UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

BANK OF AMERICA, N.A., and BANC OF AMERICA SECURITIES LLC, Plaintiffs,	:	
v.	:	08 Civ. 9265 (PAC)
BEAR STEARNS ASSET MANAGEMENT INC., RALPH CIOFFI, MATTHEW TANNIN, and RAYMOND McGARRIGAL, Defendants.	:	ECF Case

PLAINTIFFS' MEMORANDUM OF LAW
IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

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Dated: March 24, 2009

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Plaintiffs submit this memorandum in opposition to the motions to dismiss.[1]

INTRODUCTION

As the Complaint in this case makes clear, Defendants – two of whom are under federal indictment for fraud – deceived Bank of America,[2] breached a contract requiring prompt (not belated) disclosure of adverse events, and waited until the day *after* the Bank had assumed enormous risks to tell Plaintiffs what Defendants were obligated to disclose weeks if not months earlier: that two of BSAM's most prominent hedge funds – the source of most of the assets for a transaction scheduled to close the next day – were about to collapse. And yet, a reader of BSAM's motion would know almost none of this. Unwilling or unable to address the allegations actually in the Complaint, Defendants ignore large portions of it, mischaracterize others, and resort to irrelevant documents far outside the Complaint. Perhaps the most persistent refrain in Defendants' papers – really, a rehearsal for their defense at trial – is that the Complaint fails to establish proximate cause. But a complaint need not *prove* proximate cause – that threshold must be crossed (and Plaintiffs fully expect to cross it) only after the close of discovery. Defendants' reasons for dismissing the Complaint are entirely meritless.

BACKGROUND[3]

In or about late 2006, Bank of America began to discuss with BSAM a "CDO-Squared

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[1] McGarrigal has filed a memorandum of law but has not noticed a motion to dismiss. See docket sheet (Item 33). Nevertheless, in an abundance of caution, Plaintiffs will respond to the arguments in his memorandum.

[2] Capitalized terms used but not defined herein have the meanings assigned to them in the Complaint.

[3] The following account is drawn from the Complaint, including the documents Plaintiffs annexed to it. The additional documents that BSAM has submitted are not appropriate for consideration given that the Complaint does not even refer to, much less rely on, them. *See Patane v. Clark*, 508 F.3d 106, 111 n.2 (2d Cir. 2007) (on motion to dismiss, court may consider outside documents "'that the plaintiffs either possessed or knew about *and upon which they relied in bringing the suit*'" (emphasis added)); *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002) ("[W]e reiterate here that a plaintiff's *reliance* on the terms and effect of a document in drafting the complaint is a necessary prerequisite to the court's consideration of the document on a dismissal motion; *mere notice or possession is not enough*." (second emphasis added)); *accord Global Network Commc'ns, Inc. v. City of New York*, 458 F.3d 150, 156 (2d Cir. 2006). The sole arguable exception is Sheldon Decl. Ex. C, but substantially all of it was already quoted at Compl. ¶ 70.

Transaction" in which a special-purpose entity (the Issuer) would acquire, mostly from two of BSAM's in-house hedge funds, a portfolio of collateralized debt obligations (CDOs), and then issue tranches of securities (the "Securities") backed by that collateral (the "Collateral"). BSAM would be the Collateral Manager, meaning that it would manage the Issuer's portfolio. The most senior (least risky) tranche, the so-called Super-Senior Notes, would be marketed to third-party investors and backed by Bank of America in the form of a "put" option; the remaining tranches of securities would be sold back to Defendants' hedge funds. Compl. ¶¶ 2, 17-20.

A. The Engagement Letter

On March 9, 2007 the Bank and BSAM executed an Engagement Letter outlining the transaction and imposing certain obligations on the parties. *See id*. ¶ 18, Ex. A. Because "[t]he financial stability and market reputation of BSAM and the Bear Stearns Funds were of paramount importance to the Bank," the parties agreed that BSAM would "notify [Bank of America] of the occurrence of" certain types of "Collateral Manager Events" and, moreover, would do so "*promptly* after the Collateral Manager becomes aware of such occurrence." *Id*. ¶ 22, Ex. A § 4(c) (emphasis added). In fact, "Collateral Manager Events" did occur and continue. *Id*. ¶¶ 23, 57-58, 119-122. No later than April and May, and quite possibly for months earlier than that, the Funds experienced an ever-deepening liquidity crisis that culminated in their collapse in June 2007. *Id*. ¶¶ 28-56, 106-115.

B. Defendants' Concealment of Problems with the Funds

Although the Engagement Letter was executed in March 2007, and the transaction did not close until the end of May, Defendants failed to disclose the Funds' severe problems to the Bank.

The Complaint's account begins in the fall of 2006, when a moratorium on intra-firm trading deprived the first Fund of an important source of liquidity. *Id*. ¶¶ 28-30. By the spring of

2007, Defendants "were privately becoming increasingly desperate about" the Funds' liquidity problems. *Id*. ¶ 38. On March 2, 2007, Defendant Ralph Cioffi met with Defendants Matthew Tannin and Raymond McGarrigal, "remarked on how difficult February had been for the Funds," and "directed the [others] not to discuss the Funds' grave condition with anyone else." *Id*. ¶ 39. On March 3, Cioffi emailed Tannin: "the worry for me is that sub prime losses will be far worse than any thing people have modeled . . . ." *Id*. ¶ 40. Less than two weeks later, Cioffi wrote to a colleague: "I'm fearful of these markets. Matt [Tannin] said it's either a melt down or the greatest buying opportunity ever, I'm leaning more towards the former. As we discussed, it may not be a melt down for the general economy but in our world it will be." *Id*. And by the end of that month Cioffi was "sick to my stomach over our performance in march." *Id*.

Internal BSAM reports "showed throughout March 2007 that the High-Grade Fund was in an extremely precarious position," and Cioffi, Tannin, and McGarrigal even discussed the possibility of merging it with the Enhanced Leverage Fund. *Id*. ¶ 42. On April 22, Tannin sent an email from his personal account to personal accounts used by Cioffi and McGarrigal saying that "over the last few months" he had believed that the Funds should either be closed or "get very very aggressive." *Id*. ¶ 45. Tannin asked: "Who do we talk to about this? . . . Outside counsel? (And here we have to be careful because our outside counsel is BSAM's counsel. NOT our counsel – This is [a] very big issue we at least need to think about.[)]" *Id*. The next day Tannin cautioned Cioffi not to disclose the extent of the Funds' troubles to BSAM's employees. *Id*. ¶ 46.

Yet throughout this time Defendants continued to assure investors that the Funds would be immune from the softening credit market and would earn a profit. *Id*. ¶¶ 38, 44, 47. In February Cioffi told investors: "We're going to make money on this . . . We don't believe what the markets are saying." *Id*. ¶ 39. In March, Tannin told investors that "we wouldn't have made money in February if we were long, or overexposed, to subprime," and that "it was a very bad time to redeem." *Id*. ¶ 44. Tannin also falsely told investors and salespersons for the Funds that he was adding more of his own money to the Funds. *Id*. Similarly, although Cioffi initiated the withdrawal of $2 million of his own money from one of the Funds, he did not inform investors even as BSAM's sales force was telling investors that the Funds' managers were increasing their personal investments. *Id.* ¶ 41.

On April 25, 2007, Cioffi, Tannin, and McGarrigal held a telephone conference for investors. During the call Cioffi estimated that the Funds would have a loss of less than 1% for April, and assured investors that "at this point in time, the [Enhanced Leverage Fund] has significant amounts of liquidity." *Id*. ¶ 47. Tannin added reassuring words of his own. *Id*. Cioffi also said that "[t]he next big redemption date would be June 30th, and as of now, I believe we only have a couple million [dollars] of redemptions for the June 30 date." *Id*. ¶ 48. Defendants repeated their optimistic assessment of the Funds' current and future performance numerous times in late April and May. *Id*. ¶¶ 48, 49, 109.

But Defendants knew that their representations were false. Both Funds in fact suffered dramatic losses in April. *Id*. ¶¶ 49, 106-107. The Funds, moreover, were actually facing significant redemptions for April 30 and May 31 (and so June 30 was not the "next big redemption date"), as well as for June 30, when much more (by orders of magnitude) than "a couple million" were scheduled to be redeemed. *Id*. ¶¶ 43, 49. On May 13, Cioffi wrote to Tannin and McGarrigal: "I think . . . the [Enhanced Leverage Fund] has to be liquidated which seems to be somewhat certain given the redemption activity." *Id*. ¶ 51. On May 26, Tannin sent a lengthy email to Cioffi and McGarrigal observing that the Funds were "in danger of a wipe out because of a lack of liquidity" and referring to an undisclosed plan to sell the Funds to another firm. *Id*. ¶¶ 53-54. On May 31, Cioffi and Tannin exchanged emails debating whether to disclose to investors a dramatic 18.97% loss for April (the number calculated by BSAM's oversight committee for fund valuation), or the less alarming number (6.5%) that BSAM had used earlier, including in a communication with Bank of America. *Id*. ¶¶ 106-108.

C. The CDO-Squared Transaction

Despite daily interaction with Defendants, Bank of America did not and could not know that the Funds were in such dire straits. The Bank accordingly prepared for the CDO-Squared Transaction. *Id*. ¶¶ 24, 61-62. To facilitate the closing of the transaction, on May 22 the Bank purchased from the Funds approximately $2.9 billion of assets that were to be sold to the Issuer as the initial Collateral at closing, which was scheduled for May 24. As the Defendants knew, once the Bank purchased those assets, the Bank – rather than the Funds – bore the risks associated with those assets, as well as the risk that the transaction would not close. *Id*. ¶ 62. The Bank would not have agreed to purchase those assets had it known the truth about the Funds' precarious financial condition. *Id*. ¶ 63.

Defendants waited until the Bank had taken the assets onto its books. And then, late on May 23 – the night before closing – Defendants at long last disclosed that one (but not both) of their Funds had received so many redemption requests that its continued existence was threatened. *Id*. ¶ 70. Defendants had long known of the redemptions, but deliberately withheld this information until the Bank was already in harm's way. *Id*. ¶¶ 68, 74.

D. The Repurchase ("Repo") Agreements

Bank of America's "repo" department regularly provided financing to the Bear Stearns Funds.[4] *Id*. ¶ 97. The Bank continued to fulfill that role throughout May of 2007, including by

[4] A "repo," or repurchase agreement, is a financing in which title to the asset serving as collateral transfers to the party extending financing. *See id*. ¶ 29.

agreeing to provide $750 million in financing on or about May 24 for some of the securities issued in the CDO-Squared Transaction. *Id*. ¶ 101. Each repo financing was governed by a "master agreement" signed by Tannin. Pursuant to these agreements, each Fund represented, in connection with *each* repo transaction, that "[n]o material adverse change in [its] financial condition" had recently occurred. *Id*. ¶¶ 98-100, Ex. C at 11, 27. The Funds and Defendants knew that the representations about the Funds' financial health were false as to some or all of the May 2007 repo transactions. Indeed, those transactions were possible only because Defendants caused the Funds not to disclose that they were about to implode. *Id*. ¶¶ 97, 102-104.[5]

E. The Collapse of the Funds and Bank of America's and the Issuer's Losses

On June 7, 2007, BSAM publicly acknowledged what Defendants had long concealed: the Enhanced Leverage Fund would be unable to satisfy investors' redemption requests. *Id*. ¶¶ 110-111. By the middle of June, creditors had made so many "margin calls" that BSAM was forced to liquidate much of both Funds' holdings, effectively ending their life. *Id*. ¶ 115.

The Funds' collapse foreseeably harmed Bank of America and the Issuer in a number of interrelated ways – each of which is set forth in the Complaint. First, the rapid liquidation of the Funds' holdings increased the supply of CDO and CDO-squared assets (which were always thinly traded), and thereby drove down the value of (a) the Issuer's portfolio (which consisted of CDOs) and (b) the Securities, which were backed by that portfolio. (The Bank owned or backed the Securities via the put option and the repo trades.) Second, the Funds' demise eliminated two of the world's biggest buyers of CDO-type assets, thus reducing market demand and similarly devaluing the Issuer's portfolio and the Securities backed by it. *Id*. ¶¶ 113, 116, 123-127.

[5] The master agreements expressly required that communications with the Bank relating to repo transactions – including notice of any material adverse change – be sent to specified addresses in New Jersey and North Carolina. *Id*. Ex. C at 8, 13-15, 24, 30. No such notice was sent, at least not in May 2007.

Third, the value of assets backed by an actively managed portfolio depends in part on the market's evaluation of the portfolio manager. The Securities at issue here were backed by a portfolio *managed by BSAM*. Once the market learned that BSAM's flagship Funds – despite all of the earlier denials – had imploded, the market reassessed BSAM's reputation and thus the riskiness of the Securities. Relatedly, the revelation that the Funds – which had an extensive portfolio of mortgage-backed securities and were managed by a well-known and respected manager – had collapsed caused the market to devalue mortgage-backed CDO and CDO-squared securities in general. *See id*. ¶¶ 14, 22, 57, 121, 123-127, 130.

ARGUMENT

Apart from Rule 9(b), the Federal Rules of Civil Procedure require only "a short and plain statement of the claim showing that the pleader is entitled to relief." Fed. R. Civ. P. 8(a). Although a plaintiff may be required to "amplif[y] [on] facts in certain contexts," *Abdullahi v. Pfizer, Inc.*, ___ F.3d ___, No. 05-4863-cv, 2009 WL 214649, at *4 n.6 (2d Cir. Jan. 30, 2009); *see also Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955, 1974 (2007), in general "[s]pecific facts are not necessary; the statement need only give the defendant fair notice of what the . . . claim is and the grounds upon which it rests." *Erickson v. Pardus*, 551 U.S. 89, 127 S. Ct. 2197, 2200 (2007) (quotation marks omitted); *see also Boykin v. KeyCorp*, 521 F.3d 202, 215 (2d Cir. 2008) ("[B]oth *Twombly* and *Erickson* explicitly disavow that Rule 8(a) requires any plaintiff . . . to plead 'specific facts.'"). On a motion under Rule 12(b)(6), a court must construe the complaint liberally, accept its allegations as true, and draw all reasonable inferences in the plaintiffs' favor. *E.g., Burch v. Pioneer Credit Recovery, Inc.*, 551 F.3d 122, 124 (2d Cir. 2008).

I. Plaintiffs Have Stated a Claim for Breach of the Engagement Letter

BSAM's meritless attack on the First Cause of Action relies primarily on contentions that cannot be considered on a motion to dismiss.[6]

A. The Impending Collapse of the Funds Triggered the Disclosure Obligation Under Section 4(c) of the Engagement Letter

BSAM first contends that the Engagement Letter's disclosure requirement was never triggered. BSAM Mem. ("Mem.") 11-13. Section 4(c)(iii) of the Engagement Letter required BSAM to disclose to the Bank "any . . . adverse . . . event or change at [BSAM] which would reasonably be expected to impair" the Bank's "ability . . . to market the Securities issued in connection with the Transaction." Compl. Ex. A at 4. Contrary to BSAM's suggestion (at 11), the destruction of two of BSAM's flagship in-house hedge funds was certainly an event or change "at BSAM." As the Complaint alleges in detail, the demise of these funds shattered BSAM's reputation – and with it the marketability of the Securities. Compl. ¶¶ 23-24, 57, 121, 128, 130. It is therefore a false choice to suggest, as BSAM does, that an implosion "at the fund level" cannot also be "an 'event or change at [BSAM]'" for purposes of Section 4(c)(iii).[7]

The other critical portion of the disclosure clause is Section 4(c)(i), which refers to "a material adverse change, or development that would reasonably be expected to result in a material adverse change, in the business, properties, financial condition or prospects of" BSAM. *Id*. Ex. A at 4. The Complaint explains why this clause, too, was independently triggered. Specifically:

- Paragraphs 58 and 120, explaining that BSAM's revenues were based on the amount and performance of the assets it managed, and so a precipitous decline by two of its largest funds would be expected to – and did – severely damage BSAM's financial health.

[6] Not surprisingly, this section of BSAM's brief cites only one case, *see* BSAM Mem. 11 – *U.S. Bank N.A. v. Ables & Hall Builders*, 582 F. Supp. 2d 605 (S.D.N.Y. 2008) – and that case illustrates the very principle that dooms BSAM's argument: a contract claim may not be dismissed on the basis of a defense that is not apparent from the face of the complaint and the resolution of which would require a factual inquiry. *See id*. at 610-11.

[7] Even if the contract were considered ambiguous on this point (which it should not be), the ambiguity would have to be resolved in Plaintiffs' favor at this stage. *E.g.*, *Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 425 F.3d 119, 122 (2d Cir. 2005).

- Paragraphs 58, 119, and 121, explaining that dramatic losses for the Funds would be expected to – and did – damage BSAM's reputation as an asset manager and thus its ability to maintain its assets under management and raise new funds – in other words, its "business," "financial condition," and "prospects."

- Paragraphs 3 and 119, explaining that the collapse of the Funds decimated not just BSAM's reputation but that of the entire Bear Stearns firm, and contributed to the ultimate demise of Bear Stearns as an independent institution.

- Paragraphs 23-24, 71, 122, and 128, spelling out that throughout the spring of 2007, the imminent demise of the Funds – of which Defendants were fully aware (*see id*. ¶¶ 25-55) – continuously triggered the § 4(c) disclosure obligation.

Remarkably, BSAM's memorandum ignores all of this. *See* Mem. 12 ("[The] complaint is devoid of any explanation of how the financial conditions of the Funds triggered the disclosure obligations . . . ."). Instead BSAM asserts that "the Funds were only a limited part of BSAM's business." *Id*. Even if that contention were accepted, the Funds *were* part of BSAM's "business" and were two of the "properties" managed by it; their collapse would be a "material adverse change" within the plain meaning of Section 4(c)(i). In any event, the Complaint alleges that the Funds were a *major* component of BSAM's business (*e.g.*, Compl. ¶¶ 14, 58 (Funds among BSAM's "largest and most prominent"), ¶ 25 (reporting that fees from the High-Grade Fund at one point were 75% of BSAM's revenues), ¶ 8 (senior manager of the Funds granted membership on BSAM's board of directors), ¶ 120 (BSAM's financial health severely damaged by collapse of Funds given loss of management revenues)), and the various allegations and (improperly introduced) extraneous items on which BSAM relies do not begin to suggest otherwise.[8]

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[8] In its effort to downplay the importance of the Funds to its business, BSAM relies on a self-description in an outside document (to which the Complaint does not refer or in any way rely on, *see* note 3, *supra*) as catering to a diverse clientele and managing different types of investment portfolios. Mem. 12. But this does not contradict Plaintiffs' allegation that the Funds constituted a major portion of BSAM's business. BSAM also attempts (again on the basis of a document nowhere mentioned or relied on in the Complaint) to compare the $54.1 billion in funds supposedly under management with the $1 billion in investor equity in the Enhanced

BSAM also asserts (at 12) that the Complaint fails to show that "BSAM was . . . concerned about its overall financial condition." That is not true.[9] In any case, BSAM's contractual obligations turned not on whether BSAM was "concerned" about its own condition but on whether it was actually aware of (among other things) any occurrence that "would reasonably be expected to" have the effects set forth in Section 4(c). Nor does it matter whether the Complaint has alleged that "BSAM's ability to function as [Collateral Manager] was in any way impaired by the liquidation of the Funds," *id*. at 13, 14. Section 4(c) does not even mention BSAM's continued service as Collateral Manager, much less limit the disclosure obligation to instances in which BSAM could not continue as Collateral Manager.

B. BSAM Breached Its Disclosure Obligation

BSAM next contends (at 13-14) that it in fact complied with its disclosure obligations under the Engagement Letter when it gave notice at 6:30 p.m. on May 23 that the Enhanced Leverage Fund had experienced heavy redemption requests and might not survive, *see* Compl. ¶ 70. That is a puzzling argument. The contract explicitly required notice "*promptly*" after BSAM became aware of a Collateral Manager Event, *see* Compl. Ex. A § 4(c), and the Complaint repeatedly alleges that BSAM was aware of the impending collapse of both Funds long before May 23. Indeed, the Complaint alleges, BSAM waited until literally the night before the May 24 closing, and thus was in continuous breach of the Engagement Letter for much of the

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Leverage Funds. *Id*. at 12-13. Among other flaws, this is simply misleading: the document in question makes it quite clear that BSAM "*and its affiliates*" (including Bear, Stearns & Co. Inc.) *all together* – not, as the brief suggests, BSAM alone – had the $54.1 billion under management. Sheldon Decl. Ex. J. at 28 (emphasis added); *contra* Mem. 12-13.

[9] *See, e.g.*, Compl. ¶ 40 (describing March 15 email from Cioffi: "I'm fearful of these markets. . . . As we discussed it may not be a melt down for the general economy but in our world it will be."), ¶¶ 55-56, 117 (describing enlistment of top executives to deal with the crisis and "the major strategic decisions *affecting BSAM* and the Funds" (emphasis added)).

spring of 2007 right up to, and beyond, the May 23 disclosure.[10]

BSAM also invokes defenses of materiality, fair warning, and reliance that not only are inappropriate at the motion to dismiss stage, but moreover have no application to a contract claim. Mem. 14-15. Nor is it relevant that redemption requests at the High-Grade Fund are pled on information and belief and without specific dates, amounts, and "other such details," *id*. at 14. The Federal Rules permit the former when (as here) "information [is] particularly within [a defendant's] knowledge and control," and do not (even after *Twombly*) require "specific facts." *Boykin*, 521 F.3d at 215.

C. BSAM's Breach Caused Plaintiffs' Damages

BSAM next advances (at 15) a causation defense. In BSAM's view, Plaintiffs' losses were not caused by the breach of contract because Bank of America could have declined to close the transaction on May 24. Among other failings, this argument elides a central allegation of this case: once Bank of America purchased the Collateral from the dying Funds *on May 22*, it was stuck. It bore the risk associated with the portfolio of assets backing the CDO-Squared Transaction, as well as the risk that the transaction would not close. *E.g.*, *id*. ¶¶ 62, 63, 65, 67-68. Had the Bank derailed the transaction, it would have been left holding assets whose value –

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[10] *See, e.g.*, Compl. ¶ 1 (contractual obligations breached "throughout extensive dealings" in the "spring of 2007"), ¶ 3 (BSAM concealed collapse "[o]ver the course of many months"), ¶¶ 23-24 (disclosure obligation triggered in April and possibly earlier), ¶¶ 57-58 (undisclosed liquidity crisis triggered disclosure obligation), ¶¶ 61, 64, 68 ("Defendants had been aware of the redemption requests at both Funds for some time and were anticipating that those requests would continue. . . . Yet Defendants deliberately concealed all such information until after . . . Bank of America had purchased $2.89 billion worth of Collateral"), ¶¶ 128-129 (contractual disclosure provision triggered by Funds' liquidity crisis "by at least the spring of 2007"), ¶ 135 (BSAM breached Engagement Letter in that Section 4(c) events occurred and continued, with no notice to Bank of America); *see also id.* ¶¶ 38-46 (detailing Defendants' increasing desperation in February, March, April and May 2007, including "extremely precarious position" of High-Grade Fund in March 2007), ¶¶ 47-49 (Defendants concealed significant redemption requests in late April and early May); ¶ 49 (dramatic losses suffered in April), ¶ 51 (May 13 email from Cioffi: "I think . . . the [Enhanced Leverage Fund] has to be liquidated which seems to be somewhat certain given the redemption activity."), ¶ 53 (by mid-May, deterioration so severe that Defendants were developing undisclosed plan to sell the Funds), ¶ 54 (May 26 email from Tannin: "We have[] 2 hedge funds . . . that are in danger of a wipe out because of a lack of liquidity."), ¶ 74 (Cioffi admitted he knew of the redemptions for some time).

thanks to the precise circumstance concealed by BSAM until it was too late – was about to collapse. *See* pages 6-7 above; sections II.D.-E., *infra*.

In all events, BSAM's argument presupposes, mistakenly, that a plaintiff must allege causation and damages in order to state a valid claim for breach of contract. The New York Court of Appeals and Second Circuit have said just the opposite: once a contract is breached, at least nominal damages are available and thus "all of the elements necessary to maintain a lawsuit" are present. *Ely-Cruikshank Co. v. Bank of Montreal*, 81 N.Y.2d 399, 402 (1993) (quotation marks omitted); *accord T&N PLC v. Fred S. James & Co.*, 29 F.3d 57, 60 (2d Cir. 1994) ("All of the necessary elements for relief" are "present at the time of breach [of contract]."); *see also Semi-Tech Litig. LLC v. Bankers Trust Co.*, 353 F. Supp. 2d 460, 487 (S.D.N.Y. 2005) (awarding judgment on contract claim for $1 where no damages were caused by the breach), *expressly adopted as Circuit law*, 450 F.3d 121, 123, 126-127 (2d Cir. 2006).[11]

In sum: BSAM's attempt to litigate prematurely the merits of the claim for breach of the Engagement Letter should be rejected. The First Cause of Action states a claim.[12]

II. Plaintiffs Have Stated a Claim for Fraud Related to the CDO-Squared Transaction

Defendants' deliberate nondisclosures induced Bank of America to purchase $2.9 billion worth of assets from the Funds on May 22, which in turn led the Bank to back the Super-Senior Notes two days later. Bank of America would not have entered into these transactions if

[11] Relatedly, BSAM suggests (at 31, 32) that contract claims are subject to the same type of loss causation analysis as federal securities fraud claims. The Second Circuit recently rejected a very similar fallacy. *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171, 184-85 (2d Cir. 2007) (overruling use of "federal cases addressing securities fraud" to analyze causation and damages for breach of contract based on non-disclosures). Not surprisingly, BSAM's only authority for this point pre-dates *Merrill Lynch* – and relied on the very ruling <u>reversed</u> by *Merrill Lynch*. *See* Mem. 32 (citing *CompuDyne Corp. v. Shane*, 453 F. Supp. 2d 807, 832 (S.D.N.Y. 2005) (citing *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, No. 02 Civ. 7689 (HB), 2005 WL 1663265 (S.D.N.Y. July 18, 2005))).

[12] Plaintiffs dispute that any of their claims are insufficiently pled, but in the event this Court disagrees, Plaintiffs request leave to replead to cure any alleged deficiencies in any claims.

Defendants had told the truth before May 22. Accordingly, the Second Cause of Action asserts that Defendants are liable for fraud and fraudulent inducement (which Plaintiffs will refer to collectively as "fraud"). Compl. ¶¶ 138-149. To sue for fraud based on concealment, a plaintiff must allege "(1) failure to discharge a duty to disclose; (2) an intention to defraud, or scienter; (3) reliance; and (4) damages." *TVT Records v. Island Def Jam Music Group*, 412 F.3d 82, 90-91 (2d Cir. 2005). A duty to disclose exists when "one party possesses superior knowledge, not readily available to the other, and knows that the other is acting on the basis of mistaken knowledge." *Id*. at 91 (quoting *Brass v. Am. Film Techs., Inc.*, 987 F.2d 142, 150 (2d Cir.1993)). The Complaint more than sufficiently alleges each of these elements.

A. The Fraud Claim Is Not Preempted by the Engagement Letter

BSAM first contends (at 16-19) that the existence of a contract (the Engagement Letter) forecloses any liability for fraud.[13] BSAM relies on *Bridgestone/Firestone, Inc. v. Recovery Credit Servs., Inc.*, 98 F.3d 13, 20 (2d Cir. 1996), but that case stands only for the principle, irrelevant here, that a breach of contract cannot be converted into a fraud claim merely by alleging that the defendant falsely stated its intent to perform the contract. *E.g., Randolph Equities, LLC v. Carbon Capital, Inc.*, No. 05 Civ. 10889 (PAC), 2007 WL 914234, at *7 (S.D.N.Y. Mar. 26, 2007); *see also Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171, 184 (2d Cir. 2007) (recognizing distinction in New York law between "a promissory statement of what will be done in the future" giving rise only to a contract cause of action and a "misstatement[] or omission[] of present facts" giving rise to "a separate cause of action for fraudulent inducement."). As *Bridgestone* itself recognized, its bar does not apply "if the plaintiff

[13] Tannin – but not Cioffi and McGarrigal – adopts this argument wholesale. *See* Tannin Mem. 3; Cioffi Mem. 3; McGarrigal Mem. 1, 5-10. But the argument cannot insulate Tannin from primary liability for fraud. Beyond the points made in text above, a fraud claim cannot possibly duplicate a contract claim with respect to a defendant who was not even a *party* to the applicable contract. "It goes without saying that a contract cannot bind a nonparty." *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002).

(1) demonstrates a legal duty separate from the duty to perform under the contract; (2) points to a fraudulent misrepresentation that is collateral or extraneous to the contract; or (3) seeks special damages that are unrecoverable as contract damages." *Id*. at 183 (citing *Bridgestone*, 98 F.3d at 20).[14] Plaintiffs easily satisfy at least the first two of these independently sufficient criteria.

As the Complaint expressly alleges (*e.g.*, ¶¶ 62-65, 139-140, 142-143), Defendants had a duty, based on their superior knowledge (which was not available to Bank of America, "readily" or otherwise), to disclose to the Bank that, in assuming the $2.9 billion of Collateral, the Bank was acting on the basis of mistaken information. This duty did not arise from the Engagement Letter – indeed, it would have existed even if there had been no Engagement Letter. The duty arose rather from the well-pleaded circumstances: Defendants were selling assets to the Bank while fully aware that the Bank lacked critical facts available only to Defendants. *See, e.g.*, *Brass*, 987 F.2d at 151-52 (duty to disclose established because seller of securities knew that purchaser did not know of securities' transferability restrictions).

BSAM counters (at 18, 19 n.10) with Section 11(iii) of the Engagement Letter,[15] which reads in pertinent part (Compl. Ex. A at 9 (emphasis and bracketed numbers added)):

> [1] neither party has assumed nor will assume an advisory, agency or fiduciary responsibility in favor of the other party *with respect to any of the transactions contemplated hereby* . . . and [2] neither party has any obligation to the other party *with respect to the Offering* except the obligations expressly set forth in this Letter Agreement.

"Offering" is defined as the placement of the Issuer's securities, *id*. § 1(b), and refers neither to

[14] BSAM's New York Court of Appeals cases (*see* Mem. 16) are to the same effect. *See Clark-Fitzpatrick, Inc. v. Long Is. R.R. Co.*, 70 N.Y.2d 382, 389 (1987); *N.Y. Univ. v. Cont'l Ins. Co.*, 87 N.Y.2d 308, 316 (1995).

[15] BSAM also argues in a footnote (at 19 n.10) that the allegation that Defendants knew that Plaintiffs were acting on "mistaken knowledge" is insufficiently particularized. But Rule 9(b) says that "knowledge . . . may be alleged generally." In any event, the Complaint makes clear in great detail that Defendants knew (i) that their Funds were about to collapse, (ii) that nobody outside of BSAM, including Bank of America, knew the Funds were about to collapse, and (iii) that Bank of America was operating on the basis of incorrect information about the Funds' condition. *See* Compl. ¶¶ 3, 28-51, 53-55, 59, 62-64, 68, 138-140, 143.

the entirety of the CDO-Squared "Transaction" (*see id*. § 1(a)) nor to the Bank's May 22 purchase of Collateral (*see id.* § 3). Section 11(iii), therefore, merely (1) disclaims *fiduciary-style* relationships between BSAM and Bank of America with respect to *all* of the transactions contemplated by the Engagement Letter, and (2) disclaims general non-contractual obligations with respect to *the Offering only* – but not with respect to the Bank's May 22 purchase or other matters. The parties, in other words, did *not* disclaim the duty that Defendants violated.

Plaintiffs also satisfy the second *Bridgestone*/*Merrill Lynch* criterion. The fraud at issue here occurred *after* the Engagement Letter was signed and was therefore collateral or extraneous to it. *See, e.g., First Bank of the Ams. v. Motor Car Funding, Inc.*, 690 N.Y.S.2d 17, 20-21 (1st Dep't 1999) (post-contractual misrepresentations were "collateral" to contract even though they also breached the contract); *Eagle Comtronics, Inc. v. Pico Prods., Inc.*, 682 N.Y.S.2d 505, 507 (4th Dep't 1998) ("The complaint states a viable cause of action for fraud. Plaintiff . . . alleges that, *after the contract was entered into*, defendant repeatedly *misrepresented or concealed existing facts*." (emphasis added)). Moreover, as BSAM concedes (at 21-22), the May 22 purchase was not even covered by the Engagement Letter. *See* Compl. Ex. A § 3. It is hard to see how the inducement of a transaction explicitly not covered by a contract, and occurring after that contract was signed, could be anything but collateral or extraneous to that contract.

To avoid these conclusions, BSAM implies (at 17-19) that conduct actionable as a breach of contract can never give rise to a fraud claim. But that is not the law. *Merrill Lynch* is on point: "That the alleged misrepresentations would represent, if proven, a breach of the contractual [obligation] as well does not alter the result. A plaintiff may elect to sue in fraud on the basis of misrepresentations that breach express [contractual obligations]." 500 F.3d at 184. Nor do BSAM's cases call into question any of these principles. The misrepresentation in *International*

CableTel Inc. v. Le Groupe Videotron Ltee, 978 F. Supp. 483, 487-88 (S.D.N.Y. 1997), was the precise type distinguished in *Merrill Lynch* and innumerable other cases: namely, a statement regarding future intention to perform a contract, not present facts. And in *Seven Hanover* and *Amy Axelrod*, *see* Mem. 17-18, the plaintiffs – unlike Plaintiffs here – failed to identify any "duties other than those specified in the contract," *Seven Hanover*, 2008 WL 464337, at *4; *accord Amy Axelrod*, 2007 WL 2412257, at *6 (fraud claim "rest[ed] entirely on the duties contained in the agreements"). In sum, the Engagement Letter does not bar the fraud claims.

B. The Complaint Is Replete with Particularized Allegations of Scienter

Defendants argue that the Complaint "does not allege *any* facts" to establish scienter.[16] Mem. 19. They reach this conclusion only by ignoring huge swaths of the Complaint.

A fraud plaintiff can plead scienter "either (a) by alleging facts to show that defendants had both motive and opportunity to commit fraud, or (b) by alleging facts that constitute strong circumstantial evidence of conscious misbehavior or recklessness." *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290-91 (2d Cir. 2006) (quotation marks omitted).[17] "Although speculation and conclusory allegations will not suffice, neither do we require 'great specificity' provided the plaintiff alleges enough facts to support 'a strong inference of fraudulent intent.'" *Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 169 (2d Cir. 2000); *see also Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 538 (2d Cir. 1999) ("'Whether a given intent existed is generally . . .' appropriate for resolution by the trier of fact.").

The Complaint readily establishes motive and opportunity. Opportunity is obvious from

[16] McGarrigal's separate arguments regarding scienter are addressed in the next section.

[17] This standard is enunciated most frequently in the securities fraud context, in which the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4(b)(2), now codifies a particularity requirement for allegations of scienter. Rule 9(b), however, says that scienter for fraud "may be alleged generally." Plaintiffs do not concede that the PSLRA's requirements for pleading scienter properly apply to their state-law claims, but nonetheless address some of those principles here.

Defendants' control over the Funds and all transactions and disclosures relating to them. As for a motive to deceive the Bank, the defendants were highly regarded asset managers, and yet were facing "2 hedge funds . . . in danger of a wipe out because of a lack of liquidity," Compl. ¶¶ 14, 16, 54. Defendants accordingly were desperate for liquidity to rescue not just the Funds, *see, e.g.*, *id*. ¶ 64, but their own "professional reputations as successful asset managers, as well as their employment," *id*. ¶ 60; *see also id*. ¶ 40 (Cioffi: "[I]t may not be a melt down for the general economy but in our world it will be."), ¶¶ 119-21 (BSAM's reputation and livelihood were devastated by the Funds' collapse).[18] The individual defendants even worried aloud that they might need their own counsel, not BSAM's, in light of their individual exposure.[19] *Id*. ¶ 45.

Defendants' desperate drive to save their Funds, reputations, and careers from collapse is worlds apart from a generic "desire . . . to increase [one's] compensation" or make a corporation "appear profitable," *Kalnit v. Eichler*, 264 F.3d 131, 139 (2d Cir. 2001), and easily qualifies as a "personal interest sufficient to establish motive," *Rombach v. Chang*, 355 F.3d 164, 177 (2d Cir. 2004); *see also Teamsters Local 445 Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 194 (2d Cir. 2008) (scienter can be established by allegations that defendants stood to "benefit[] in a concrete and personal way from the purported fraud").

Even more compelling is the evidence of "conscious misbehavior or recklessness." This criterion can be satisfied by (among other things) allegations that Defendants "'knew facts or had access to information suggesting that their public statements were not accurate.'" *Dynex Capital*,

[18] The Court may also take note of an email that, according to the federal indictment, Cioffi wrote on June 9, 2007: "If I can't [turn the Funds around], I've effectively washed a 30 year career down the drain." Indictment ¶ 24, United States v. Cioffi, No. 08 Cr. 415 (E.D.N.Y. June 18, 2008) ("Indictment").

[19] The individuals' scienter can be attributed to BSAM. *See Teamsters Local 445 Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 195 (2d Cir. 2008). The Complaint never suggests that the individuals (despite their personal motives) "totally abandoned [BSAM]'s interests," *Center v. Hampton Affiliates, Inc.*, 66 N.Y.2d 782, 784-85 (1985), or came anywhere close.

531 F.3d at 194; *see also In re Scholastic Corp. Secs. Litig.*, 252 F.3d 63, 76-77 (2d Cir. 2001) (recklessness established by contrast between what defendants knew and their "public statements that painted a different picture"). Here there was that, and much more.

The Complaint is replete with detail showing that Defendants knew they were improperly hiding information not just from the public generally,[20] but from Bank of America in particular. Defendants first disclosed that the Enhanced Leverage Fund had experienced significant redemption requests in a letter sent at 6:30 p.m. on May 23. Compl. ¶ 70. Defendants say this move "undermine[s] any inference of scienter" because Bank of America "could . . . have elected not to proceed with the transaction at all." Mem. 20; *see also* Cioffi Mem. 3. But that claim completely ignores what happened here. As the Complaint alleges, Defendants sent that letter only after Plaintiffs had already paid billions to the Funds and assumed all of the risk associated with the Collateral and the Transaction. Compl. ¶¶ 62, 65, 70. By that point, Defendants had long since concluded that the Enhanced Leverage Fund probably "ha[d] to be liquidated . . . given the redemption activity," *id*. ¶ 51; and sure enough, Cioffi admitted knowing of the redemptions sooner than May 23, *id*. ¶ 74. *Cf. In re Time Warner Inc. Secs. Litig.*, 9 F.3d 259, 271 (2d Cir. 1993) (allegations that undisclosed circumstance was present "significantly before it was announced" would have established scienter). As Defendants also knew, May 23 was a moment for the Bank of maximum inconvenience (because its senior personnel were unavailable) and pressure (because the Bank was getting ready to sell the Super-Senior Notes). *Id*. ¶¶ 66-67.

[20] *See, e.g.*, Compl. ¶ 39 (Cioffi directing a colleague not to "talk about [the February results] to anyone or I'll shoot you"), ¶ 40 (Cioffi privately commenting he was "sick to my stomach over our performance in march"), ¶¶ 41, 44 (Cioffi and Tannin withdrawing or not increasing personal investments in Funds despite contrary representations to investors), ¶¶ 47-50, 109 (repeated false representations about Funds' health and redemption requests), ¶ 54 (Tannin to Cioffi and McGarrigal on May 26: "this may not sound great – but I believe there is NO ONE out there who has put it all together."), ¶ 107 (Tannin asking whether to use "the -6.5 april or the larger down april?" and Cioffi replying "that one deserves a phone call"), ¶ 112 (Cioffi telling Barclays and the Bank on June 7-8 that Enhanced Leverage Fund was slightly up in May even though it was down 38%).

As if this were not enough, both before and after the letter was sent, Cioffi made misrepresentations, downplaying in telephone conversations the severity of the situation and falsely reassuring Plaintiffs that the letter overstated the Enhanced Leverage Fund's condition. *Id*. ¶¶ 65, 74. Finally, the May 23 letter itself was false and misleading insofar as Defendants (i) *did* believe that the impending redemptions would materially adversely affect BSAM, (ii) failed to disclose that the High-Grade Fund, too, was in dire straits, and (iii) failed to disclose their belief that recent occurrences and changes would be expected to impair Bank of America's ability to market the Securities. *Id*. ¶¶ 71-73. And this was not all. Before closing, the Bank insisted on approval rights for the post-closing purchase of certain assets. Cioffi and BSAM promised to sign a letter memorializing those rights but later reneged, with McGarrigal and BSAM causing the purchase of such an asset over the Bank's objection. *Id*. ¶¶ 76-77, 79-80.

These entirely non-conclusory allegations overwhelmingly establish Defendants' motive and opportunity to deceive the Bank, and their awareness of their own misconduct in doing so. As in *In re Bristol Myers Squibb Co. Securities Litigation*, No. 07 Civ. 5867 (PAC), 2008 WL 3884384, at *19 (S.D.N.Y. Aug. 20, 2008), the Complaint "alleges that [Defendants] [were] at the very heart of the fraudulent scheme which surrounded [them], and [were] well aware that [they] . . . were [concealing] material facts." Here as there, "[s]uch allegations are more than sufficient to survive the threshold pleading requirements of scienter." *Id*.[21]

[21] Defendants ignore all of these allegations and focus almost exclusively on the allegations of an agreement among the individuals (*see, e.g.*, Compl. ¶¶ 60, 145), which Defendants say are "conclusory." Mem. 19-20. But first, those allegations are designed to support a conspiracy theory of liability, and therefore (as this Court has recently concluded) are not, on their own, subject to Rule 9(b). *Kottler v. Deutsche Bank AG*, No. 05 Civ. 7773 (PAC), 2009 WL 55885, at *9 (S.D.N.Y. Jan. 9, 2009). It is enough to set forth, as Plaintiffs have done (*see, e.g.*, Compl. ¶¶ 32-37, 39, 40, 42, 45-46, 53-55, 60, 97, 104, 107-108, 145-148, 173-176), "some factual basis for a finding of a conscious agreement among the defendants," *Hecht v. Commerce Clearing House, Inc.*, 897 F.2d 21, 26 n.4 (2d Cir. 1990). In any event, just as with federal securities fraud, "[t]he inquiry . . . is whether *all* of the facts alleged, taken collectively," establish scienter, "not whether any individual allegation, scrutinized in isolation," does so, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 127 S. Ct. 2499, 2509 (2007).

C. The Complaint Satisfies Rule 9(b) as to McGarrigal

McGarrigal argues that the Complaint impermissibly lumps him in with the other Defendants and fails to establish his scienter. McGarrigal Mem. 5-10. But the Complaint is more than sufficient at this early stage to "inform [him] of the nature of his alleged participation in the fraud," *DiVittorio v. Equidyne Extractive Indus., Inc.*, 822 F.2d 1242, 1247 (2d Cir. 1987). The Complaint makes clear that McGarrigal breached a duty to disclose owed by virtue of his position at BSAM and his dealings with Bank of America in connection with the CDO-Squared Transaction. Because this fraud claim is based upon omissions rather than affirmative misrepresentations, Plaintiffs cannot possibly inform McGarrigal what he did – it is what he (and his co-Defendants) did *not* do that matters here.

Pleading requirements, moreover, are relaxed for "facts peculiarly within the opposing party's knowledge," provided the plaintiff indicates the facts upon which his allegations are based. *Id*. at 1247. In this case, many of the details of what McGarrigal said and did within BSAM are as yet unavailable to Plaintiffs. But Plaintiffs do know, and have alleged: that McGarrigal was a Managing Director at BSAM, a co-founder of the Enhanced Leverage Fund, and the third-most senior manager (after Cioffi and Tannin) of both Funds; that his job included monitoring the Funds' performance and structuring CDO deals; that he dealt with Bank of America on an almost daily basis in preparation for the CDO-Squared Transaction; and that he knew full well but did not disclose that redemption activity foretold the demise of the Enhanced Leverage Fund. Compl. ¶¶ 11, 14, 24, 26, 27, 51, 79. This is more than sufficient to establish that McGarrigal owed a duty to disclose. *See also* page 14, *supra*.

As for scienter, the arguments above about "motive and opportunity" apply equally to McGarrigal. And although McGarrigal has pointed (at 7-9) to certain "individual allegation[s]" that, "scrutinized in isolation," *Tellabs*, 127 S. Ct. at 2509, do not name him, he overlooks a plethora of allegations that *do* demonstrate his consciousness of misbehavior or recklessness, as well as his participation in Defendants' effort to extract liquidity from the Bank for the Funds.

McGarrigal's September 19, 2006 email (Compl. ¶ 37), for instance, easily permits an inference that he knew of the Funds' longer-term liquidity problems. He attended the private gathering on March 2, 2007, at which Cioffi remarked how difficult February had been for the Funds and directed his colleagues not to discuss the Funds' condition with anyone else. *Id*. ¶ 39. Throughout March 2007, McGarrigal "consistently" heard Cioffi express his concern about the health of the Funds and the risk of their collapse, *id*. ¶ 40,[22] and participated in discussions about merging one Fund into the other, *id*. ¶ 42. McGarrigal was one of three individuals using personal email accounts to exchange thoughts like "BSAM's counsel [is] NOT our counsel." *Id*. ¶ 45. Given his role and responsibilities, he surely knew as well as Cioffi or Tannin that the April conference call for investors hosted by the three of them created a false and misleading picture of the Funds' financial health. *See id*. ¶¶ 27, 47, 49.

What is more, McGarrigal learned in a May 13 email (if not sooner) of the likelihood that the Enhanced Leverage Fund would "ha[ve] to be liquidated . . . given the redemption activity," *id*. ¶ 51, which thoroughly discredits his suggestion that the Complaint is "devoid of factual support" for knowledge on his part, before the transactions closed, "that the Funds' liquidity problems . . . threatened [their] viability," McGarrigal Mem. 9. (Nor does the Complaint supply any basis for his raw assertion that by mid-May "decisions as to what disclosures should be made to BOA were not . . . in [his] control." *Id*.) And McGarrigal was not only party to the highly

[22] Plaintiffs qualified certain allegations with "apparently" because the SEC complaint (and indictment) against Cioffi and Tannin refer to an unnamed "Third Manager" (Complaint ¶¶ 29, 41, 65, 116, SEC v. Cioffi, No. 08 Civ. 2457 (E.D.N.Y. June 19, 2008); *see also* Indictment ¶ 41) who is almost certainly McGarrigal.

questionable communications of May 23 and May 24, *see* pages 18-19, *supra*, it was he who helped BSAM and Cioffi renege on their pre-closing commitments. *See* Compl. ¶¶ 70, 79.

To be sure, only a portion of this evidence constitutes communication *from* (as opposed to *to*) McGarrigal, but with good reason: the government is not proceeding against McGarrigal, and so has not made his communications public. Many of the facts pertaining to McGarrigal thus remain "peculiarly within [his] knowledge," *DiVittorio*, 822 F.2d at 1247. Plaintiffs are not required to allege what they do not yet know, but what they *have* alleged is entirely sufficient.

D. Plaintiffs Have Adequately Alleged Reliance

Defendants contend that Plaintiffs have not adequately alleged "justifiable reliance." But as this Court has recognized, "the fact-specific nature of reasonable reliance generally renders it 'inappropriate for determination on a motion to dismiss.'" *484 Assocs., L.P. v. Moy*, No. 06 Civ. 2290 (PAC), 2007 WL 683999, at *3 (S.D.N.Y. Mar. 5, 2007). And while this principle sometimes gives way if a "Plaintiff had actual notice of the falsity of the misrepresentations or indisputable access to information that would have revealed the truth," *id*. (collecting cases), here it is undisputed that Bank of America had neither notice of nor access to the truth before its critical act of reliance – namely, its May 22 purchase of Collateral.

Defendants contend (Mem. 21-22) that it was unreasonable for the Bank to rely on their failure to disclose the truth because the Bank "could have contracted for specific protection" in connection with the May 22 transaction. But first, a party is not required to contract for "specific protection" from material nondisclosures, and this Court has expressly rejected the argument that "because Plaintiffs are sophisticated and familiar with complex . . . transactions, . . . any reliance on matters not contained in [a] contract is unreasonable." *Randolph Equities, LLC v. Carbon Capital, Inc.*, No. 05 Civ. 10889 (PAC), 2007 WL 914234, at *8 (S.D.N.Y. Mar. 26, 2007). In any event, Plaintiffs *did* contract for "specific protection" – they contracted for disclosures, pursuant to the Engagement Letter, and Defendants breached that obligation by failing to make timely and complete disclosures. *See* I.A.-B. above.[23]

Defendants also find it significant that Plaintiffs have not alleged that they sustained their losses at the very moment that they sold the initial Collateral to the Issuer on May 24, and that it was the Bank's "elective decision" to close the deal. Mem. 21-22. But that misses the point. On the night of May 23, Bank of America faced a choice about what to do the next day: it could either refuse to close the CDO-Squared Transaction, in which case it would be stuck with $2.9 billion in assets that it had never expected to own and whose value was now (in light of Cioffi's revelation) in serious question, or it could close as planned, in which case it would be on the hook for Super-Senior Notes backed by those same assets if (as it turned out) the owners of the Super-Senior Notes could not dispose of them in the market. The Bank decided to close.

It is "a 'natural corollary' of the doctrine of mitigation of damages" that a fraud victim "'will be allowed to recover the expenses of a proper effort [to avoid or reduce damages] even though it proves unsuccessful.'" *Gordon & Co. v. Ross*, 84 F.3d 542, 546-47 (2d Cir. 1996) (quoting *Den Norske Ameriekalinje Actiesselskabet v. Sun Printing & Publ'g Ass'n*, 226 N.Y. 1, 8 (1919)). In other words, actions taken as part of a "proper effort" to avoid or reduce damages do not break the chain of causation – or negate "justifiable reliance" – at the pleading stage, and injury incurred from such actions is compensable. *See id*. Plaintiffs are entitled to offer evidence that the May 24 decision to sell the Collateral, close the transaction, and issue a "put" on the Super-Senior Notes were "proper efforts" to reduce or avoid damages from the May 22 purchase

[23] Tannin also argues in passing that "[g]iven that one important purpose of the BOA transactions was to provide liquidity, it strains credulity for BOA now to argue that it did not know the Funds needed liquidity." Tannin Mem. 2. The short answer is that there is an important difference between being thirsty and being on the verge of death from dehydration.

induced by Defendants' deception. In sum, reliance is a matter for trial.

E. Proximate Cause Is Satisfied

Defendants dispute proximate cause. Mem. 31-35. As an initial matter, and contrary to Defendants' implication (*id*. at 33), allegations of causation are subject to Rule 8(a), not 9(b). *See, e.g.*, *In re Bristol Myers Squibb Co. Secs. Litig.*, No. 07 Civ. 5867 (PAC), 2008 WL 3884384, at *11 (S.D.N.Y. Aug. 20, 2008). Accordingly, and because "ordinary pleading rules are not meant to impose a great burden on a plaintiff," a plaintiff need do no more than give "some indication of the loss and the causal connection that the plaintiff has in mind." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347 (2005).

Next, Defendants are wrong to equate proximate cause requirements for common-law fraud to loss causation in the Rule 10b-5 context. The Second Circuit has explained that the "analogy" between the two "is imperfect" because common-law torts require only a "foreseeable injury," whereas federal securities fraud specifically requires "a drop in the value of a security [that] is 'caused' by . . . misstatements or omissions made about it." *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172-73 (2d Cir. 2005). Indeed, the Circuit recently reversed a district court for relying on federal securities fraud cases to assess proximate cause for common-law fraud. *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171, 182-83 (2d Cir. 2007).[24]

To be sure, Plaintiffs could satisfy either standard. "Under New York law, an 'injury [from fraud] is proximately caused . . . if the defrauder ought reasonably to have foreseen that the injury was a probable consequence of his fraud.'" *Citibank, N.A. v. K-H Corp.*, 968 F.2d 1489, 1496 (2d Cir. 1992); *accord Banque Franco-Hellenique de Commerce Int'l et Maritime, S.A. v.*

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[24] *See also Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 285 (2d Cir. 2006) (observing that on identical facts, "proximate causation may be present or absent depending on the cause of action" asserted); *Moore v. PaineWebber, Inc.*, 189 F.3d 165, 180 n.12 (2d Cir. 1996) (Calabresi, J., concurring) ("[W]e should be especially wary of applying *statutory* precedents involving proximate cause to common-law cases . . . .").

Christophides, 106 F.3d 22, 27 (2d Cir. 1997); *Gordon*, 84 F.3d at 545. Loss causation for federal securities fraud, on the other hand, requires a plaintiff to establish that its loss was "caused by the materialization" of a risk concealed by Defendants. *Lentell*, 396 F.3d at 173.

In this case, as the Complaint makes abundantly clear, when the Funds were forcibly liquidated, the market supply of CDO assets soared, demand plummeted, and this (thinly-traded) asset class was called into question. That impaired the value both of the Issuer's portfolio and the Super-Senior Notes. Compl. ¶¶ 113, 116, 123-125, 127; pages 6-7 above. This operation of the laws of supply and demand (and its effect on the Bank) were entirely foreseeable, *see, e.g.*, *id*. ¶ 113 ("'If the Enhanced Fund started dumping its holdings . . . , that could send the prices of the securities in the High-Grade fund tumbling.'"), and resulted directly from the materialization of the risk that the Funds would collapse. Nor is there anything far-fetched about the collapse of the Funds having a market-wide impact – this was a global cataclysm that led to the demise of Bear Stearns as an independent firm. *Id*. ¶ 3.

What is more, the value of assets backed (as the Securities were) by an actively managed portfolio depends in part on the market's evaluation of the portfolio manager. Thus when the Funds collapsed after months of denials and reassurances to the contrary, the market suddenly recognized that BSAM was far less capable, reliable, and honest than previously thought, which translated (foreseeably) into a decrease in the value of the Super-Senior Notes. *Id.* ¶¶ 14, 22, 57, 113, 116, 121, 123-125, 127, 130; pages 6-7 above. In this way, too, Plaintiffs have alleged "loss resulting from the market's realization that . . . [Defendants] concealed [a] risk that could plausibly (let alone foreseeably) have caused plaintiffs' loss," *Lentell*, 396 F.3d at 176.

This is enough. Issues like the exact contribution of different factors to Plaintiffs' losses cannot and need not be resolved now. *See id*. at 174 ("'[I]f the loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation . . . is a matter of proof at trial and not to be decided on a Rule 12(b)(6) motion to dismiss.'"); *Duncalf v. Swamsington*, No. 05 Civ. 7020 (PAC), 2007 WL 2387968, at *4 (S.D.N.Y. Aug. 21, 2007) ("'[I]n general, the issue of proximate cause is for the jury.'"). This is one reason why Defendants' reliance on *Shanahan v. Vallat*, No. 03 Civ. 3496 (PAC), 2008 WL 4525452 (S.D.N.Y. Oct. 3, 2008), *see* Mem. 31, 33, is so misplaced – and misleading. *Shanahan* was a summary judgment ruling rendered *after* the development of a full factual record; Chief Judge Mukasey had previously *sustained* the allegations of loss causation at the Rule 12(b)(6) stage. 2004 WL 2937805, at *5 (Dec. 19, 2004). *Contra* Mem. 31 (citing *Shanahan* as main example of this Court's having "repeatedly held" that claims "cannot survive" unless loss causation "has been adequately pled").

And yet Defendants repeatedly argue that Plaintiffs' losses were merely a byproduct of a market-wide decline. Contrary to the misleading impression created by BSAM's spliced quotations, *see* Mem. 33, what the Complaint alleges is *not* (as in *Shanahan* and the kind of cookie-cutter shareholder suits dismissed in the *Merrill Lynch Research Reports* cases on which Defendants so heavily rely, *see* Mem. 31-35) the typical situation in which losses "coincide with" a decline in the whole market for reasons unrelated to the fraud. Here, the specific "market-wide decline" to which Plaintiffs have referred (Compl. ¶ 123) was no "coincidence" at all. Rather, as the Complaint explains in the immediately surrounding sentences, this specific decline was caused by the spectacular collapse of two of the biggest players in the CDO world – in other words, by the materialization of the very risk concealed by Defendants.

Defendants also chastise Plaintiffs for failing to allege that the market for the Super-Senior Notes dried up because of Defendants' conduct, rather than because of "the overall decimation of the CDO market." Mem. 34. But that simply ignores what the Complaint actually says. Again, read together with the immediately adjoining paragraphs (¶¶ 123-124), paragraph 125 alleges that, precisely because of Defendants' conduct, *these specific Notes* had lost value by the time the Bank bought them. Moreover, because the Bank was following through on its "put" commitments and the value of the Super-Senior Notes had declined, the Bank was paying much more than the Super-Senior Notes were actually worth. *See id*. ¶ 125. It may be that *some* of the decline in the value of the Super-Senior Notes from June 2007 to the present was proximately caused by the "overall decimation of the CDO market" (Mem. 34), but some of it assuredly was, as the Complaint alleges, due to the Funds' collapse.[25] How much is a matter for trial. *See, e.g.*, *Lentell*, 396 F.3d at 177 ("We do not suggest that plaintiffs were required to allege the precise loss attributable to Merrill's fraud[.]"); *Bristol Myers*, 2008 WL 3884384, at *16 ("Any further requirement to ascribe the actual amount of loss to one cause or another does not arise on a motion to dismiss. The Plaintiffs need only plead that Defendants' fraudulent behavior concealed facts or circumstances which, when revealed, contributed to the loss.").[26]

That is one reason why Defendants' reliance on the quarterly and annual reports for Bank of America's corporate family (Mem. 10, 34-35) is so misplaced. Even if the filings were cognizable here (which they assuredly are not[27]), the macro trends that Defendants find so

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[25] Nor is it fatal to Plaintiffs' claims that there may have been a decline in this sector of the market *before* the collapse of the Funds (Mem. 35 n.18). That the net asset value of the Enhanced Leverage Fund – or even the market as a whole – may have begun to decline before the Funds' collapse hardly means that the collapse had no impact on the market as a whole, let alone on the BSAM-linked Securities at issue here.

[26] Defendants are quite wrong to suggest that the Complaint must "ascribe some rough proportionality of the whole loss" to the materialization of the concealed risk, Mem. 34. The need to do so arises if at all only when – as in *Lentell*, but not this case – separate portions of a document simultaneously conceal and disclose aspects of a risk. Then a plaintiff may meet its burden by alleging "facts sufficient to apportion the losses between the disclosed and concealed portions of the risk." *Lentell*, 396 F.3d at 177; *see also Lattanzio v. Deloitte & Touche LLP*, 476 F.3d 147, 158 (2d Cir. 2007).

[27] SEC filings are properly considered on a Rule 12(b)(6) motion only "[w]hen a complaint alleges, for example, that a document filed with the SEC failed to disclose certain facts," because then "it is appropriate for

significant (*e.g.*, Sheldon Decl. Ex. O at 10 ("We have been an active participant in the CDO market . . . and have incurred losses associated with these exposures.")) at the very most suggest that *some* of the decline in the Securities' value following the collapse of the Funds *might* be attributable to causes *in addition to* the collapse of the Funds. That a $1.7 trillion company (*see id*.) lost money on other CDO positions hardly means that the losses at issue in *this* case have nothing to do with Defendants' wrongdoing, or that Plaintiffs today would be in the same position if Defendants had not deceived them.

F. Plaintiffs Have Adequately Alleged Aiding and Abetting

The Second Cause of Action asserts, as an alternative theory of liability, aiding and abetting by the individual defendants. *E.g.*, Compl. ¶ 144. "To establish liability for aiding and abetting fraud, the plaintiffs must show '(1) the existence of a fraud; (2) [the] defendant's knowledge of the fraud; and (3) that the defendant provided substantial assistance to advance the fraud's commission.'" *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 292 (2d Cir. 2006). Cioffi (apparently joined by Tannin, *see* Tannin Mem. 1, but not McGarrigal) cursorily challenges each of these elements. *See* Cioffi Mem. 3-5.

As to the first element, Cioffi argues that none of his co-defendants are primarily liable. Plaintiffs have explained that they are. Cioffi also argues that the Complaint fails to allege his knowledge of the fraud. Yet all he points to is one paragraph of the Complaint "scrutinized in isolation," *Tellabs*, 127 S. Ct. at 2509. Assuming, as Cioffi seems to (*see* Cioffi Mem. 5 (citing *Lerner*, 459 F.3d at 292-93); *see also Wight v. BankAmerica Corp.*, 219 F.3d 79, 92 (2d Cir. 2000)), that the standard for pleading the knowledge element of aiding and abetting fraud is

the court . . . to see whether or not those facts were disclosed" in the document. *Roth v. Jennings*, 489 F.3d 499, 509 (2d Cir. 2007). Even then the court may consider the documents "'only to determine what the documents stated,' and '*not to prove the truth of their contents*.'" *Id*. (quoting *Kramer v. Time Warner Inc.*, 937 F.2d 767, 774 (2d Cir. 1991)). Needless to say, this case does not concern misrepresentations in Plaintiffs' SEC filings, and Defendants *are* seeking to have the Court accept the truth of their contents.

equivalent to that for pleading scienter for fraud, Plaintiffs explained in section II.B. above why they satisfy it. More generally, the only plausible reading of the Complaint is that Cioffi and Tannin each knew that his co-defendants were concealing the truth about the Funds.

Next, Cioffi argues that Plaintiffs fail to allege that he "substantially assisted" the primary fraud – as opposed to merely "assisted" it. This argument is meritless. Cioffi and Tannin are among the central figures in this case. They were the co-founders and senior executives of both Funds. They made or approved every important decision. Their "assistance" – the existence of which Cioffi does not actually dispute – was nothing if not "substantial." As this Court has explained, "The 'substantial assistance' requirement of the third prong exists where a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed." *Kottler v. Deutsche Bank AG*, No. 05 Civ. 7773 (PAC), 2009 WL 55885, at *10 (S.D.N.Y. Jan. 9, 2009) (quotation marks omitted). That is precisely what the Complaint describes, and it is of no consequence that certain paragraphs omitted the talisman "substantial."

Finally, Cioffi says that Plaintiffs fail to allege that his assistance caused the Bank's losses. But the crux of the aiding and abetting theory is that Cioffi, Tannin, and McGarrigal caused BSAM to conceal the Funds' impending collapse – the event that materialized to Plaintiffs' detriment. *See* section II.E., *supra*. Because of their central role in the deception, the individual defendants' assistance with the fraud was just as much a proximate cause of the losses as the fraud itself. *See id.* at *10-*11; *Fezzani v. Bear, Stearns & Co.*, 592 F. Supp. 2d 410, 435 (S.D.N.Y. 2008) ("Defendants were also the proximate cause of the Plaintiffs' harm, as they allegedly helped plan, execute, and fund the scheme.").

III. The Complaint States A Claim for Breach of Fiduciary Duty on Behalf of the Issuer

BSAM and its officers owed the Issuer fiduciary duties because BSAM was the Issuer's asset manager. Yet in selecting assets for transfer to the Issuer, Defendants placed their own interests ahead of the Issuer's by causing the Issuer to purchase $2.9 billion worth of assets from BSAM's own distressed Funds. *See* Compl. ¶¶ 81-84. Accordingly, the Third Cause of Action seeks to hold Defendants liable for breach of fiduciary duty. *Id*. ¶¶ 150-159.

A. This Claim Is Not Preempted by the Martin Act

Defendants argue (Mem. 22-23) that this claim is preempted by the Martin Act. But the gravamen of the claim is BSAM's self-dealing as the Issuer's collateral manager – *not* fraud in the sale of securities. The Martin Act, N.Y. Gen. Bus. Law §§ 352-359-h, "regulates the offer and sale of securities and commodities" and its purpose is "to protect the public from fraudulent exploitation" in such transactions. *People v. Landes*, 84 N.Y.2d 655, 660 (1994) (emphasis added). The Second Circuit has held that a claim for "breach of fiduciary duty in the context of securities fraud" is barred by the Act, *Castellano v. Young & Rubicam, Inc.*, 257 F.3d 171, 190 (2d Cir. 2001), but not every breach of fiduciary duty that "involves securities" is within the Act's scope. *Louros v. Kreicas*, 367 F. Supp. 2d 572, 595-96 (S.D.N.Y. 2005) (emphasis added). In *Louros*, a portfolio manager allegedly failed to manage his client's assets "in a way that comported with [the client's] needs" and to "keep [the client] informed." *Id*. Because the claim was not premised on "deception, deliberate or otherwise," it did "not come within the Martin Act" and was not dismissed on that basis. *Id.* at 596.

Here the Complaint alleges a classic breach of fiduciary duty in which an investment adviser abused its position of trust and confidence by placing its own interests ahead of its beneficiary's. *See* Compl. ¶ 154. It is true that the breach could never have occurred if proper disclosures had been made, *see id*. ¶¶ 83-84, but the same could have been said of *Louros* or any breach of fiduciary duty. Because the essence of this claim is not deception in the offer or sale of securities, it is not "based on the sort of wrong given over to the Attorney General under the Martin Act," *Caboara v. Babylon Cove Dev., LLC*, 862 N.Y.S.2d 535, 538 (2d Dep't 2008) (quotation marks and citation omitted). The claim is not preempted.

B. Section 11 of the Engagement Letter Is Irrelevant

BSAM next contends (at 23-24) that its fiduciary duty is somehow disclaimed by the Engagement Letter.[28] But this claim belongs to the Issuer, not the Bank; it is asserted here by Plaintiff BANA only as trustee and assignee of the Issuer. Compl. ¶ 5, p.37 & n.1. The disclaimer of fiduciary relations between BSAM *and the Bank* in Section 11 of their Engagement Letter is entirely irrelevant to the fiduciary duty BSAM owed *to the Issuer*.

C. BSAM's Selection of Assets for the Issuer Was Subject to Fiduciary Duties

Defendants also argue (Mem. 24-25) that as a matter of law they had no fiduciary duty to the Issuer when they selected – for transfer to the Issuer and on its behalf – the initial Collateral. BSAM asserts, incredibly, that "[n]othing in the [Collateral Management Agreement ("CMA")] gives rise to a fiduciary relationship," Mem. 25; but the CMA appoints BSAM as the Issuer's "investment adviser and manager with respect to the Collateral," Compl. Ex. B § 2(a), and it is black-letter law that investment advisers owe fiduciary duties. *E.g., Bullmore v. Ernst & Young Cayman Islands*, 846 N.Y.S.2d 145, 148 (1st Dep't 2007); *Rasmussen v. A.C.T. Envtl. Servs. Inc.*, 739 N.Y.S.2d 220, 222 (3d Dep't 2002); *Scalp & Blade, Inc. v. Advest, Inc.*, 722 N.Y.S.2d 639, 640 (4th Dep't 2001).

What is more, the passages of the CMA to which BSAM refers *reinforce* the existence of a fiduciary duty. The CMA required BSAM to discharge its obligations with no less "skill and

[28] Tannin – but not Cioffi or McGarrigal – adopts this argument. *See* Tannin Mem. 3; Cioffi Mem. 5; McGarrigal Mem. 10-11. Tannin is wrong for the reasons set forth in text above, and because he was not even *party* to the Engagement Letter. *See* note 13 above.

attention" than is "*generally exercised by institutional managers* of national standing for clients *in substantially similar transactions*" or than BSAM "exercises for itself." Compl. Ex. B § 2(a)(i) (emphasis added). Nor do these contractual provisions render BSAM's duty to the Issuer solely contractual, for "[i]t is well-settled that the same conduct which may constitute the breach of a contractual obligation may also constitute the breach of a duty arising out of the relationship created by contract but which is independent of the contract itself." *Mandelblatt v. Devon Stores, Inc.*, 521 N.Y.S.2d 672, 676 (1st Dep't 1987) (citing authorities); *accord, e.g.*, *Dime Sav. Bank of N.Y., FSB v. Skrelja*, 642 N.Y.S.2d 84, 85 (2d Dep't 1996).[29]

BSAM also suggests (at 25) that the fact that it selected the assets shortly before the effective date of the CMA meant no duty existed. But "it is fundamental that fiduciary 'liability is not dependent solely upon an agreement or contractual relation between the fiduciary and the beneficiary but [rather] results from the relation.'" *EBC I, Inc. v. Goldman, Sachs & Co.*, 5 N.Y.3d 11, 20 (2005) (quoting Restatement (Second) of Torts § 874 cmt. b); *see also Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC*, 376 F. Supp. 2d 385, 408 (S.D.N.Y. 2005); *Wiener v. Lazard Freres & Co.*, 672 N.Y.S.2d 8, 14 (1st Dep't 1998). In any event, it is typically a question of fact for resolution *at trial* whether fiduciary duties existed before a relationship was formalized in writing. *See Reznor v. J. Artist Mgmt., Inc.*, 365 F. Supp. 2d 565, 574-75 (S.D.N.Y. 2005) (denying summary judgment because jury "could find . . . a fiduciary duty to [the plaintiff] . . . beginning even before the . . . signing of the management agreement"); *Tyson v. Cayton*, 784

[29] Relatedly, New York courts have squarely rejected the notion that a fiduciary duty cannot coexist with a contract that does not expressly recite such a duty. *E.g.*, *Sergeants Benevolent Ass'n Annuity Fund v. Renck*, 796 N.Y.S.2d 77, 79-80 (1st Dep't 2005); *Bender Ins. Agency, Inc. v. Treiber Ins. Agency, Inc.*, 729 N.Y.S.2d 142, 145 (2d Dep't 2001); *Moser v. Devine Real Estate, Inc. (Florida)*, 839 N.Y.S.2d 843, 847 (3d Dep't 2007). BSAM's only contrary authority (at 25) is *World Wrestling Entertainment, Inc. v. Jakks Pacific, Inc.*, 530 F. Supp. 2d 486 (S.D.N.Y. 2007), but that case stands merely for the unremarkable proposition that parties engaged in "*arms length business transactions*" – which manifestly was *not* the nature of Defendants' relationship to the Issuer – are presumed not to have a fiduciary relation. *Id*. at 503-05.

F. Supp. 69, 76 (S.D.N.Y. 1992) (denying summary judgment because the defendant could have owed the plaintiff a fiduciary duty before they signed their first management contract).

D. Proximate Cause Is Satisfied

BSAM's scant challenge (at 31-32) to proximate cause simply ignores the nature of the allegations. The Issuer suffered significant damages from the loss of the initial Collateral's value after the Funds' collapse. And that injury was entirely foreseeable when BSAM and its officers selected the Collateral for the Issuer in violation of their fiduciary duties. *See* Compl. ¶¶ 123, 124, 127, 130, 132, 158, 159; pages 6-7, *supra*. Accordingly, the Complaint more than adequately establishes proximate cause. *See LNC Invs., Inc. v. First Fidelity Bank, N.A. New Jersey*, 173 F.3d 454, 465 (2d Cir. 1999) (fiduciary duty claims subject to same causation principles as other common-law claims); sections I.C, II.E., *supra*.

E. The Complaint Adequately Alleges Aiding and Abetting

The Third Cause of Action asserts aiding and abetting by the individual defendants. "'A claim for aiding and abetting a breach of fiduciary duty requires: (1) a breach by a fiduciary of obligations to another, (2) that the defendant knowingly induced or participated in the breach, and (3) that plaintiff suffered damage as a result of the breach.'" *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 294 (2d Cir. 2006). Defendants take issue with the first element and with proximate cause, but we have explained (in sections III.A-D. above) why those attacks fail. Cioffi (apparently joined by Tannin) also argues that the Complaint fails to allege "substantial assistance" – as opposed to mere "assistance." Cioffi Mem. 5-6. We have addressed this meritless argument on page 29 above.

IV. The Complaint States a Claim for Breach of Contract on Behalf of the Issuer

BSAM's argument for dismissing the Fourth Cause of Action (Mem. 26) simply asks the

Court not to accept as true the allegations (Compl. ¶¶ 85-96, 160-164) that BSAM caused the Issuer to engage in conflicted transactions involving the Funds or other Bear Stearns entities without the requisite disclosures and consents. In particular, BSAM has submitted documents (Sheldon Decl. K, L) that appear (at least at first blush) to reflect the Issuer's consent to certain transactions. These documents, however, were not (contrary to BSAM's assertion) signed by Plaintiffs[30] or in their possession, nor even mentioned in the Complaint, much less relied on for their terms and effect. *See* note 3, *supra*. Even if these documents *were* proper for consideration here (which they certainly are not), they apply only to *some*, not all, of the relevant post-closing transactions. As for BSAM's suggestion that the Complaint must identify every "single transaction that was not approved," Mem. 26, that is not the law. *E.g., Boykin v. KeyCorp*, 521 F.3d 202, 215 (2d Cir. 2008) (Rule 8(a) does not require "specific facts").

V. Plaintiffs Have Stated a Claim for Fraud Related to the Repo Transactions

The Fifth Cause of Action asserts primary and aiding and abetting theories of liability for fraud relating to repo transactions in late May 2007. Compl. ¶¶ 165-177. In particular, Defendants requested repo financing from Bank of America even though the Funds' condition was worsening and the chances were increasing that the Funds would not be able to repay the Bank. In doing so, Defendants and the Funds failed to disclose material facts and falsely represented that the Funds' financial condition was materially unchanged.

A. The Allegations of Primary Liability Are Sufficient

1. The June 2007 Termination Agreement Does Not Bar the Claims

Defendants first contend that these fraud claims were "extinguished" by the June 2007 Termination and Purchase Agreement (the "Termination Agreement"). *E.g.*, Mem. 28. First of

[30] The documents were apparently signed by a representative of the *Issuer*. Plaintiff BANA is not the Issuer; it has the Issuer's *claims* by assignment, *see* Compl. ¶ 5, p.39, but not all of its documents.

all, this is yet another improperly introduced document: far from being "clearly integral" (Mem. 10 n.5) to Plaintiffs' claims, the document is not even mentioned in the Complaint, much less relied on heavily for its terms or effect.[31] And with good reason: the document is totally irrelevant. *See also Faulkner v. Beer*, 463 F.3d 130, 134 (2d Cir. 2006) (even "integral" documents may not be considered on motion to dismiss unless "there exist no material disputed issues of fact regarding the relevance of the document.").

Defendants single out Section 13(b), which says that the settlement of all outstanding repo and other derivative positions between the insolvent Funds and the Bank "constitutes a final settlement of all obligations, rights and remedies that each Party may have *under the [master] Repurchase Agreements* and the ISDA Agreements." Sheldon Decl. Ex. H at 12 (emphasis added). But the claims here do not invoke rights or remedies "under" those agreements at all. These are fraud, not contract, claims, and they are asserted against the individual defendants and BSAM, who are not even parties to the master repo agreements.[32] Defendants assert that Plaintiffs' repo claims "clearly arise[] under the Master Repo Agreements, as plaintiffs allege that the Funds breached one of the representations and warranties in that agreement." Mem. 28. But Plaintiffs are *not* suing for breach of warranty; they are suing on the basis of tort duties.

Defendants' contention that the Termination Agreement extinguished the Bank's tort claim in the Fifth Cause of Action is also impossible to square with the litigation release contained in the Agreement. That release provides that the Funds, their officers, and BSAM release Bank of America – *but Bank of America does not release the Funds, their officers, or*

[31] The Second Circuit has repeatedly said that a document is "integral" only if the complaint "relies heavily on [the document's] terms and effect." *Sahu v. Union Carbide Corp.*, 548 F.3d 59, 68 (2d Cir. 2008) (quoting *Chambers v. Time Warner, Inc.*, 282 F.3d 147, 153 (2d Cir. 2002)); *accord, e.g., Int'l Audiotext Network, Inc. v. AT&T Co.*, 62 F.3d 69, 72 (2d Cir. 1995); *see also* note 3, *supra*.

[32] The individuals also are not party to the Termination Agreement. *See* Sheldon Decl. Ex. H at 1.

BSAM – from all claims "arising out of, or connected or relating to, the [master] Repurchase Agreements." Sheldon Decl. Ex. H at 10; *see also id*. at 2 ("the Parties desire to . . . settle and release *certain other* claims" besides the mere termination of the transactions). If, as Defendants now claim, the parties meant for Section 13(b) to extinguish tort claims like those alleged here, it would have been nonsensical for Defendants simultaneously to agree to such a broad, but entirely one-sided, release. *See, e.g.*, *Pinto v. Allstate Ins. Co.*, 221 F.3d 394, 404 (2d Cir. 2000) ("[A] release like any contract must be construed to give force and effect to the intention of the parties."). The Termination Agreement is not properly before the Court, but even if it were, the only way to read it is as permitting Bank of America's fraud claims.[33]

2. The Individual Defendants Had a Duty To Disclose

Tannin and Cioffi assert that there is no "basis to conclude that [they] [were] individually obligated to make disclosures" in connection with the repo transactions. Tannin Mem. 5. But there are at least two such bases. *See* Compl. ¶¶ 166-167. First, the defendants "possesse[d] superior knowledge, not readily available to the [Bank]" concerning the true state of the Funds, "and [knew] that the [Bank] [was] acting on the basis of mistaken knowledge." *TVT Records v. Island Def Jam Music Group*, 412 F.3d 82, 90-91 (2d Cir. 2005); *see also* pages 13-14 above. This duty would have existed even if the master agreements had not. Second, the Funds were deemed to make representations about their health in connection with each repo transaction, and Defendants, who controlled the Funds and were responsible for the transactions, knew that the representations were false. *See, e.g.*, *In re IBM Corp. Secs. Litig.*, 163 F.3d 102, 109-10 (2d Cir. 1998) (describing duties to correct and to update).[34] Tannin and Cioffi point out that they were

[33] Even if the Court were to find the Termination Agreement ambiguous (which, we respectfully submit, it should not), the ambiguity would have to be construed in Plaintiffs' favor at this stage. *See* note 7, *supra*.

[34] Tannin and Cioffi note that the master agreements contain warranties that the Funds breached by failing to apprise Plaintiffs of their deteriorating financial condition. Accordingly, they reason, the Fifth Cause of Action

not parties to the master agreements. Tannin Mem. 5. But it is black-letter law that while an officer is not normally liable on a corporate entity's contracts, "'[o]fficers . . . of a corporation may be held liable for fraud if they participate in it or have actual knowledge of it.'" *Cohen v. Koenig*, 25 F.3d 1168, 1173 (2d Cir. 1994) (citing New York authorities).

3. Plaintiffs Have Sufficiently Alleged the Other Elements of Fraud

BSAM and McGarrigal next argue that the Complaint is "vague about the specifics of the repo transactions at issue." Mem. 29; McGarrigal 11-12. But Rule 9(b) requires a plaintiff to specify merely the fraudulent statements or omissions (including the "who," "when," and "where"), and explain why they were fraudulent. *E.g.*, *Lerner v. Fleet Bank, N.A.*, 459 F.3d 273, 290 (2d Cir. 2006). Plaintiffs have done all this.[35] BSAM argues that Plaintiffs have not alleged "when," but they have specified "late May 2007," Compl. ¶ 101, and are not required to "'plead dates, time and places with absolute precision,'" *In re Bristol Myers Squibb Co. Secs. Litig.*, No. 07 Civ. 5867 (PAC), 2008 WL 3884384, at *11 (S.D.N.Y. Aug. 20, 2008)). Nor do Defendants offer any authority for their assertion (Mem. 29) that information about the induced transactions such as "in what amounts and with which Fund(s)" must be particularized.

Defendants argue that "the Bank's decision to proceed" with one of the repo transactions – the $750 million financing for the mezzanine Securities – in the face of the disclosure on the evening of May 23 "negates any claim of justifiable reliance or losses incurred 'as a result of

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at best "suggest[s] only a claim against the Funds . . . for supposedly breaching the warranties." Tannin Mem. 4-5. That is mistaken. Just because Defendants' concealment may have amounted to "a breach of the contractual warranties as well does not alter the result. A plaintiff may elect to sue in fraud on the basis of misrepresentations" – or for that matter, nondisclosures – "that breach express warranties." *Merrill Lynch*, 500 F.3d at 184; *accord First Bank of the Ams. v. Motor Car Funding, Inc.*, 690 N.Y.S.2d 17, 21 (1st Dep't 1999).

[35] The individual defendants complain that Plaintiffs have failed to specify their actions in relation to the repo transactions. *See* Cioffi Mem. 6-7; McGarrigal Mem. 12. But the Complaint explains that these individuals were responsible for the Funds' repo transactions (which were an important source of liquidity), and controlled communications with the Bank and other repo providers. *See, e.g.*, Compl. ¶¶ 33, 37, 48, 98, 102-103, 110-112, 168, 171. Plaintiffs do not yet have access to, and therefore cannot reasonably be expected to allege, the details of who did what behind the scenes. *See* page 20 above.

such reliance.'" *Id*. That is not fair to the Complaint, which refers to "a $750 million repo financing *on or about* May 24." Compl. ¶ 101 (emphasis added). As the proof will show, the Bank's "decision to proceed" with the repo financing that occurred either on *or about* (that is to say, possibly before) May 24 was made well *before* the May 23 disclosure. And the same is true of other repo financings in late May 2007.

What is more, the May 23 letter cannot possibly have constituted real notice for purposes of the repo transactions because it was sent to the wrong department. *Compare* Compl. Ex. C at 8, 13-15, 24, 30 *with id*. ¶ 70. Bank of America is part of a company with hundreds of thousands of employees; it "'cannot realistically be thought of as the equivalent (say) of a small law office, in which notice to one person may fairly be deemed notice to all,'" *Affymetrix, Inc. v. PE Corp.*, 306 F. Supp. 2d 363, 375 (S.D.N.Y. 2004). And if none of this were enough, the May 23 disclosure was woefully incomplete: it did not even mention the High-Grade Fund, nor did it track (and hence correct the misrepresentations pursuant to) the master agreements. *Compare* Compl. ¶ 70 *with id*. ¶¶ 99-100. In sum, the May 23 letter does not even begin to negate the highly fact-bound (*see* section II.D., *supra*) issues of justifiable reliance and resulting damages.

Equally far-fetched is the suggestion that the May 23 letter "negates any conceivable inference of fraudulent intent," Mem. 29. Quite the contrary, the questionable circumstances of its transmission confirm that Defendants were desperately seeking to use Bank of America as a source of liquidity for the Funds. In any event, Defendants' motive and opportunity, and conscious misbehavior (*see* sections II.B-C., *supra*), easily satisfy scienter requirements.

Finally, Defendants' arguments about proximate cause are as flawed with respect to the repo-related claims as they are with respect to the other tort claims, and for the same reasons. Given the Funds' condition, it was entirely foreseeable that the Bank would be left holding the collateral for the repos. *See* Compl. ¶ 131 (Bank insisted on representations about financial health "precisely in order to avoid advancing funds to a potentially insolvent counterparty"). And it was entirely foreseeable that the value of those assets – which consisted of CDO and CDO-squared securities – would be diminished by the collapse of the Funds. Or in the terminology of loss causation, the decline in value of those assets was caused by the materialization of precisely the risk concealed by Defendants. *E.g.*, *id*. ¶¶ 126-127; section II.E, *supra*.

B. The Allegations of Aiding and Abetting Are Sufficient

Defendants challenge each of the elements of aiding and abetting fraud. *See* page 28, *supra*. Plaintiffs addressed the "existence of a fraud" element in section V.A. above.

On the "knowledge" requirement, BSAM argues only that plaintiffs "would have to allege that someone at the management level at BSAM, and not just the fund managers . . . had actual knowledge of what the Funds did or did not tell [the Bank] about the Funds' financial condition." Mem. 30. But the Complaint explains that Cioffi, Tannin, and McGarrigal knew that the Funds were withholding information from the Bank. And these individuals were (in addition to being officers of the Funds) managing directors or senior managing directors at BSAM; Cioffi was even a member of its board of directors. Compl. ¶¶ 8, 9, 11. There is no denying that these individuals were "at the management level at BSAM" or that their knowledge can be imputed to BSAM. *See, e.g.*, *In re CBI Holding Co.*, 529 F.3d 432, 448 (2d Cir. 2008) ("'[T]he misconduct of managers within the scope of their employment will normally be imputed to the corporation.'"); *Center v. Hampton Affiliates, Inc.*, 66 N.Y.2d 782, 784 (1985) (corporate officer's knowledge normally imputed to corporation).

Instead BSAM seems to be arguing (with no authority) that an individual cannot have been *both* a primary wrongdoer *and* have knowingly caused BSAM to lend substantial assistance. Whether or not that is true, it is irrelevant: discovery may reveal, for example, that one individual defendant, acting as a BSAM officer, knowingly lent assistance (or deliberately caused another BSAM employee under his control to lend assistance) to one of the other individuals (or to someone else at the Funds) in the commission of the primary fraud.

As for "substantial assistance," BSAM similarly argues that "plaintiffs do not identify any separate person at the management level at BSAM who allegedly assisted the fund managers or the Funds." Mem. 31. Again, Plaintiffs have identified three such individuals, any of whom might, in his capacity as a BSAM officer, have aided and abetted another fund manager or the Funds. Finally, BSAM's cursory contention that the allegations of substantial assistance are insufficiently particularized and fail to establish proximate cause, and McGarrigal's challenges to the knowledge and substantial assistance elements, *see id*; McGarrigal Mem. 13, are flawed for reasons discussed elsewhere in this memorandum. *See* pages 20-22, 28-29, 37 n.35, *supra*.

In sum: both the primary and aiding and abetting theories of liability are sufficiently pled.

CONCLUSION

The motions to dismiss should be denied.

Dated: Washington, D.C.
March 24, 2009

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