Sealink Funding Ltd. v Morgan Stanley
2014 NY Slip Op 31031(U)
April 17, 2014
Sup Ct, New York County
Docket Number: 650196/2012
Judge: Eileen Bransten

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK PART 3

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SEALINK FUNDING LIMITED,

Plaintiff,

- against -

Index No. 650196/2012
Motion Date: 10/17/2013
Motion Seq. No. 003

MORGAN STANLEY; MORGAN STANLEY & CO., INC., MORGAN STANLEY ABS CAPITAL I INC., MORGAN STANLEY CAPITAL I INC., MORGAN STANLEY MORTGAGE CAPITAL INC., and MORGAN STANLEY MORTGAGE CAPITAL HOLDINGS LLC,

Defendants.

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BRANSTEN, J.:

In this action for common-law fraud, fraudulent inducement, and aiding and abetting fraud, defendants Morgan Stanley, Morgan Stanley & Co., Inc. ("MS&Co."), Morgan Stanley ABS Capital I Inc. ("MSAC"), Morgan Stanley Capital I Inc. ("MSC"), Morgan Stanley Mortgage Capital Inc. ("MSMC"), and Morgan Stanley Mortgage Capital Holdings LLC (collectively "defendants") move to dismiss the Second Amended Complaint, pursuant to CPLR 3211(a)(1). Defendants contend that plaintiff Sealink Funding Limited ("Sealink") lacks standing to assert fraud claims and that plaintiff has not pled the requisite elements to state a cause of action sounding in fraud. Sealink opposes. For the reasons that follow, defendants' motion is granted.

I. Background

This action concerns certificates to 10 residential mortgage-backed securities ("RMBS"), which were purchased at the direction of Sachsen LB Europe Plc. ("Sachsen Europe") from defendants for $507 million between 2005 and 2007. Through a complex series of transactions described below, Sealink came into possession of the RMBS.

Investors in RMBS receive payments from the cash flow generated by thousands of mortgages, which have been deposited into designated pools. The actual securities held by the investor are pass-through participation certificates, which are an ownership interest in the issuing trust, the entity that holds the pools.

The first step in the securitization process is the creation of a pool of designated mortgages by the sponsor. The mortgages can be originated by the sponsor itself, purchased from other financial institutions, or be a mixture of self-originated and purchased loans. Before creating the pool, the sponsor reviews a sample of the mortgages in order to verify that they comport with underwriting guidelines.

After the pool of designated mortgages has been created by the sponsor, the mortgages are transferred to the depositor. The depositor carves up the projected cash flow from the mortgages into tranches; the tranches are ordered by seniority on the basis of risk, thus, any losses in the loan pool are applied to the junior (riskiest) tranches first. Once the tranche structure has been finalized, the proposed security is sent to rating agencies for evaluation. Next, the depositor transfers the mortgage pool to the issuing

trust, which issues participation certificates for each tranche. The issuing trust then conveys the participation certificates to the depositor as consideration for the mortgages.

Once the depositor is in possession of the participation certificates, the underwriter will begin marketing the RMBS to potential investors, providing them with free writing prospectuses and term sheets. The depositor then transfers the certificates to the underwriter, who will sell them to investors and remit the proceeds to the depositor, minus underwriting fees.

In this action, MS&Co. underwrote and sold all the RMBS in dispute, MSMC was the sponsor of 8 of the 10 securitizations, MSAC served as depositor for two of the securitizations, and MSC served as depositor for six of the securitizations. All of the certificates at issue have since been downgraded to a junk rating.

Sachsen Europe, which was incorporated in Ireland, and operated out of Dublin, was a wholly owned subsidiary of Landesbank Sachsen Girozentrale ("Sachsen LB"), a German bank. The entities that executed the initial purchases of the RMBS were special purpose vehicles which Sachsen Europe had created and incorporated under Irish law ("Irish SPVs"). The Irish SPVs had no employees, and were managed and operated by Sachsen Europe. Sachsen Europe also entered into a warehouse agreement with non-party Barclays Capital ("Barclays"); under this agreement Sachsen Europe directed Barclays to purchase RMBS it had selected, which were later transferred to Sachen Funding I, one of the Irish SPVs.

On August 26, 2007, Landesbank Baden-Würrtemberg agreed to purchase Sachsen LB, effective January 1, 2008. The terms of the acquisition specifically excluded the Irish SPVs and the "toxic" RMBS they held. *See* Second Amended Complaint ¶ 39. In order to dispose of the RMBS, Sachsen Europe put in motion a plan to transfer the RMBS at issue into a "bad bank." *Id.* ¶ 35. Sealink is that "bad bank," which is described as "a special purpose vehicle that was established to receive, hold, and manage toxic RMBS assets, including the Certificates." *Id.* ¶ 15.

The first step in this process was the incorporation of SPVs in the Cayman Islands ("Cayman SPVs") and the transfers from Barclays to Sachsen Funding I. Between December 19, 2007, and February 27, 2008, Sachsen Europe directed the Irish SPVs to sell the RMBS at issue to the Cayman SPVs at par value. On June 5, 2007, Sachsen Europe ordered Barclays to transfer the RMBS it had been warehousing to Sachsen Funding I.

On June 7, 2008, the Cayman SPVs and Sachsen Funding I sold the certificates to Sealink at par value, pursuant to series of Sale and Purchase Agreements ("SPAs"), which were executed contemporaneously with a Master Framework and Definitions Schedule ("Master Framework"). After consummation of the sale, the Irish and Cayman SPVs were dissolved.

In its second amended complaint, plaintiff alleges that defendants fraudulently induced Sachsen Europe into directing the purchase of the participation certificates.

Specifically, plaintiff alleges that defendants misrepresented the due diligence and underwriting standards on the underlying mortgages, misrepresented the loan-to-value ratios of the mortgaged properties, and misrepresented the debt-to-income ratios of the borrowers. Plaintiff further alleges that defendants misrepresented the risks associated with the RMBS in general, and made misrepresentations to rating agencies, resulting in artificially high ratings. Plaintiff asserts that in reliance on defendants' misrepresentations, the Irish SPVs were damaged by paying far more for the RMBS than they were worth.

Sealink alleges that it has standing as "exclusive assignee" to pursue fraud claims by virtue of the preceding chain of transfers. *Id.* ¶ 15. Plaintiffs pray for compensatory, rescissory and punitive damages, as well as costs and expenses incurred in this action.

II. Discussion

A. *Standing*

In their motion papers, defendants argue that the plaintiff does not have standing to sue, because the chain of transfers did not assign causes of action sounding in tort. Plaintiff opposes, arguing that it has specifically alleged standing and assignment of the claims, and that the sales and alleged assignments did assign fraud claims.

Plaintiff's argument that the motion must be denied because the second amended complaint specifically alleges standing, is not persuasive. It cannot be denied that Sealink

has alleged standing and has gone through, in painstaking detail, the chain of possession of the certificates from the initial purchases to the final transfers to Sealink. *See* Second Amended Complaint ¶¶ 15, 35-41. However, this alone is not sufficient to defeat a motion to dismiss. While a complaint is to be liberally construed in favor of plaintiff, "[d]ismissal is warranted under CPLR 3211(a)(1) where documentary evidence and undisputed facts negate or dispose of claims in the complaint or conclusively establish a defense." *Zanett Lombardier, Ltd. v. Maslow,* 29 A.D.3d 495, 495 (1st Dep't 2006); *see also Robinson v. Robinson*, 303 A.D.2d 234, 235 (1st Dep't 2003). Defendants have proffered the transaction documents as evidence to support their argument that a valid assignment was not effected.

The court must now determine if claims sounding in tort were assigned. The court will first examine the final transfers to Sealink; for the purposes of this analysis, the court will presume that the SPVs which sold the certificates to Sealink were in possession of fraud claims against defendants.

1. The Transfers From the Sachen Funding I and the Cayman SPVs to Sealink are Governed by English Law

The parties are in agreement that the transfers to Sealink are governed by English law, pursuant to the governing law clauses of the SPAs and Master Framework. *See* Affidavit of Stephen Auld, Q.C. ("Auld Aff.") Exs. B-4[1], B-5[2], B-6[3], B7[4]-B8[5].

The parties have submitted expert affidavits, accompanied by a voluminous submission of English case law, treatises and commentaries, providing the court with a sufficient basis for interpreting English law. Defendants' expert is Stephen Auld, barrister and Queens Counsel who practices in London. Plaintiff has submitted the affidavit of Andrew Onslow, also barrister and Queens Counsel, who practices in London.

Under English law, causes of action fall under the umbrella of "choses in action," *see* Smith & Leslie, Assignment ¶ 2.69 (2nd ed 2013); choses in action are intangible rights and interests to property. *Id.* at ¶ 2.71. As a general rule, choses in action are not assignable at common law, *id.* at ¶ 10.04, however they are statutorily authorized by the Law of Property Act 1925 § 136, and can be found in equity by a court.

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[1] At 9, ¶ 7.

[2] At 10, ¶ 7.

[3] At 11, ¶ 7.

[4] At 10, ¶ 7.

[5] At 72, ¶ 1.

The Law of Property Act 1925 § 136 states the requirements of a legal (as opposed to equitable) assignment:

> (1) Any absolute assignment by writing under the hand of the assignor (not purporting to be by way of charge only) of any debt or other legal thing in action, of which express notice in writing has been given to the debtor, trustee or other person from whom the assignor would have been entitled to claim such debt or thing in action, is effectual in law (subject to equities having priority over the right of the assignee) to pass and transfer from the date of such notice-
>
> (a) the legal right to such debt or thing in action;
>
> (b) all legal and other remedies for the same; and
>
> (c) the power to give a good discharge for the same without the concurrence of the assignor.

An equitable assignment is not limited to "any particular form, but it is essential that there should be an intention to assign and, . . . some act by the assignor showing that he is passing the chose in action to the supposed assignee." *Kijowski v. New Capital Prop.*, 15 on LR 1 at 8 (Queens Bench 1987).

Under English law, there is no prescribed set of words necessary to effect an assignment, whether statutory or equitable: "[T]he mere form of words is immaterial if the assignor has used any form of words which expressed a final and settled intention to transfer the property to the assignee there and then. That would be sufficient. He need not use the word 'give' or 'assign' or any particular words." *Re Williams*, 1 Ch. 1 at 8 (Court of Appeal 1917). However, "[t]he assignment must sufficiently identify the chose which is being assigned." John McGhee, Snell's Equity, ¶ 3-016 (32nd ed 2010). "There is no doubt that an assignment may be so indefinite and uncertain in its terms that the Courts

will not give effect to it because of the impossibility of ascertaining to what it is applicable." *Tailby v. Official Receiver*, 13 App. Cas. 523 at 529 (House of Lords 1888).

English law construes contracts from an objective perspective, "in the sense that it is concerned with what a reasonable person to whom the utterance was addressed would have understood the author to be using the words to mean." Kim Lewison, Interpretation of Contracts, ¶ 2.03 at 28 (5th ed 2001), citing *Kirin Amgen Inc. v. Hoechst Marion Roussel Ltd.*, [2004] UKHL 46 ¶ 32. This "reasonable person" is not limited to the bare words of the contract, but is imputed with "all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract." *Investors Compensation Scheme v. West Bromwhich Building Society*, 1 WLR 912 (House of Lords 1998). When objectively interpreting a contract, the court "is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended." *Attorney General v. Belize Telecom*, 1 WLR 1988 at ¶ 16 (Privy Council 2009).

2. Application of English Law

Defendants argue that an assignment of claims emanating from a complex commercial transaction requires "some express reference to legal claims or the fruits of

the claims " in order to be sufficiently identifiable.[6] *See* Auld Aff. ¶ 41. They contend that, because the SPAs and Master Framework contain no such expression, there has been no assignment, and, thus, plaintiff lacks standing.

Plaintiff counters that the motion should be denied because the contractual language is sufficient to assign claims in tort under English law. However, the main thrust of plaintiff's opposition is that, under English principles of contractual interpretation, an English court would find a manifestation of intent to assign, resulting in an equitable assignment.

The sale language of the transfers to Sealink can be found on the second page of each SPA:

> **Agreement to Sell and Purchase**
>
> The Seller with full title guarantee and as beneficial owner hereby agrees to sell, and the Purchaser hereby agrees to purchase, each Asset at a price equal to the relevant Asset Purchase Price, on the terms and subject to the conditions of this Agreement.

(Auld Aff. Ex. B4-B7).

The real language at issue in this motion is the definition of "asset" in the "Principles of Interpretation and Construction" of the Master Framework (section 2.1.2,

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[6] Mr. Auld clarifies that "it is not my view that there is some sort of *inflexible* rule that, in all cases there must be an express reference to claims (or some alternative) but rather that, without such a reference the court is very unlikely to uphold an assignment in this case." (Auld Aff. ¶ 50 [4].)

schedule 1). It reads as follows: "'**assets**' includes present and future properties, revenues and rights of every description." (Auld Aff. Ex. B8 at 60.)

Defendants' expert avers that he is not aware of any case in which a causes of action was assigned without express language. Defendants have cited a number of cases in support of their position that an express reference to claims or their fruits is necessary to be valid. The Court will examine some of the more illustrative cases.

In *24 Seven Utility Servs.Ltd. v. Rosekey Limited,* 2003 EWHC 3415 (Queens Bench), an electric utility (LPN) had its power lines damaged by an allegedly negligent construction company. 24 Seven repaired the damage at its own cost, and the utility assigned the right to collect the cost of the damage from the allegedly negligent party with the following language: "As owner of the Network [sic] LPN wishes to assign 24seven [sic] the right to claim the cost of the damage from the said third parties." *Id.* ¶ 5. The court held that this was a valid assignment of a tort claim pursuant to section 136.

Weddell v Pearce & Major, 1986 W. No. 385 (Chancery Division) involved a bankruptcy trustee who statutorily came into possession of the legal malpractice claims of the bankrupted plaintiffs. The trustee assigned back "all claims and legal rights of action which the trustee may have against Messrs. Pearce & Major, Mr. Robin Miller and all debts due therefrom for the benefit of the property and estate of each of the bankrupts and the bankrupts jointly," *id.* at 29 ¶ F, to the plaintiffs, with an agreement to remit any recovery to the trustee for the payment of debts. The defendants objected to plaintiffs'

standing because they were not notified of the assignment, as required by section 136. The court held that there was an equitable assignment of the claims, as the written assignment to the trustee manifested a intention to assign an identifiable cause of action.

In *Batey v Jewson,* 2008 EWCA Civ. 18 (Court of Appeal), a real estate developer which was winding up its business, assigned the plaintiff-shareholder "any sums of money recoverable from the dispute with Jewson," who had allegedly supplied the developer with defective building materials. The court looked at the assignment in the context of the factual background, and held that, because the contract was an informal one, drafted without the assistance of counsel, it was sufficient to assign causes of action.

In response, plaintiff has cited a number of cases to support the contention that not only is express language is unnecessary, an equitable assignment requires no language at all. *Coulter v. Chief Constable of Dorser Police,* [2004] 1 WLR 1425 (Chancery Division) is proffered in support of this contention, however, the circumstances of *Coulter* are so unusual, it is not relevant to the current analysis.[7]

Ifejika v Ifejika, [2009] Claim No. 08C00480 (Patents Court) is also submitted in support of the "no assignment language necessary" contention. This action involved a joint venture between two brothers, that was controlled by the claimant brother. On application for summary judgment, the court held that it was possible that there was an

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[7] The equitable assignment of a judgment debt from the former chief constable of Dorset, to the current chief constable; the chose in action was to benefit the officeholder, and was not personal to the former chief constable.

equitable assignment of a design right (intellectual property) despite the lack of any contractual language of assignment. The court allowed the case to move on to trial, however; it made no determination if an equitable assignment had actually been made.

In another attempt to argue that no assignment language is required, plaintiff refers to *Allied Carpets Group v. Macfarlane,* [2002] EWHC 1155 [TCC] [Queens Bench], which involved the question of whether warranties accompanied the assignment of a lease. *Allied* quotes *Kijowski* for the premise that an equitable assignment may follow any form, as long as an intent to assign is manifested, followed by an act of the assignor showing the passage of the chose in action to the assignee. The *Allied* court held that the documents contained no expression of intent to assign the warranties, and did not find an equitable assignment. The *Allied* court reasoned that in a lengthy sales agreement, which was drafted by experienced counsel, an assignment would not be left for a court to imply.

> [I]t does not take many words to assign the benefit of a warranty: and where in other respects many words were required, words were not spared. The agreement for sale itself is 43 pages long, and the total number of pages used, including the Schedules was 606. If Harris Queensway and the Liquidator had told their solicitors Clifford Chance that they wished to assign the benefit of the Warranty, I cannot believe that Clifford Chance would have drafted a document that left such an assignment to be implied

Allied Carpets Grp. v. Macfarlane, [2002] EWHC 1155 [TCC] [Queens Bench] ¶ 35. This is damaging to plaintiff's argument; the sale of complicated securities is far more complex than an assignment of a lease, and the transaction documents are far more

voluminous than 43 pages. As in *Allied,* plaintiff was assisted by very highly regarded counsel in drafting the SPAs and Master Framework.

The Court finds defendants' argument persuasive; an English court would not find an equitable assignment of tort claims in the sale of complex securities by sophisticated financial institutions without any reference to those claims. Additionally, plaintiff has submitted no judicial authority of an equitable assignment without express reference to claims, or their fruits.

The court also does not agree with plaintiff's argument that, given the contextual background of the transactions, an English court would imply an assignment of tort claims. The purpose of implication is to manifest the parties intentions, looking at the words and overall context of an agreement.

> The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so

Attorney General v. Belize Telecom, 1 WLR 1988 ¶17 (Privy Council 2009). Before implying terms into a contract, the court will take into account the forseeability of the event, and the draftsmanship of the contract.

> It is to be noted that, in the present case, the event in question is not one which might have been difficult to foresee; nor is the risk of it one which the parties might naturally have overlooked. . . . Also, there is no doubt as to the care taken in constructing the document: all parties were

> advised throughout by firms of the highest quality, and it is obvious on their face that the contracts have been carefully crafted.

Proctor & Gamble v. Svenska Cellulosa Aktiebolaget, [2012] EWHC 498 ¶ 84(Chancery Division).

Plaintiff's motion papers and pleadings detail that Sachsen Europe devised a plan to place all the "toxic" RMBS into a "bad bank." Onslow describes how the Irish SPVs lost access to funding in late 2007, as the RMBS plummeted in value, leading to the "bad bank" strategy. *See* Auld Aff. ¶ 63. When transferring distressed assets through a number of entities, and depositing the assets in an entity which was specifically created to hold those distressed assets, it is not unforeseeable that the final purchaser may wish to pursue claims against the issuer of the assets. Additionally, the SPAs and Master Framework bears the imprimatur of Linklaters LLP, a very highly regarded international law firm. If it had been the intention between the parties who drafted the SPAs and Master Framework to assign causes of action in tort, it would have been included by express language.

III. Conclusion

Accordingly, it is,

ORDERED that defendants Morgan Stanley, Morgan Stanley & Co., Inc. ("MS&Co."), Morgan Stanley ABS Capital I Inc. ("MSAC"), Morgan Stanley Capital I Inc. ("MSC"), Morgan Stanley Mortgage Capital Inc. ("MSMC"), and Morgan Stanley

Mortgage Capital Holdings LLC's motion to dismiss is granted and the second amended complaint is dismissed in its entirety as against said defendants, with costs and disbursements to said defendants as taxed by the Clerk of the Court, and the Clerk is directed to enter judgment accordingly in favor of said defendant.

This constitutes the decision and order of the court.

Dated: New York, New York
April 17, 2014

ENTER:

Hon. Eileen Bransten, J.S.C.