465. “Only disputed material facts, those ‘that might affect the outcome of the suit under the governing law,’ will preclude summary judgment.” Daugherty v. Sajar Plastics, Inc., 544 F.3d 696, 702 (6th Cir.2008) (quoting Anderson, 477 U.S. at 248, 106 S.Ct. 2505). Accordingly, the nonmoving party must present “significant probative evidence” to demonstrate that “there is [more than] some metaphysical doubt as to the material facts.” Moore v. Philip Morris Cos., Inc., 8 F.3d 335, 340 (6th Cir.1993).

A district court considering a motion for summary judgment may not weigh evidence or make credibility determinations. Daugherty, 544 F.3d at 702; Adams v. Metiva, 31 F.3d 375, 379 (6th Cir.1994). Rather, in reviewing a motion for summary judgment, a court must determine whether “the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law.” Anderson, 477 U.S. at 251–52, 106 S.Ct. 2505. The evidence, all facts, and any inferences that may permissibly be drawn from the facts must be viewed in the light most favorable to the nonmoving party. Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986); Eastman Kodak Co. v. Image Technical Servs., Inc., 504 U.S. 451, 456, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992). However, “[t]he mere existence of a scintilla of evidence in support of the plaintiff’s position will be insufficient; there must be evidence on which the jury could reasonably find for the plaintiff.” Anderson, 477 U.S. at 252, 106 S.Ct. 2505; see Dominguez v. Corr. Med. Servs., 555 F.3d 543, 549 (6th Cir.2009).

III. CLAIMS FOR PRIMARY LIABILITY

Pharos alleges that primary liability must be placed on Credit Suisse for the loss of its equity investment in National Century. This is so, Pharos argues, because it relied on Credit Suisse’s misrepresentations and material omissions about National Century and how the NPF note-issuing programs were operated. Pharos advances three causes of action against Credit Suisse for primary liability: fraud, negligent misrepresentation, and violations of the Ohio Securities Act.

A. Fraud and Negligent Misrepresentation

The parties argue at length over whether the law of New York or Ohio should apply to the fraud and negligent misrepresentation claims. Credit Suisse believes that New York law should apply because it dealt with Pharos from its New York offices and because the Letter Agreement
has a New York choice of law provision. Pharos, which has offices in Tennessee and Texas, counters that Ohio law should apply because it was the central site of the National Century fraud. Though Credit Suisse has pointed to some areas where New York and Ohio law might differ (such New York's clear and convincing evidence standard, compare In re Vivendi Universal, S.A. Sec. Litig., 765 F.Supp.2d 512, 534 (S.D.N.Y.2011), with Cornwell v. N. Ohio Surgical Ctr., 185 Ohio App.3d 337, 345, 923 N.E.2d 1233, 1239–40 (Ohio Ct. App.2009)), the court finds that a choice of law determination is unnecessary with respect to these claims because Pharos cannot clear a fundamental hurdle under the law of either state—that of justifiable reliance.

[1, 2] Justifiable reliance is an element of both a fraud and a negligent misrepresentation claim. See Lama Holding Co. v. Smith Barney Inc., 88 N.Y.2d 413, 421, 646 N.Y.S.2d 76, 668 N.E.2d 1370, 1373 (N.Y. 1996); Russ v. TRW, Inc., 59 Ohio St.3d 42, 49, 570 N.E.2d 1076, 1083–84 (Ohio 1991); Delman v. Cleveland Hts., 41 Ohio St.3d 1, 4, 534 N.E.2d 835, 838 (Ohio 1989). In determining whether reliance is justifiable, courts consider such factors as the sophistication of the parties, the nature of their relationship, their access to information, whether the plaintiff initiated the transaction or sought to expedite it, the nature of the alleged misrepresentation, and the content of any agreement they entered into. See Brown v. Earthboard Sports USA, Inc., 481 F.3d 901, 921 (6th Cir. 2007) (federal securities law context); Merrill Lynch & Co. Inc. v. Allegheny Energy, Inc., 500 F.3d 171, 181 (2nd Cir. 2007) (applying New York law); Johnson v. Church of the Open Door, 179 Ohio App.3d 532, 539, 902 N.E.2d 1002, 1007 (Ohio Ct.App.2008). Many courts decline to adopt a per se rule that a no-reliance provision forecloses recovery, see Brown, 481 F.3d at 921 (citing cases), but the existence of such a provision can be “a fairly convincing [factor] in many cases.” Rissman v. Rissman, 213 F.3d 381, 388 (7th Cir.2000) (Rovner, J., concurring).

[3] After examining the relevant factors, the court finds as a matter of law that Pharos cannot establish justifiable reliance. Pharos was a private equity fund with about $160 million in committed capital in 2002. CS Ex. 77. It was Pharos who first approached Credit Suisse, looking for an investment deal in the healthcare sector. When Credit Suisse mentioned that it was raising equity for National Century, Pharos said it already knew “quite a bit about the healthcare receivables business” and wanted to take a look. CS Ex. 76. Pharos, which considers itself skilled at doing due diligence, had access to “bankers boxes full of materials,” conducted “extensive due diligence,” communicated directly with National Century’s management, and met with them in person during a site visit. Ph. Ex. 22, Crants Dep. at 78, 103; CS Ex. 64, Pl.’s First Am. Answer to Interrog. No. 4.

This is not a case where Pharos was shielded from adverse information about National Century. Pharos knew that Goldman Sachs had decided not to serve as lead investor. It received a lengthy document outlining some of the areas of concern that Goldman had, particularly National Century’s practice of engaging in related-party transactions, and Pharos stated that it did not see a “material issue.” CS Exs. 110, 111. Pharos admits that it also learned, during its due diligence, that National Century had failed to maintain reserve accounts in the NPF programs at the levels required by the Master Indentures governing those programs. Ph. Ex. 22, Crants Dep. at 90–94. Pharos knew as well that National Century’s equity offering sought to raise $190 million and
that without a lead investor, National Century would be raising only $12 million from Pharos and another $10–12 million from National Century’s management. Dale LeFebvre felt the financial risk of proceeding without Goldman was too great, but his colleagues overrode his objection. CS Ex. 71, LeFebvre Dep. at 40, 125. Even in the face of Fitch, Inc. putting certain NPF notes on a “Ratings Watch Negative” and National Century being overdue in issuing its audited financial statement for 2001, Pharos remained enthusiastic about investing. CS Ex. 96, at PHAROS00001159; CS Ex. 108, Pl.’s Response to Request for Admission No. 7.

The Letter Agreement was the product of negotiations between the parties. When Credit Suisse circulated a proposed agreement, Pharos found it to be “obnoxious” and engaged counsel to craft revisions. Ph. Ex. 20. After Credit Suisse incorporated some of the revisions, Pharos “elected to sign the document” and close on the deal with National Century. Ph. Ex. 22, Crants Dep. at 173, 186 (“[O]ur changes were not taken..... And at that point the discussion about signing it stopped because we did want to close.”). Pharos confesses that it does not “offer up signatures unnecessarily” and that it was “quite confident that [Credit Suisse] had information that [Pharos] didn’t have.” Id. at 118, 186.

The language of the Letter Agreement is clear. It states that Pharos is a “sophisticated institutional investor” who was “relying exclusively” on its own due diligence investigation, its own sources of information, and its own credit analysis in deciding to invest in National Century preferred stock. Ph. Ex. 293. Indeed, Pharos represented in the Agreement that Credit Suisse’s information and advice was not “necessary or desired,” that Credit Suisse had made no representations about National Century or the credit quality of the securities, and that any non-public information Credit Suisse possessed about National Century “need not be provided” to Pharos. Id. The parties referred to the Letter Agreement as a “big boy” agreement because Pharos in essence said that it knew what it was doing and could take care of itself. See Extra Equipamentos E Exportacao Ltda. v. Case Corp., 541 F.3d 719, 724 (7th Cir.2008) (“as in ‘we’re big boys and can look after ourselves’”). To underscore the point, the Agreement stated that Pharos would bear the risk of an “entire loss” of its investment. Ph. Ex. 293.

Thus, the clear language of the Letter Agreement and the surrounding factors render any claimed reliance by Pharos unjustifiable. The case law strongly supports this conclusion in the context of sophisticated parties who have agreed to no-reliance language. See Jackvony v. RIHT Fin. Corp., 873 F.2d 411, 416–17 (1st Cir.1989) (reliance unreasonable where sophisticated plaintiff received written proxy statement directing him not to rely on it); Harsco Corp. v. Segui, 91 F.3d 337, 343 (2d Cir.1996) (reliance unreasonable where sophisticated business entities negotiated an agreement containing a “no other representations” clause); Extra Equipamentos, 541 F.3d at 724–26 (reliance unreasonable where large company signed a no-reliance clause and was represented during negotiations by attorneys who were experienced in commercial transactions); Paracor Fin., Inc. v. General Elec. Capital Corp., 96 F.3d 1151, 1159–60 (9th Cir.1996) (reliance unreasonable where investors were expected to do their own due diligence and signed an agreement saying that they were making their

1. Pharos does not argue that the “relying exclusively” language in the Letter Agreement has any less import than the “no-reliance” language enforced in the cases cited below.
own decision and not relying on other persons).

To allow Pharos to proceed any further with its fraud and negligent misrepresentation claims would upset the risk allocation the parties bargained for. Pharos agreed that it was relying exclusively on its own investigation and analysis and that it would bear, as to Credit Suisse, 100% of the risk of loss. The Seventh Circuit in *Rissman* emphasized that securities transactions would be "impossibly uncertain" if courts fail to protect the primacy of written agreements entered into by sophisticated parties. 213 F.3d at 383. The court thus rejected plaintiff's attempt to set aside a no-reliance clause and shift the risk in a way that "could not conceivably have been the outcome of bargaining." Id. at 385. So too here Pharos's attempt to shift risk onto Credit Suisse must be rejected. See also *Grumman Allied Indus., Inc. v. Rohr Indus., Inc.*, 748 F.2d 729, 735 (2d Cir.1984) ("Where the parties to an agreement have expressly allocated risks, the judiciary shall not intrude into their contractual relationship."); *DynCorp v. GTE Corp.*, 215 F.Supp.2d 308, 322 (S.D.N.Y.2002) ("It is not the role of the courts to relieve sophisticated parties from detailed, bargained-for contractual provisions that allocate risks between them, and to provide extra-contractual rights or obligations for one side or the other.").

[4] Pharos offers a number of reasons why its claims should survive summary judgment. Each reason is unavailing. It argues that the reasonableness of reliance is a fact-intensive issue that cannot be resolved at the summary judgment stage. The court agrees that the issue depends on context, see *Brown*, 481 F.3d at 921, but "cases involving a non-reliance clause in a negotiated contract between sophisticated parties will often be appropriate candidates for resolution at the summary judgment stage." *AES Corp. v. Dow Chemical Co.*, 325 F.3d 174, 181 (3d Cir.2003); see also *Extra Equipamentos*, 541 F.3d at 725 (holding that the reliance issue can be settled on summary judgment where parties have signed valid no-reliance clause); *Paracor*, 96 F.3d at 1160 (resolving the issue on summary judgment).

Pharos next contends that Credit Suisse had an independent duty to disclose material information to Pharos because Credit Suisse chose to act as National Century's placement agent. Picking up from language in this court's order on Credit Suisse's motion to dismiss, Pharos contends that Credit Suisse assumed a duty to disclose because it chose to speak by providing the PPM to Pharos. See *In re Nat'l Century Fin. Enterprises, Inc., Inv. Litig.*, 541 F.Supp.2d 986, 998 (S.D.Ohio 2007) (citing *Rubin v. Schottenstein, Zox & Dunn*, 143 F.3d 263, 268 (6th Cir.1998)). However, the court in the earlier order had to accept as true the allegations Pharos made in its complaint. The court did not have before it the Letter Agreement, which states that Pharos neither needed nor desired any information or advice from Credit Suisse about National Century and that Credit Suisse had no obligation to provide such information. The Agreement further states that Credit Suisse was not a financial advisor or fiduciary of Pharos. This unmistakable language defeats any argument Pharos now makes about a duty to disclose and renders unreasonable any expectation Pharos may have had about informational parity. See *Harborview Master Fund, LP v. Lightpath Technologies, Inc.*, 601 F.Supp.2d 537, 547-48 (S.D.N.Y.2009) (party in securities transaction cannot recover for "omissions to which it contractually agreed"); *DynCorp*, 215 F.Supp.2d at 320 (under New York law contracting parties are able to limit the representations made and the duties owed); *Blon v. Bank One, Akron, N.A.*, 35 Ohio St.3d 98, 101, 519 N.E.2d 363 (Ohio
(presumption in business transactions is that parties have no duty to disclose absent a fiduciary duty or some other special relationship).

Again citing this court’s opinion on the motion to dismiss, Pharos argues that disclaimers are not enforceable when the party making them is engaged in fraud. See Nat’l Century, 541 F.Supp.2d at 1005 (holding that boilerplate disclaimers in PPMs did not necessarily protect Credit Suisse if it knew the disclaimers were false when made). But again discovery has disproved the complaint’s allegations and the issue is no longer whether Pharos can state a claim for fraud. Credit Suisse has proved the existence of language having greater force than a boilerplate disclaimer in a PPM. It has proved that the parties entered into a bargained-for, retrospective statement of their dealings. Their Agreement establishes that Pharos agreed not to rely on Credit Suisse and agreed that Credit Suisse had no duty to provide information to Pharos.

Pharos next argues under New York law that disclaimers are enforceable only if they track the substance of the alleged misrepresentation. See Danann Realty Corp. v. Harris, 5 N.Y.2d 317, 320–21, 184 N.Y.S.2d 599, 157 N.E.2d 597 (N.Y. 1959). Pharos argues that the language of the Letter Agreement is too general to be enforced, but the line of cases Pharos cites is not applicable. Those cases hold that general disclaimers do not preclude a claim for fraud in the inducement. See, e.g., Manufacturers Hanover Trust Co. v. Yanakas, 7 F.3d 310, 316 (2d Cir.1993) (“[I]n order to be considered sufficiently specific to bar a defense of fraudulent inducement under Danann, a guarantee must contain explicit disclaimers of the particular representations that form the basis of the fraud-in-the-inducement claim.”); In re CINAR Corp. Sec. Litig., 186 F.Supp.2d 279, 313 (E.D.N.Y.2002). But Pharos does not claim that it was fraudulently induced to sign the Letter Agreement. If Pharos was fraudulently induced to enter into a contract, it would have been the Preferred Stock Purchase Agreement—a contract to which Credit Suisse was not a party.

Also under New York law, Pharos contends that disclaimers do not preclude a party from claiming reliance on an alleged misrepresentation of a fact that is peculiarly within the other party’s knowledge. See DIMON Inc. v. Folium, Inc., 48 F.Supp.2d 359, 368 (S.D.N.Y.1999). This facet of law likewise has no application here. The peculiar knowledge exception was recognized to protect those parties who have “no independent means of ascertaining the truth.” Lazard Freres & Co. v. Protective Life Ins. Co., 108 F.3d 1531, 1542 (2d Cir.1997). Pharos is not such a party.

As a prospective equity investor, Pharos had access to boxes of data room materials, conducted extensive due diligence, and communicated directly with National Century’s management. After becoming aware that Goldman had withdrawn as lead investor, Pharos received a detailed listing of Goldman’s concerns and National Century’s responses, and Pharos told National Century that it did not see a material issue with the related-party transactions. See Tr. of Nov. 16, 2009 Hearing at 158 (counsel for Pharos admitting that it had knowledge of certain related-party transactions). Pharos moreover knew of the Fitch downgrade and the delayed 2001 audited financial statement, yet it remained unwavering in its enthusiasm to invest in National Century. Pharos then represented in the Letter Agreement that it, being a sophisticated investor, had the “knowledge and expertise” to independently conduct due diligence and assess the merits and risks of the equity investment. Pharos further stated in the Agreement
that information known by Credit Suisse was not "necessary or desired" and "need not be provided." Pharos cannot now seek reprieve in the peculiar knowledge exception, regardless of what it claims Credit Suisse knew. See DIMON, 48 F.Supp.2d at 368 (noting that for a sophisticated party that "has the means of learning the facts and disclaims reliance on the defendant's representations, there simply is no reason to relieve it of the consequences of both its failure to protect itself and its bargain to absolve the defendant of responsibility"); DynCorp, 215 F.Supp.2d at 321–22 (declining to apply the peculiar knowledge exception because plaintiff was aware "that the information it had received had been selected. . . . Sophisticated parties to major transactions cannot avoid their disclaimers by complaining that they received less than all information, for they could have negotiated for fuller information or more complete warranties.").

[5–7] Finally, Pharos argues that the Letter Agreement should be disregarded because it was not signed until "late" in the process and Pharos was led to believe that the Agreement was "standard" and had to be signed in order to complete the stock purchase. Pharos fails to cite any legal basis for why these considerations would invalidate the Agreement, but they could charitably be construed as an argument that Pharos was under duress. "To avoid a contract on the basis of duress, a party must prove coercion by the other party to the contract. It is not enough to show that one assented merely because of difficult circumstances that are not the fault of the other party." Blodgett v. Blodgett, 49 Ohio St.3d 243, 246, 551 N.E.2d 1249, 1251–52 (Ohio 1990); see also 805 Third Ave. Co. v. M.W. Realty Associates, 58 N.Y.2d 447, 451, 461 N.Y.S.2d 778, 448 N.E.2d 445, 447 (N.Y.1983) (duress claim requires the existence of a threat or coercion that precludes the exercise of free will). The factual record at most shows that Credit Suisse exerted financial or business pressures on Pharos, but this does not constitute duress. See Gartech Elec. Contracting Corp. v. Coastal Elec. Const. Corp., 887 N.Y.S.2d 24, 40, 66 A.D.3d 463, 485 (N.Y.App.Div.2009); Sheet Metal Workers Nat'l Pension Fund v. Bryden House Ltd. P'ship, 130 Ohio App.3d 132, 141, 719 N.E.2d 646, 652–53 (Ohio Ct.App.1998). As one court aptly stated, "A defense of duress cannot be sustained by a contracting party who has simply been bested in contract negotiations by the 'hard bargaining' of another contracting party, . . . even when the hard bargainer knowingly takes advantage of his counterpart's difficult financial circumstances." Regent Partners, Inc. v. Parr Dev. Co., Inc., 960 F.Supp. 607, 612 (E.D.N.Y.1997) (internal citations omitted).

Thus, the court finds that Credit Suisse is entitled to summary judgment as to the fraud and negligent misrepresentation claims.

B. Ohio Revised Code Section 1707.41

The Ohio Securities Act provides,

[A]ny person that, by a written or printed circular, prospectus, or advertisement, offers any security for sale, or receives the profits accruing from such sale, is liable, to any person that purchased the security relying on the circular, prospectus, or advertisement, for the loss or damage sustained by the relying person by reason of the falsity of any material statement contained therein or for the omission of material facts, unless the offeror or person that receives the profits establishes that the offeror or person had no knowledge of the publication prior to the transaction complained of, or had just and reasonable grounds to believe the statement to
be true or the omitted facts to be not material.

O.R.C. § 1707.41(A). Pharos asserts that Credit Suisse violated this provision because the PPM Credit Suisse supplied to Pharos contained material misrepresentations.

Pointing again to the Letter Agreement, Credit Suisse argues that the § 1707.41 claim fails because Pharos cannot establish justifiable reliance. Pharos responds, in passing in its response brief, that reliance need not be justifiable; Pharos clarified at oral argument that its position is based on the absence of the words “reasonably” or “justifiably” in front of “relying” in § 1707.41(A). See Tr. of Nov. 16, 2009 Hearing at 167.

The court has found little case law on the issue, but the cases do not favor Pharos’s interpretation. Two Ohio courts of appeals, though not directly ruling on the issue, have imposed a reasonableness requirement. In Federated Mgmt. Co. v. Coopers & Lybrand, the court held that summary judgment could not be granted against a § 1707.41 claim because the plaintiff had demonstrated that a jury could find both that the plaintiff had relied on a prospectus and that “the reliance was reasonable.” 137 Ohio App.3d 366, 396, 738 N.E.2d 842, 864 (Ohio Ct.App.2000).


Courts interpreting Ohio securities law have often looked to parallel provisions of federal law. See, e.g., In re Columbus Skyline Securities, Inc., 74 Ohio St.3d 495, 499–500, 660 N.E.2d 427, 429–30 (Ohio 1996); Baker v. Conlan, 66 Ohio App.3d 454, 462, 585 N.E.2d 543, 548 (Ohio Ct. App.1990); Roddy v. Alexander, No. 18503, 2001 WL 1174276, at *2 (Ohio Ct. App. Oct. 5, 2001); see also Booth v. Verity, Inc., 124 F.Supp.2d 452, 460 (W.D.Ky. 2000) (“To interpret provisions of Blue Sky Laws patterned after the Uniform Securities Acts, other state courts have looked to decisions construing parallel federal securities laws.”). It is therefore appropriate to note that federal courts have held that justifiable reliance is an essential element of a claim for securities fraud under 15 U.S.C. § 78j(b) even though that requirement is not expressly stated in the statute. See Ley v. Visteon Corp., 543 F.3d 801, 806 (6th Cir.2008); Helwig v. Vencor, Inc., 251 F.3d 540, 554 (6th Cir.2001) (en banc); see also Harrison v. Dean Witter Reynolds, Inc., 79 F.3d 609, 618 (7th Cir.1996) (“The fact of reliance in this case, however, is not enough by itself; that reliance must be justifiable, or reasonable.”).

[8] Pharos has not cited any authority for why a party whose reliance is unjustifiable should still have recourse under § 1707.41(A). Putting aside a fraud-on-the-market theory, the requirement of reasonable reliance is an important one for claims of primary liability under securities law. See Aschinger v. Columbus Showcase Co., 934 F.2d 1402, 1410 (6th Cir. 1991); Banca Cremi, S.A. v. Alex. Brown & Sons, Inc., 132 F.3d 1017, 1028 (4th Cir.1997); Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 529–30 (7th Cir.1985); Zobrist v. Coal–X, Inc., 708 F.2d 1511, 1516 (10th Cir.1983). “Because the justifiable reliance requirement ‘requir[es] plaintiffs to invest carefully,’ it ‘promotes the anti-fraud policies’ of the securities acts by making fraud more readily discoverable.” Banca Cremi, 132 F.3d at 1028 (quoting Dupuy v. Dupuy, 551 F.2d 1005, 1014 (5th Cir.1977)); accord Aschinger, 934 F.2d at 1410. Further, it serves as a critical limitation to ensure that a causal connection exists between the
misrepresentation and the plaintiff’s harm, *Zobrist*, 708 F.2d at 1516, and precludes an investor from “closing his eyes.” *Teamsters Local 282*, 762 F.2d at 530. For these reasons, the court finds that justifiable reliance is an element of a § 1707.41(A) claim.

As discussed above in connection with the fraud and negligent misrepresentation claims, Pharos cannot establish justifiable reliance; thus, summary judgment is granted on the § 1707.41(A) claim.

**IV. CLAIMS FOR SECONDARY LIABILITY**

**A. Ohio Revised Code Section 1707.43**

1. **Predicate Violation Based on Section 1707.41**

Ohio law imposes joint and several liability on any person who “has participated in or aided the seller in any way” in making a sale that violates Chapter 1707. O.R.C. § 1707.43(A). Secondary liability cannot be imposed if the plaintiff fails to establish a primary violation of Chapter 1707. In the complaint, Pharos alleged that National Century committed a primary violation of § 1707.41 by issuing a PPM containing misrepresentations about how National Century operated.

[9] Credit Suisse’s motion for summary judgment contends that Pharos cannot prove a predicate violation of § 1707.41 by National Century because discovery failed to uncover any false statements in the PPM on which Pharos relied. After Pharos initially received the PPM, it proceeded to conduct extensive due diligence and had numerous direct interactions with National Century’s management. Certain aspects of what Pharos claims was misrepresented in the PPM, such as the related-party transactions and the failure to maintain reserve accounts at certain levels, were later disclosed by National Century. See Ph. Ex. 22, Crants Dep. at 88–94 (acknowledging that Pharos knew of related-party transactions and of reserve accounts dipping below required levels). Credit Suisse argues that Pharos, having learned so much, cannot show that it relied on any alleged misrepresentations made in the initial document. Credit Suisse challenges Pharos to “identify a single false statement in the PPM that it reasonably relied on” when it finally bought the stock. CS Mot. for Summ. J. at 90.

Pharos has no good answer to Credit Suisse’s challenge. Indeed Pharos devotes a single paragraph to the matter and contends that Credit Suisse admitted in its briefs that Pharos relied on the PPM. But this mischaracterizes what Credit Suisse said about the PPM. Credit Suisse concedes that it sent the PPM to Pharos and argues that Pharos read certain disclaimers in the PPM (that Credit Suisse was not guaranteeing the accuracy of the information in the PPM, that investors should conduct their own due diligence, and that they should rely only on representations made in a final purchase agreement). See CS Ex. 57; CS Ex. 61, Crants Dep. at 72–73; CS Ex. 70, Devlin Dep. at 265–66. However, nowhere has Credit Suisse conceded that Pharos reasonably relied on false statements in the PPM.

[10] Pharos also points to the fact that National Century committed a massive fraud—a point Credit Suisse does not dispute. See CS Mot. for Summ. J. at 36–42. Even so, the fact that National Century defrauded some investors does not mean that it defrauded Pharos in particular or in the manner proscribed by § 1707.41. That section is not violated unless there is reliance upon a false statement in written offering materials. Pharos has failed to direct the court to any evidence from which a jury could reasonably find that Pharos justifiably relied on a false statement made by National Century in the PPM.
The court has no duty to comb the record for facts to support Pharos's claim. See InterRoyal Corp. v. Sponseller, 889 F.2d 108, 111 (6th Cir.1989). "Thus, a court is entitled to rely, in determining whether a genuine issue of material fact exists on a particular issue, only upon those portions of the verified pleadings, depositions, answers to interrogatories and admissions on file, together with any affidavits submitted, specifically called to its attention by the parties." Books A Million, Inc. v. H & N Enterprises, Inc., 140 F.Supp.2d 846, 853 (S.D. Ohio 2001).

Again, Pharos has failed to direct the court's attention to any evidence in the record that would support its claim that it relied on a misrepresentation by National Century in the PPM. Nonetheless, the court has examined certain documents—among the 850 exhibits submitted by the parties—that would seem to be the most likely to speak to the issue of reliance on specific misstatements in the PPM. These documents include the depositions of the managing partners of Pharos, their contemporaneous communications about the investment, and Pharos's answers to interrogatories.

The court is unable to locate facts from which a jury could reasonably find that Pharos, in making its decision to invest, relied on a misrepresentation by National Century in the PPM. Pharos sometimes cites the PPM as a document that it received and reviewed. See, e.g., Ph. Ex. 34, Devlin Dep. at 264; CS Ex. 71, LeFebvre Dep. at 174. However, Pharos does not pinpoint any specific alleged misrepresentations by National Century in the PPM on which it relied. For instance, in response to interrogatories asking Pharos on which documents it relied, Pharos stated that it received the PPM but cited other documents (a legal opinion letter, unaudited financial forecasts attributed to Credit Suisse, the Hurwitz email) as the particular ones it relied on when deciding to invest. CS Ex. 63, Pl's Answer to Interrog. Nos. 4 and 5; CS Ex. 64, Pl's First Am. Answer to Interrog. No. 4. Pharos also relied on the strength of National Century's management, see Ph. Ex. 251 (Devlin saying the day after the site visit that "we loved the company and the management team"), and took comfort in the fact that Poulsen himself was putting his own money in the deal, see Ph. Ex. 23, Crants Dep. at 242. Managing partner Bob Crants, who was Pharos's Rule 30(b)(6) corporate representative, stated in his deposition that Pharos relied on the PPM. Ph. Ex. 22, Crants Dep. at 65-66. Yet his testimony went no further than this—a general statement that Pharos relied on the PPM. Crants did not identify any allegedly false representation within the PPM, and attributable to National Century, on which Pharos reasonably relied.2

It is appropriate at the summary judgment stage for the court to expect Pharos to demonstrate reliance with a greater degree of specificity than a general statement that it relied on the PPM. Indeed, more than that is required at the pleading stage. See Fed.R.Civ.P. 9(b) (complaint must "state with particularity the circumstances constituting fraud"); U.S. ex rel. Marlar v. BWXT Y-12, L.L.C., 525 F.3d 439, 444 (6th Cir.2008) ("To satisfy Rule 9(b), a complaint of fraud, at a minimum, must allege the time, place, and content of

2. Crants did testify that he believed the PPM failed to disclose the extent or magnitude of the related-party transactions and the failure to maintain reserve accounts. Ph. Ex. 23, Crants Dep. at 254-56. Crants, however, admitted to Pharos having learned of these problem areas during its due diligence and of having had follow-up communications with Poulsen, who downplayed the seriousness of these issues. Any reliance, thus, would have been on Poulsen's later statements and not the PPM.
the alleged misrepresentation on which the plaintiff relied . . . .” (internal citations omitted). The PPM is nearly 100 pages long and Pharos has never claimed that the whole document is false. After having had several years to prepare its case and having conducted substantial discovery, Pharos must do more than what it has done to create a genuine issue of fact concerning an essential element of its claim. When, as here, the moving party meets its initial burden of showing the absence of a genuine issue of material fact, the burden shifts to the nonmoving party to “set forth specific facts showing there is a genuine issue for trial.” Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 250, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (quoting Fed.R.Civ.P. 56(e)). Rule 56(e) “requires the nonmoving party to go beyond the [unverified] pleadings” and offer admissible evidence supporting its position. Celotex Corp. v. Catrett, 477 U.S. 317, 324, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). Pharos has failed to do so.

The court thus finds that Pharos has failed to establish a primary violation of § 1707.41 for purposes of its § 1707.43 secondary liability claim against Credit Suisse.

2. Predicate Violation Based on Section 1707.44

Pharos argues that even if it cannot establish a primary violation of § 1707.41, it can still show that National Century violated paragraphs (B)(4), (G), and (J) of § 1707.44, which provide:

(B) No person shall knowingly make or cause to be made any false representation concerning a material and relevant fact, in any oral statement or in any prospectus, circular, description, application, or written statement, for any of the following purposes: . . . (4) Selling any securities in this state;

(G) No person in purchasing or selling securities shall knowingly engage in any act or practice that is, in this chapter, declared illegal, defined as fraudulent, or prohibited;

(J) No person, with purpose to deceive, shall make, issue, publish, or cause to be made, issued, or published any statement or advertisement as to the value of securities, or as to alleged facts affecting the value of securities, or as to the financial condition of any issuer of securities, when the person knows that the statement or advertisement is false in any material respect.

O.R.C. § 1707.44(B)(4), (G), and (J).

[13] Credit Suisse protests that the complaint does not allege predicate violations of § 1707.44 and that a party may not present a legal theory for the first time after the close of discovery and in response to a properly-supported motion for summary judgment. The Sixth Circuit has made clear that a party may not “expand its claims to assert new theories” in response to a motion for summary judgment. Bridgeport Music, Inc. v. WM Music Corp., 508 F.3d 394, 400 (6th Cir.2007); see also Priddy v. Edelman, 883 F.2d 438, 446 (6th Cir.1989) (holding that “[a] party is not entitled to wait until the discovery cutoff date has passed and a motion for summary judgment has been filed on the basis of claims asserted in the original complaint before introducing entirely different legal theories”); Tucker v. Union of Needletrades, Industrial and Textile Employees, 407 F.3d 784, 788 (6th Cir.2005) (holding that a plaintiff may not raise a new claim in response to summary judgment); Desparois v. Perrysburg Exempted Village Sch. Dist., 455 Fed.Appx. 659, 666 (6th Cir.2012); Yanovich v. Zummer Austin, Inc., 255 Fed.Appx. 957, 970 (6th Cir. 2007). District courts have thus held that a plaintiff may not offer new theories in support of a claim in response to a motion for summary judgment. See, e.g., Sweitzer
In Count Two of the Second Amended Complaint, Pharos specifically identified § 1707.41 as the section that National Century violated and as underpinning its secondary liability claim against Credit Suisse. See Sec. Am. Compl. at ¶¶ 99–105. The complaint made no mention of § 1707.44, which differs from § 1707.41 in important ways. As applied to this case, § 1707.44 has a broader imposition of liability than does § 1707.41. Section 1707.41 contains a reliance requirement, but paragraphs (B)(4), (G), and (J) of § 1707.44 do not appear to require a plaintiff to prove reliance upon a false statement. See Wilson v. Ward, 183 Ohio App.3d 494, 502, 917 N.E.2d 821, 827 (Ohio Ct.App.2009); Ferritto v. Alejandro, 139 Ohio App.3d 363, 368, 743 N.E.2d 978, 982 (Ohio Ct.App. 2000). Further, § 1707.41 is limited to false statements in written materials or advertisements, but paragraph (B)(4), which prohibits any written or oral misrepresentations, and paragraph (G), which prohibits any fraudulent acts or practices, have a greater sweep. And § 1707.44(J) is different still, being directed at statements as to the value of securities or the financial condition of the issuer. The effect of these differences is that Credit Suisse has prepared a defense—focusing on reliance and on the PPM—that is different from the defense it would have likely prepared had it been given notice of an alleged violation of § 1707.44.

The court has reviewed Pharos’s responses to interrogatories and has revisited the briefing associated with Credit Suisse’s earlier motion to dismiss. Nothing in those materials gave notice to Credit Suisse that Pharos would assert that National Century had committed a violation of paragraphs (G) or (J) of § 1707.44. Even now that Pharos has attempted to raise those paragraphs in opposition to the motion for summary judgment, it does so only in passing. It quotes those statutory provisions in footnotes and makes no effort to match the language of the provisions to record evidence that would support a finding that paragraphs (G) and (J) were violated.

Pharos did mention paragraph (B)(4) of § 1707.44 in responding to Credit Suisse’s original motion to dismiss. Pharos cited both § 1707.41 and § 1707.44(B)(4) in arguing that its § 1707.43 should claim should survive dismissal. (Doc. 63 in Case No. 2:03–cv–362 at 32–33). After filing this brief, Pharos twice was granted leave to amend its complaint; however, Pharos chose not to allege a primary violation of § 1707.44(B)(4) in either its first or second amended complaints. Instead, it expressly claimed a primary violation of § 1707.41, alleging that defendants had aided unlawful sales “in violation of Chapter 1707.41” and had aided “National Century’s misdeeds under Chapter 1707.41.” (Doc. 105 in Case No. 2:03–cv–362 at ¶¶ 90, 93; doc. 64 in Case No. 2:03–md–1565 at ¶¶ 100, 103).

The court finds that the operative pleading, the Second Amended Complaint, does not give Credit Suisse notice of an alleged primary violation of § 1707.44(B)(4). Credit Suisse has tailored its defense to the elements of § 1707.41. Pharos may not now avoid summary judgment by expanding its § 1707.43 claim to include the new alleged violation. See Bridgeport Music, 508 F.3d at 400; Sweitzer, 554 F.Supp.2d at 797. Moreover, as it did with para-
graphs (G) or (J) of § 1707.44, Pharos’s brief simply cites paragraph (B)(4) without providing any legal analysis or directing the court to record evidence supporting a finding that paragraph (B)(4) was violated.

The court thus finds that Credit Suisse is entitled to summary judgment against Pharos’s claim under O.R.C. § 1707.43.

B. Aiding and Abetting Fraud

[14] The Restatement (Second) of Torts § 876 provides for liability for persons acting in concert with a wrongdoer. In particular, it imposes liability on one who: (1) knows that the primary party’s conduct constitutes a breach of duty and (2) substantially assists or encourages the primary party’s conduct. See Restatement (Second) of Torts § 876(b). Many states, New York included, expressly recognize a cause of action for aiding and abetting tortious conduct. See Lerner v. Fleet Bank, N.A., 459 F.3d 273, 292 (2d Cir. 2006) (discussing New York law). But, as will be discussed below, it recently became clear that Ohio does not. See DeVries Dairy, L.L.C. v. White Eagle Coop. Ass’n., Inc., 132 Ohio St.3d 516, 974 N.E.2d 1194 (Ohio 2012). This makes a choice of law determination necessary for this claim. The parties have argued that either Ohio or New York law applies.


[17, 18] The primary inquiry in making a choice-of-law decision for a tort claim is which state “has the most significant relationship to the occurrence and the parties.” Restatement (Second) of Conflict of Laws § 145(1); Morgan, 15 Ohio St.3d at 342, 474 N.E.2d at 289. Factors to be considered are:

(a) the place where the injury occurred,
(b) the place where the conduct causing the injury occurred,
(c) the domicil, residence, nationality, place of incorporation and place of business of the parties, and
(d) the place where the relationship, if any, between the parties is centered.

Restatement § 145(2). In the context of a fraud-based tort, the court may also consider:

(a) the place, or places, where the plaintiff acted in reliance upon the defendant’s representations,
(b) the place where the plaintiff received the representations,
(c) the place where the defendant made the representations,
(d) the domicil, residence, nationality, place of incorporation and place of business of the parties,
(e) the place where a tangible thing which is the subject of the transaction between the parties was situated at the time, and
(f) the place where the plaintiff is to render performance under a contract which he has been induced to enter by the false representations of the defendant.

Restatement § 148(2).

[19] From the outset, the parties acknowledge that several of the factors do not favor either the application of Ohio or New York law. Pharos is a Delaware limited partnership whose partners maintained offices in Tennessee and Texas at the time of the investment in National Century. See CS Ex. 70, Devlin Dep. at
Thus, the places of injury, reliance, and domicile of the plaintiff do not favor applying either Ohio or New York.

Looking to the remaining factors, the court finds that Ohio has the most significant relationship to the occurrence and parties relevant to the aiding and abetting claim. As Pharos argues, the subject of the claim is a primary fraud based in Ohio. Pharos invested in an Ohio company and this private equity investment counted on the integrity and skill of those who ran National Century. CS Ex. 73 at PHAROSOS0002028 (Pharos memo explaining that the “most important determinant of success” to its investment approach was “the strength of the management team” of the private companies in which it invested). Pharos alleges that National Century made misrepresentations and deceived Pharos about the nature of the company and its operations. The deception included a site visit made by Pharos to National Century’s offices in Dublin, Ohio in March 2002, as well as direct communications between Lance Poulsen and Pharos. See CS Ex. 61, Crants Dep. at 104–06; CS Exs. 109–16; Ph. Exs. 251, 282. The deception culminated in Pharos rendering performance of the stock purchase by wiring $12 million to National Century in Ohio in July 2002. See Ph. Ex. 284.

Credit Suisse allegedly aided National Century’s fraud in several ways: it introduced Pharos to the potential investment opportunity, sent Pharos a PPM, arranged for Pharos to receive data room materials, answered Pharos’s questions about the investment, and set up the site visit. See, e.g., Sec. Am Compl. at ¶¶ 76–78; Ph. Mem. in Opp’n at 16–26. Though Credit Suisse was based in New York, it purchased notes directly from Credit Suisse in New York, from Pharos, who has no such New York connections and who made its stock purchase directly from National Century. In those other actions, Credit Suisse was a party to the allegedly fraudulent securities transactions. Here it was not. And in those other actions, Credit Suisse allegedly made direct misrepresentations on which the investors relied. Here, the Letter Agreement establishes that Credit Suisse did not.

The court thus finds that Ohio law should apply to the claim for aiding and abetting fraud. Until recently the issue of whether Ohio recognizes such a cause of action has been murky. State courts repeatedly expressed doubt about whether a claim for aiding and abetting tortious conduct was cognizable. See Andonian v. A.C. & S., Inc., 97 Ohio App.3d 572, 574, 647 N.E.2d 190, 191 (Ohio Ct.App.1994) (“Ohio has not definitively adopted this section [Restatement(Second) of Torts § 876] and few Ohio cases have applied it. The Supreme Court of Ohio has never expressly approved Section 876.”); Whelan v. Vanderwist of Cincinnati, Inc., No. 2010–G–2999, 2011 WL 693600, at *4 (Ohio Ct.App. Dec. 30, 2011) (“[I]t remains unclear whether The Supreme Court of

Ohio would adopt the doctrine of liability for civil aiding and abetting as derived from the Restatement of the Law 2d, Torts (1979), Section 876(b). Some courts flatly refused to recognize such a claim. See Federated Mgmt. Co. v. Coo-
pers & Lybrand, 137 Ohio App.3d 366, 382, 738 N.E.2d 842, 853 (Ohio Ct.App.2000) ("Ohio does not recognize such a claim for relief [for civil aiding and abetting]."); Col-

Federal court decisions have reflected this uncertainty. The Sixth Circuit twice noted that it was unclear whether Ohio would recognize a claim for aiding and abetting tortious conduct. See Acta Cas. and Sur. Co. v. Leahey Constr. Co., 219 F.3d 519, 533 (6th Cir.2000); Pavlovich v. National City Bank, 435 F.3d 560, 570 (6th Cir.2006). This court in the National Century MDL previously denied Credit Suisse’s motion to dismiss aiding and abetting claims because it could not be said conclusively that Ohio law did not recognize such a cause of action. See In re Nat’l Century Fin. Enterprises, Inc., Inv. Litig., 541 F.Supp.2d 986, 1014 (S.D.Ohio 2007). See also William D. Mundinger Trust U/A v. Zellers, 473 B.R. 222, 231–32 (N.D.Ohio 2012).

[20] The Ohio Supreme Court just recently settled the issue by holding that Ohio does not recognize a cause of action under Restatement (Second) of Torts § 876. The matter was presented by way of a question certified by the United States District Court for the Northern District of Ohio: “does Ohio recognize a cause of action for tortious acts in concert under the Restatement (2d) of Torts, § 876?” The Ohio Supreme Court answered: “The certified question is answered in the negative. This court has never recognized a claim under 4 Restatement 2d of Torts, Section 876 (1979), and we decline to do so under the circumstances of this case.” DeVries Dairy, L.L.C. v. White Eagle Cooper Ass’n, Inc., 132 Ohio St.3d 516, 517, 974 N.E.2d 1194, 1194 (Ohio 2012). The Court did not elaborate further, but it is clear now that a claim under § 876 for aiding and abetting tortious conduct is not cognizable under Ohio law.

Thus, summary judgment is granted to Credit Suisse on the claim asserted by Pharos for aiding and abetting fraud.

V. CONCLUSION

Accordingly, Credit Suisse’s motion for summary judgment (doc. 1547) is granted. The court denies as moot Credit Suisse’s motions to strike evidence and exclude an expert report (docs. 1714, 1729).

The Clerk shall enter judgment in favor of Credit Suisse in Case No. 2:03–cv–362 and shall close Case No. 2:03–md–1565.

No. 12-4381

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

13a0909n.06; 535 Fed. Appx. 522; 2013 U.S. App. LEXIS 21912; 2013 FED App. 0909N (6th Cir.)

October 23, 2013, Filed

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PRIOR HISTORY: [**1] ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF OHIO.

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For DELOITTE & TOUCHE, Deloitte & Touche LLP c/o Lawrence A Hilsheimer, Statutory Agent, Defendant - Appellee: Andrew L. Goldman, Bartlit, Beck, Herman, Palenchar & Scott, Chicago, IL.

For CREDIT SUISSE FIRST BOSTON CORPORATION, c/o Prentice Hall Corp System, Statutory Agent, Defendant - Appellee: Jeffrey Q. Smith, Laila Abou-Rahme, Steven G. Brody, Susan Felice DiCicco, Colleen J. O'Loughlin, Bingham McCutchen, New York, NY; Sherri B. Lazear, Thomas L. Long, Baker & Hostetler, Columbus, OH.

For PURCELL & SCOTT CO LPA, c/o Peggy A Scott, Statutory Agent, Defendant - Appellee: Matthew B. Andelman, Delaney McKinney, Chevy Chase, MD; Robert M. Cary, Craig D. Singer, John K. Villa, Williams & Connolly, Washington, DC; Matthew L. Fornshell, Ice Miller, Columbus, OH.


OPINION
PER CURIAM. In this chapter of the multi-district National Century Financial Enterprises, Inc., Investment Litigation, MDL No. 2:03-md-1565, which arises from National Century's fraudulent business practices and stock offerings, investor Pharos Capital Partners, L.P., sued one of National Century's stock placement agents, alleging primary and secondary liability under Ohio securities law, fraud, and negligent misrepresentation for its role in facilitating Pharos's now-worthless $12-million equity investment in National Century stock. The district court granted summary judgment to the placement agent, Credit Suisse Securities (USA) LLC, finding in pertinent part that: (i) Pharos unjustifiably relied on Credit Suisse's representations in light of the parties' "big boy agreement" in which Pharos eschews reliance on Credit Suisse in favor of its own due diligence, and (ii) Pharos failed to present evidence of a predicate violation of Ohio securities law to support its secondary liability claim against Credit Suisse. After carefully reviewing the record, the applicable law, the parties' briefs, and having had the benefit of oral argument, we find that the district court's opinion diligently and correctly sets out the undisputed facts and the governing law.

During oral argument, Pharos defended its failure to designate evidence supporting the secondary liability claim by denying that Credit Suisse's motion for summary judgment challenged its reliance on National Century's Private Placement Memorandum (PPM). The record reveals otherwise. (Appellee App. vol. 1 at 11175, CS Summ. J. Br. at 90 ("As a threshold matter, Pharos has not established a primary violation of Section 1707.41, as required to recover under Section 1707.43. For example, Pharos has not identified a single false statement in the PPM that it reasonably relied on to support its claim.").) Pharos makes much of the fact that Credit Suisse's motion brief states that "Pharos admits it reviewed and relied on the PPM in connection with its investment decision." (Id. at 11109-10, Br. at 24-25.) But, as the district court noted, this generic statement of Pharos's legal position concedes nothing in terms of justifiable reliance.

The district court thoroughly reviewed the record for evidence that Pharos reasonably relied on material misstatements appearing in the PPM, finding nothing more than a handful of vague assertions of reliance on the PPM. Indeed, the court granted Pharos more review than its proffer required. See, e.g., Wimbush v. Wyeth, 619 F.3d 632, 638 n.4 (6th Cir. 2010) ("[I]t was [the non-movant's] job to point to the evidence with specificity and particularity in the relevant brief rather than just dropping a pile of paper on the district judge's desk and expecting him to sort it out."); Tucker v. Tennessee, 539 F.3d 526, 531 (6th Cir. 2008) (explaining that the district court has no "duty to search the entire record to establish that it is bereft of a genuine issue of material fact" (quotation omitted)). We discern no error with its judgment that Pharos failed to present evidence demonstrating justifiable reliance. See Guarino v. Brookfield Twp. Trs., 980 F.2d 399, 405 (6th Cir. 1992) ("[I]f the non-moving party fails to discharge [the summary judgment] burden--for example, by remaining silent--its opportunity is waived and its case wagered.").

Pharos attempts to remedy this evidentiary shortcoming on appeal, pointing to deposition testimony from its managing partners stating that it relied on the PPM's performance forecasts and its failure to disclose National Century's asset-shifting practices. But even if we were to accept these forfeited statements of reliance as properly before us, they suffer from the same lack of particularity as those discovered by the district court.

Finally, the district court correctly held that Pharos could not justifiably rely on any statement by Credit Suisse because Pharos was a sophisticated investor, had substantial adverse information about National Century, and, most critically, signed an agreement disclaiming reliance on any statement by Credit Suisse. On appeal, Pharos argues that Credit Suisse had knowledge of material information about National Century's fraud that outside investors--like Pharos--could not discover. Even assuming that this scenario could make Pharos's reliance justifiable, Pharos has not demonstrated that any material information was truly unavailable to a sophisticated investor like Pharos.

Because this court's issuance of a full opinion would be duplicative and serve no jurisprudential purpose, we AFFIRM for the reasons stated in the district court's well-reasoned opinion and order of October 26, 2012.