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New York Supreme Court

APPELLATE DIVISION—FIRST DEPARTMENT

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

Plaintiffs-Appellants-Cross Respondents,

—against—

COUNTRYWIDE HOME LOANS, INC., COUNTRYWIDE SECURITIES CORP., and COUNTRYWIDE FINANCIAL CORP.,

Defendants-Respondents-Cross Appellants,

—and—

BANK OF AMERICA CORP.,

Defendant.

BRIEF OF *AMICUS CURIAE* THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS-RESPONDENTS' CROSS-APPEAL

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I. STATEMENT OF INTEREST OF AMICUS CURIAE[1]

The Securities Industry and Financial Markets Association ("SIFMA") brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's membership encompasses both sides of the securities industry – companies that sell securities, including issuers and sponsors, and those that purchase securities, including institutional investors and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. An important function of SIFMA is to represent the interests of its members in cases addressing issues of widespread concern in the securities and financial markets.

SIFMA is heard as amicus curiae in cases that raise important policy issues that impact the markets represented by SIFMA or otherwise affect common practices in the financial services industry. SIFMA's case selection is judicious to ensure that its advocacy focuses on the most significant and pressing industry interests. This is such a case. SIFMA supports the appeal of Defendants-Respondents/Cross-Appellants (collectively "Countrywide") because the order on appeal in Ambac v. Countrywide (the "Appealed Order") contravenes more than a century of clear New York law and upends the express contractual agreements and

[1] No counsel for a party authored this brief in whole or in part, and no party or counsel for a party made a monetary contribution to fund the preparation or submission of this brief.

long-settled expectations of the participants in the multi-billion dollar securitization industry – from securitization issuers, sponsors and underwriters to investors.

Residential mortgage-backed securitizations ("RMBS") like those at issue here involve certificates that entitle investors to payment of principal and interest according to the underlying mortgage payments made by borrowers. Prior to the financial crisis, many RMBS transactions included a financial guaranty insurance policy issued by a monoline insurance company which guaranteed that investors would receive the promised payment of principal and interest on their certificates, even if borrowers failed to make payments on the underlying mortgages. Such financial guaranty policies were expressly "unconditional and irrevocable." Issuing such irrevocable financial guaranties was the sole insurance business of monoline insurers such as Ambac.

Ambac's complaint, like the complaints in the other actions brought in New York by monoline insurers involving RMBS, seeks money damages on common law claims of alleged fraudulent inducement and breach of contract. SIFMA takes no position here on the merits of these common law claims. SIFMA, however, takes serious issue with Ambac's attempt, endorsed by the trial court, to create a special version of New York common law applicable only to insurers based on pro-policyholder statutes that have no application to the claims Ambac has asserted. Such a result would have widespread adverse consequences to the financial industry and beyond.

New York law has always prohibited a party, particularly a sophisticated party like Ambac, from claiming to have been defrauded when the party fails to use the reasonable means available to it to investigate the truth of the representations it claims are false—in other words, when the party's actual reliance on the alleged misrepresentation was not justifiable. That bedrock common law principle promotes an important public policy: ensuring that commercial parties cannot turn a blind eye to the discoverable risks they undertake with the hope of using a fraud claim to avoid the consequences of those risks after they materialize. New York's requirement that parties identify important aspects of a transaction in advance and conduct due diligence into those aspects promotes predictability and stability between transacting parties and has been a fundamental reason why New York is a center for commercial transactions. The trial court's decision greatly expands potential fraud liability for transactions involving insurers by allowing them, years after they issued their policies, to recover damages based on alleged misrepresentations (i) on which they did not justifiably rely and (ii) that did not cause them to pay claims.

Here, the risk Ambac took is that market turmoil or other events might cause the borrowers of the loans underlying the transactions Ambac insured to miss their mortgage payments, which would lead to shortfalls in payments to certificateholders, triggering Ambac's duty to make the certificateholders whole. This is fundamentally the same risk taken by investors who purchased certificates that were not backed by financial guaranties—Ambac's issuance of a financial guaranty merely shifts the loss from the investor to Ambac. Some investors, who like Ambac were unhappy with the losses they incurred, have sued RMBS issuers for common law fraud, just as Ambac has done here. Again, SIFMA takes no position on the merits of those claims, but it is beyond dispute that those investors must prove justifiable reliance on the alleged misrepresentations to prevail. Ambac was exposed to those same losses, based on those same type of alleged misrepresentations, but offers no reason why its claims should receive special treatment merely because it was an insurer rather than an investor, particularly when monoline insurers like Ambac were in a far better position than investors to investigate and evaluate the transactions and collateral.

The trial court erred by creating a hybrid common-law/statutory scheme wherein monoline insurers can recover damages in a civil action against parties other than the insured for fraud or breach of contract without proving all of the essential elements of those claims. It did so based on its erroneous legal conclusion that Insurance Law §§ 3105 and 3106 "informed" Ambac's common law fraud and contract claims. The trial court held that § 3105 absolves monoline insurers of their burden to prove justifiable reliance on a fraud claim and § 3106 absolves them of their burden to prove that the breach caused their injury on a contract claim. Neither statute, however, transforms the common law in such a radical manner. The exclusive function of these insurance law provisions is to <u>limit</u> an insurers' right to rescind a policy or avoid paying claims by expressly requiring that any misrepresentation or breach of warranty be "material." They do not create new private rights of action, much less eliminate essential elements of common law causes of action for damages based on alleged fraud or breach of contract.

Ambac does not assert a claim in equity to rescind or avoid paying claims under its policies because it is contractually prohibited from doing so—Ambac issued insurance policies that are unconditional and non-rescindable. The only way §§ 3105 and 3106 could "inform" Ambac's claims is by precluding Ambac from recovering unless it sustains its burden of proving materiality, a burden that the common law imposes on Ambac in any event.

Moreover, the Appealed Order's use of the Insurance Law runs afoul of longstanding Court of Appeals precedent holding that statutes may never be construed to abrogate the common law, absent clear evidence of legislative intent. There is no such evidence or intent—to the contrary, the plain intent of §§ 3105 and 3106 was to limit insurers' rights, not expand them. In short, the Appealed

Order improperly applies an inapposite statute to create an unprecedented and unwarranted remedy that did not exist at common law.

Excusing monoline insurers from their burden to prove justifiable reliance and causation in pursuing damages in connection with common law claims is further inappropriate because the monoline insurers touted their sophisticated diligence practices as a reason that investors could rely on their financial guaranties. Monoline insurance was attractive to investors because it shifted the credit risk of the bond from the underlying assets backing the bonds to the insurers, who bore the highest investment-grade rating. A monoline guaranty could thus convert a certificate that might be only "BBB+" rated if issued without a guaranty into a bond that bore the monoline's "AAA" rating. Market participants understood and expected that the monolines would conduct their own extensive due diligence into the credit characteristics of the bonds they insured to give them the comfort necessary to back a BBB+-rated risk with an irrevocable and unconditional guaranty. The monolines reinforced this expectation in shareholders, bond investors, and rating agencies by publicly proclaiming their world-class sophistication and expertise in analyzing credit risks.

Ambac identifies no good reason that monolines, among all sophisticated commercial parties, should be freed from the common law requirements of providing justifiable reliance for fraud and causation for breach of contract. After all, a sophisticated party behaving diligently should be readily able to demonstrate a reasonable investigation into the risks about which it claims to have been misled. Ambac identifies no unique disability suffered by monolines that would place them at a relative disadvantage and require judicial intervention to loosen the common law requirements. Holding Ambac to the longstanding requirements that fraud plaintiffs must prove justifiable reliance and causation does not deprive it of all relief. Even assuming Ambac is unable to sustain its fraud claim because it could not demonstrate its reliance was justifiable, it would still have the opportunity to prove its entitlement to contractual remedies for breaches of representations and warranties to obtain the benefits of its risk allocation bargain. That would be an entirely just result.

On the other hand, affirming the trial court will create a moral hazard with significant detrimental effects on financial guaranty markets and insurance markets. In essence, the trial court conferred on all insurers regulated in New York a unique statutory privilege of turning a blind eye to hints of falsity of information from third parties on which they rely in credit underwriting. Under the trial court's approach, insurers would have nothing to gain but everything to lose if they employed the means readily available to them to investigate further in response to such red flags. They would have nothing to gain because, even if they stuck their heads in the sand they would retain a civil claim for fraud damages against third parties, freed from any burden to prove that their reliance was justifiable. On the other hand, conducting further inquiry could cause them to lose a premium revenue opportunity in the near term, and a fraud claim in the long-term (because they would already know the truth). Far better for revenue- and profit-focused insurers to seize the revenue in the deal at hand, hope that risks assumed will not come to pass, but if they do, then plan to resort to a specialized fraud claim that cannot be defeated by deliberate and conscious ignorance of available information.

This rule gives insurers an economic put: if the economy hums and things work out, they recognize their premium revenues and profits; but if the economy tanks and claims materialize, they can take advantage of any alleged misrepresentation to sue large financial institutions for all of their losses, including all of the economic losses they agreed to assume. This put encourages monoline insurers to ignore negative information, eschew the means of due diligence readily available to them to inquire further, and incur unevaluated risks in order to preserve a future fraud remedy. Insurers believed that performing additional due diligence, and thus gaining more knowledge about the truth or falsity of information they would like to claim reliance upon, could undermine the viability and value of their claims in future fraud litigation. That is precisely the opposite result that New York common law requires. Enforcing the justifiable reliance element ensures that sophisticated parties do not turn a blind eye to risk and attempt to shift blame after those risks materialize.

The Appealed Order's holding on loss causation would also subvert industry expectations of the role of monoline insurance. It would allow Ambac (and other RMBS insurers) to shift the risk of loss resulting from loans that complied with all of the contractual representations and warranties, yet defaulted due to the intervening real estate collapse in 2007 and 2008 or any number of alternative risks the monolines agreed to assume. In other words, it would permit recovery of damages even where no relief is available in common law fraud or breach of contract. The monolines indisputably accepted the risks that declining housing markets, recession, or changes in economic conditions could trigger payment obligations under the irrevocable guaranties they issued.

Yet now, as claims mount due primarily to the precise risk they insured against, monoline insurers seek to transfer that risk away from themselves and onto their counterparties. This result would allow a monoline insurer to recover 100 percent of its claims payments from securitization counterparties, without linking any of those payments to a breach of any representation or warranty, and regardless of the actual cause of the loss. All of these unintended consequences would be contrary to the well-defined allocations of risk embodied in the contracts at issue and New York law. This Court should not permit such a result.

II. PERTINENT BACKGROUND: THE NATURE AND EVOLUTION OF UNCONDITIONAL, IRREVOCABLE FINANCIAL GUARANTY INSURANCE

A. Monoline Insurance Expands From Municipal Bonds to Asset-Backed Securities, Taking on Increased Risks in Exchange for Increased Premiums

Monoline insurance companies provide unconditional and irrevocable financial guaranties that insure payments of principal and interest on financial instruments. The industry dawned in the early 1970s, when monoline insurers began to guarantee principal and interest payments on municipal bonds.[2] Monoline insurers structured their business model on so-called "zero-loss" opportunities presented by the relatively placid municipal bond markets and other government-backed debt offerings. By their "zero-loss underwriting," monoline insurers "claimed to have confirmed that the insurance would not be necessary except in very extreme cases."[3] These financial guaranties reduced the cost of borrowing for municipalities and government entities, as investors were receptive to lower interest rates in exchange for the security provided by a monoline financial guaranty of payment, sometimes called a "wrap."[4]

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[2] The State of the Bond Insurance Industry: Hearing Before the H. Subcomm. on Capital Mkts., Ins., and Gov't Sponsored Entities, 110th Cong., Serial No. 110-91 at 3 (2008) (hereinafter "Bond Insurance").

[3] "Bond Insurers Led into Temptation," Forbes/Investopedia, February 2, 2008 (available at http://goo.gl/zqrlVM).

[4] Bond Insurance, supra n. 2, at 66 (statement of Charles Chaplin, Chief Financial Officer, MBIA Inc.).

But bond insurance was relatively low reward in comparison to offering insurance in other securities markets. Beginning in the 1980s, monoline insurers extended their unconditional guaranties into private asset-backed securitizations.[5] By promising to make investors' certificate payments if there was a shortfall for any reason, monoline insurers could transform a lower-rated security into one of the highest credit quality. They were able to do this because of the core premise of the monoline business: their unconditional financial guaranties of payment cannot be revoked or rescinded.[6] The monolines' expansion into asset-backed securitizations featured an aggressive push to issue financial guaranties of RMBS.

In RMBS, a party (often called the "sponsor") first acquires a pool of residential mortgage loans, either through direct origination or by purchase on the open market from mortgage originators. To create the RMBS, the sponsor transfers these pooled loans through another entity (a "depositor"), which in turn transfers the loans to a special purpose trust. The trust then issues securities to

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[5] See ABN Amro Bank, N.V. v. MBIA Inc., 17 N.Y.3d 208, 217 (2011); Gotham Partners Mgmt. Co., Is MBIA Triple A? A Detailed Analysis of SPVs, CDOs, and Accounting and Reserving Policies at MBIA, Inc. at 11-12 (Dec. 9, 2002), available at http://goo.gl/bgl9md.

[6] Assured Guaranty 2011 Annual Report, at p. 2, available at http://assuredguaranty.com/investor-information/by-company/assured-guaranty-ltd/sec-filings/ ("We guarantee timely payment of principal and interest when due. Irrevocably. Unconditionally. We back our promise with $12.8 billion of claims-paying resources and do not quibble.").

investors. The payments of principal and interest on these securities are funded by the underlying mortgage loan payments.

To reduce the credit risk to investors, the sponsor may have contracted with a monoline insurer to issue financial guaranty insurance that guarantees payment on some or all of the securities. The insurer would be paid a substantial premium, usually based on the aggregate amount insured. By design, these insurance policies are expressly irrevocable and noncancellable (a feature which increases their value to investors, and consequently, the insurance premium charged). In other words, in exchange for significant compensation, the insurer entered the transaction having knowingly and intentionally relinquished the right to rescind coverage for any reason.

For its part, the sponsor typically provides certain representations and warranties regarding the credit quality and underwriting guidelines and standards used in originating the underlying mortgage loans. RMBS transactions in general, and the transactions at issue here, contain "repurchase protocols." When it is shown that a loan in the pool breaches a representation or warranty and such breach "materially and adversely" affects the interests of the certificateholders or insurers, the repurchase protocols require the sponsor to repurchase the loan from the trust (or replace it with a non-breaching loan). This standard process reflects the agreed-upon allocation of risk among the transaction parties. Indeed, this bargained-for repurchase remedy is the express "sole remedy" in many RMBS transactions, including the transaction at issue here. In other words, not only do insurers knowingly waive any right to rescind their policies, but in many deals they bargained for and accepted the sole contractual remedy of repurchase of breaching loans only.

Further, Ambac and other monoline insurers recognized the irrevocability of their obligations and their inability to avoid payments under them. As Ambac alleged in its complaint in this case: "Under its irrevocable Policies, Ambac <u>guaranteed that it would cover certain payments to purchasers of the securities regardless</u> of whether Countrywide's representations proved false and the mortgage loans did not generate the anticipated cash flow." Complaint, Dkt. No. 1 (Sept. 28, 2010), at ¶ 8 (emphasis added). And Ambac touted to investors that its insurance "provides an unconditional and irrevocable guarantee that protects the holder of a fixed income obligation against non-payment of principal and interest when due." Ambac 2006 10-K, at 2.[7]

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[7] Other monoline insurers include MBIA Insurance Corporation ("MBIA"), Assured Guaranty Corp. ("Assured"), Financial Guaranty Insurance Company ("FGIC"), and Syncora Guarantee Inc. ("Syncora"). They underscored this same understanding in statements made in their public filings and marketing materials:

- From MBIA's 2011 10-K, at 29: "The financial guarantees issued by [MBIA] insure the financial performance of the obligations guaranteed over an extended period of time, in some cases over 30 years, <u>under policies that we have, in most circumstances, no right to cancel</u> . . . . Moreover, although the second-lien RMBS obligations we insure <u>typically include contractual provisions obligating the sellers/services to cure, repurchase or</u>

B. Monoline Insurers Claim to Have Performed Sophisticated Analyses of the Loans in the RMBS Pools They Insured

Monoline insurers aggressively and successfully marketed their unconditional financial guaranty product to the RMBS industry by touting their depth of knowledge and sophistication in the mortgage markets. Ambac told investors in its SEC filings that its underwriting guidelines were "developed . . . with the intent that Ambac Assurance guarantees only those obligations which, in the opinion of [its] underwriting officers, are of investment grade quality with a remote risk of loss."[8] Ambac's Chairman, President, and Chief Executive Officer,

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replace ineligible loans . . . we are required to pay losses on these securities irrespective of any proceeding we initiate to enforce our contractual rights." (emphasis added).

- From Syncora's 2006 10-K, at 37: "Because our financial guarantee insurance and reinsurance policies are unconditional and irrevocable, we may incur losses from fraudulent conduct relating to the securities that we insure or reinsure . . . . Financial guarantee insurance and reinsurance provided by us is unconditional and does not provide for any exclusion of liability based on fraud or other misconduct" (emphasis added).
- From Assured's 2007 10-K, at 48: "The financial guaranties issued by us insure the financial performance of the obligations guaranteed over an extended period of time, in some cases over 30 years, under policies that we have, in most circumstances, no right to cancel." (emphasis added).
- The Association of Financial Guaranty Insurers (of which Ambac is a member) also provided testimony to the House of Representatives Financial Services Committee, stating that via financial guaranty insurance, "[i]nvestors have an unconditional guaranty against default on payment of principal and interest . . . . Financial guaranty insurers also waive all defenses including fraud and non-payment of premium." Mar. 12, 2008 Hearing on "Municipal Bond Turmoil: Impact on Cities, Towns, and States" (available at http://archives.financialservices.house.gov/hearing110/mccarthy031208.pdf) (emphasis added).

[8] Ambac 2006 10-K at 9-10 (emphasis added); see also In re Ambac Fin. Grp., Inc. Sec. Litig., 693 F. Supp. 2d 241, 248 (S.D.N.Y. 2010) ("Ambac's business model has always been based on establishing underwriting guidelines and procedures that enable the company to guarantee only those obligations that were 'of investment grade quality with a remote risk of loss.'").

Robert Genader, publicly described Ambac's "very conservative risk limits"[9] and its "disciplined and rigorous . . . scrutiny" of RMBS risks.[10] He stated in 2006 that Ambac's "passion . . . is trying to find the minute detail that can cause a transaction to go – not necessarily to pay a claim, but to get downgraded."[11] Other monoline insurers made the same claims. One of Ambac's principal competitors, MBIA, trumpeted its "rigorous underwriting process proving no losses will arise."[12]

Monoline insurers also touted that they obtained "additional rights, special protections . . . and information access beforehand as the senior creditor."[13] As MBIA's CEO testified in one of its cases:

> [B]ecause we insured the whole thing, we were like the owner of that debt issue. And we had clout and bargaining chips that weren't available for the average schmo in the marketplace . . . . [B]ecause of our reputation, and our structure, and our expertise, we basically turned the BBB market into an A market on average. And that's why the rating agencies allowed us to do it.[14]

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9 "Ambac Financial Group at Piper Jaffray Financial Services Conference - Final," FD Wire, Mar. 21, 2006 (available via Westlaw).

10 Ambac 2006 Annual Report, available at http://ir.ambac.com/annuals.cfm, at 4.

11 March 21, 2006 Piper Jaffray transcript, supra n. 9, at p. 3.

12 See "Fixed Income Investor Presentation, 3rd Quarter – 2006" by MBIA, at 3, 6, available at http://library.corporate-ir.net/library/88/880/88095/items/217914/FixedQ306.pdf.

13 Id.

14 MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC, Index No. 603751/09, Dkt. 997, Exhibit 2 to the Affirmation of Paul Rugani (Dunton Dep. Tr.) at 202:18-203:4.

Similarly, Tom Gandolfo, head of Ambac's Global Structured Credit Group, told investors in mid-2007 "[w]e believe our credit-risk analysis goes far beyond that which a typical CDO investor would perform."[15] Ambac's CEO, Genader, expounded: "We, the larger participants, really lead the industry. We lead the rating agencies. We are looking for pinhole risks, where the rating agencies are looking for ratings migration."[16] In other words, far from being an "average schmo" at the mercy of large banks, monoline insurers filled a key role in RMBS, transforming BBB collateral into A-rated investment grade to make the deals more attractive to investors. They were able to do this because other market participants, like the rating agencies, believed that they were using sophisticated diligence—which monolines touted as giving them "clout and bargaining chips"—to increase the value of the insured securities.

Because of this unique role in credit enhancement, monoline insurers played a significant role in the RMBS market before the financial crisis. From 1988 to 2007, MBIA insured over 275 RMBS transactions totaling over $69 billion in original insured balances.[17] At the end of 2007, Ambac was obligated on more

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15 Mr. Gandalfo made this statement during Ambac's July 25, 2007 conference call; the transcript was publicly filed in In re Ambac Securities Litigation, Case No. 08-cv-00411-NRB (S.D.N.Y.), Doc. No. 60-6, Exhibit 48, at 5.

16 March 21, 2006 Piper Jaffray transcript, supra n. 9, at p. 2.

17 See MBIA Insured Structured Finance Portfolio, available at http://www.mbia.com/investor/structfin.html.

than $31 billion in insured balances on RMBS transactions issued between 1998-2007.[18]

C. Monoline Insurers Admit That They Irrevocably Assumed the Risk of Loss for Loans that Meet Representations and Warranties, but Nevertheless Default as a Result of Market Volatility or for Any Other Reason

Financial guaranty insurance in RMBS transactions protects investors not only from individual loan defaults, but more importantly, it guarantees investment returns against the risk of systemic underlying loan defaults caused by a housing market decline, recession, widespread unemployment and the like. The monoline insurer, not the other transaction participants, contracted to assume such risks in exchange for substantial compensation. In its 2006 Form 10-K, Ambac summarized the nature of the risks it retained:

> Changes in general economic conditions can impact our business. <u>Recessions</u>; <u>increases in</u> corporate, municipal, and/or <u>consumer bankruptcies</u>; changes in interest rate levels; changes in domestic and international law . . . could adversely affect the performance of our insured portfolio and our investment portfolio.

Ambac 2006 10-K, p. 29 (emphasis added). One year later, Ambac acknowledged the "near record volumes of delinquencies and losses" occurring in the loans underlying its insured RMBS, and that "[c]ontinued increases in RMBS defaults . . . could adversely impact residential real estate values and the

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18 Ambac 2007 10-K at 56.

probability of default and severity of loss for our transactions." Ambac 2007 10-K, p. 51.

Accordingly, in pleadings in RMBS lawsuits filed in the wake of the worst real estate meltdown since the Great Depression, monoline insurers admit (as they should) that they—not their RMBS counterparties—assumed the risk that loans satisfying representations and warranties might nevertheless fail to perform. As Ambac admitted in its complaint, "Ambac as the insurer bore the risk and the burden of evaluating whether loans bearing the attributes represented by Countrywide would perform after the closing of the Transactions." Complaint ¶ 112; see also id. ¶ 116. As MBIA admitted in another RMBS complaint, this "fundamental allocation of risk was the heart of the parties' bargain." See Complaint, MBIA v. Credit Suisse Securities (USA) LLC, et al., No. 603751/2009 at ¶ 8. These admissions acknowledge the basis of the financial guaranty bargain—monoline insurers, in exchange for premiums, assume the risk that economic decline, market forces, or other systematic or idiosyncratic risks will cause delinquencies, even among properly underwritten loans.

Unfortunately, the risks that monoline insurers acknowledged in their disclosures occurred. As Ambac acknowledged in a court filing in October 2008, it faced "losses and writedowns in the wake of this extraordinary market-wide downturn" because its business was "based upon taking on credit risk in exchange for premium payments."[19] Now, faced with having to make good on its policies covering the precise risks that it (and other monolines) insured against, Ambac seeks to evade the unconditional and irrevocable obligations it agreed to by shifting to transaction counterparties the full amount of those risks.

III. THE APPEALED ORDER IMPROPERLY USES THE INSURANCE LAW TO ABROGATE COMMON LAW REQUIREMENTS OF JUSTIFIABLE RELIANCE AND CAUSATION

The Appealed Order alters the market understanding of risk allocation in two fundamental respects. It holds (i) that Ambac does not have to prove justifiable reliance as an element of its fraud claim; and (ii) that Ambac does not have to prove proximate causation as an element of its fraud or breach of warranty claims. The Appealed Order thereby abrogates the common law requirements of justifiable reliance and proximate cause by reference to Insurance Law §§ 3105 and 3106. Those statutes, however, must be and have historically been read narrowly and applied only where an insurer actually seeks rescission or to avoid payments under a policy. The unambiguous language of these provisions makes plain that they do not apply here because Ambac issued irrevocable and unconditional policies and thus cannot (and does not try to) "avoid [its] contract of insurance" or "defeat recovery thereunder." N.Y. Ins. Law §§ 3105(b), 3106(b). To the contrary,

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[19] In re Ambac Fin. Grp., Inc. Sec. Litig., Case No. 08-cv-00411-NRB, Dkt. 59, Memorandum in Support of Ambac and Individual Defendants' Motion to Dismiss the Consolidated Amended Class Action Complaint, at p. 1.

Ambac and other insurers continue to accept premiums, make claims payments, and otherwise affirm the contracts by seeking to enforce the repurchase protocols and contractual indemnity provisions. Until 2012, no New York court had ever held that an insurer could recover damages on common law claims for fraud or breach of contract by application of §§ 3105 and 3106.

A. Ambac and Other Monoline Insurers Cannot "Avoid" or "Defeat Recovery" On Their Non-Rescindable and Irrevocable RMBS Financial Guaranties

The trial court rejected common law requirements of pleading and proof by misplaced reference to Insurance Law §§ 3105 and 3106. These statutes address only two situations: (i) where an insurer seeks rescission – that is, seeks to "avoid an insurance contract" ab initio, or (ii) seeks to avoid payments under a policy – that is, "defeat recovery thereunder." N.Y. Ins. Law §§ 3105(b), 3106(b). Neither of these situations is present here nor in any of the other actions brought by monoline insurers against RMBS issuers in the wake of the financial crisis. Instead, the monoline plaintiffs seek money damages for breach of contract and fraud. Like the other monolines, Ambac cannot (and does not try to) rescind its irrevocable and unconditional policies and is barred by contract from avoiding payment or defeating recovery under its policies. See MBIA Ins. Corp. v. Countrywide Home Loans Inc., 105 A.D.3d 412, 413 (1st Dep't 2013) (holding rescission is "legally unavailable" where monoline insurer "voluntarily gave up the right to seek rescission—under any circumstances”) (emphasis original). To the contrary, consistent with their core business model and the express terms of their agreements, Ambac and other monolines remain obligated to make policy payments when due.

The New York Legislature knows how to create a statutory cause of action for damages. Mark G. v. Sabol, 93 N.Y.2d 710, 721-22 (1999) (identifying private right of action created by New York Legislature in Social Services Law Section 420 related to failure to report suspected child abuse). It did not do so in Sections 3105 or 3106. MBIA Ins. Corp. v. J.P. Morgan Sec. LLC, 64676/2012, 2014 WL 4797010, at *10 (Sup. Ct. Westchester Cnty. Sept. 18, 2014) (proposed claim “informed by” Section 3105 was duplicative of common-law fraudulent concealment claim). Neither statute creates a separate cause of action, expressly or by implication, for damages from alleged misrepresentation. Sabol, 93 N.Y.2d at 721-22 (refusing to imply private right of action where the statute had “never included private rights for money damages”); Burns Jackson Miller Summit & Spitzer v. Lindner, 59 N.Y.2d 314, 329 (1983) (no private right of action where “legislative intent to provide a private remedy cannot be discerned”). This is especially true where the insurer cannot “rescind” or “avoid” its insurance obligation because it continues to accept premiums and to pay claims.

Nor is there any language in §§ 3105 or 3106 suggesting that the legislature intended to alter the elements of longstanding common law claims. Instead, both statutes have the straightforward purpose of requiring insurers to show materiality when attempting to avoid or defeat claims. Section 3105 prohibits avoiding or denying insurance claims based on a misrepresentation "unless such misrepresentation was material." N.Y. Ins. Law § 3105(b)(1). Similarly, Section 3106 prohibits avoiding or denying insurance claims based on a breach of warranty unless it "materially increases the risk of loss." N.Y. Ins. Law § 3106(b). The fraud and contract claims Ambac pled both include materiality as an element, so the Insurance Law does not add anything new that the common law does not already require. See Compl. ¶¶ 176, 178-80 (alleging "materially false" statements as part of fraudulent inducement claim); id. ¶ 187 (alleging R&Ws were "material to Ambac's decision" as part of breach of contract claim); id. ¶ 193 (alleging material breach of contract).

The erroneous conclusions of the Appealed Order are contrary to the rulings of every trial court to consider the issues. Justice Scheinkman explained in dismissing one monoline's fraud claim and rejecting its attempt to eliminate justifiable reliance: "There is nothing in Insurance Law Section 3105 that dispenses with, or alters, the common law requirement that an insurer must show reliance upon the claimed misrepresentation in a fraud action." J.P. Morgan, 2014

WL 4797010, at *10 (emphasis added) (dismissing MBIA's fraud claim). Similarly, in Ambac Assur. Corp. v. First Franklin Fin. Corp., Justice Singh held that Section 3105 did not relieve a monoline insurer of its duty to prove justifiable reliance where the insurer "is seeking damages for fraud." No. 651217/2012, 2015 WL 5578267, at *4 (Sup. Ct. N.Y. Cnty. Sept. 17, 2015). In MBIA v. Credit Suisse, Justice Kornreich likewise rejected a monoline's contention that it was relieved of its burden to prove justifiable reliance by Section 3105: the Court properly held that the insurer bears "the burden on the fraud claim to show reliance, justifiable reliance, what you knew."[20]

B. Common Law Fraud Claims Require a Showing of Justifiable Reliance

To prove fraudulent inducement, Ambac must offer "clear and convincing" evidence, Valenti v. Trunfio, 118 A.D.2d 480, 484 (1st Dep't 1986), on each element, including that it justifiably relied on a false representation of material fact, Schumaker v. Mather, 133 N.Y. 590, 595 (1892).

New York law "imposes an affirmative duty on sophisticated investors to protect themselves from misrepresentations . . . by investigating the details of the

[20] MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC, Index No. 603751/09, Apr. 5, 2012 Hr'g Tr., Dkt. No 222 at 21:25-22:2; MBIA Ins. Corp. v. Credit Suisse Sec. (USA) LLC, No. 603751/09, 2011 WL 4865133 (Sup. Ct. N.Y. Cnty. Oct. 7, 2011) (Kornreich, J.) ("Fraudulent inducement requires . . . 'justifiable reliance' on the misrepresentation."); accord Assured Guar. Mun. Corp. v. DLJ Mortgage Capital, Inc., No. 652837/2011, 2014 WL 3288335, at *2 (Sup. Ct. N.Y. Cnty. July 3, 2014) (Kornreich, J.) (the "elements of a cause of action for fraud require," among other things, "justifiable reliance by the plaintiff") (citation omitted).

transactions." Global Minerals & Metals Corp. v. Holme, 35 A.D.3d 93, 100 (1st Dep't 2006). "A plaintiff suing for fraud (and particularly a sophisticated plaintiff . . .) must establish that it 'has taken reasonable steps to protect itself against deception.'" Basis Yield Alpha Fund Master v. Morgan Stanley, 23 N.Y.S.3d 50, 55 (1st Dep't 2015).

Indeed, in a 2015 ruling fully applicable here, the Court of Appeals held that a financial guaranty insurer must have "justifiably relied on the alleged misrepresentations" in order to have a fraud claim. ACA Fin. Guar. Corp. v. Goldman, Sachs & Co., 25 N.Y.3d 1043, 1044 (2015). The justifiable reliance requirement protects against moral hazard in transactions. Parties without a duty to investigate will have no incentive to undertake any investigation, and instead will be encouraged to turn a blind eye to risks, safe in the knowledge that they can capitalize on the upside of a transaction and avoid the downside after the fact through a claim that they were defrauded.

In limited circumstances, a plaintiff might "be justified in accepting [a] representation rather than making its own inquiry." DDJ Mgmt., LLC v. Rhone Group LLC, 15 N.Y.3d 147, 154 (2010) (ruling on motion to dismiss). However, when "there were numerous hints from which [plaintiff] would have been put on guard with respect to the inherent risk involved in the[] transactions," the plaintiff cannot reasonably rely on such representations without conducting its own due diligence to determine their accuracy. Ambac Assur. Corp. v. EMC Mortg. LLC, No. 651013/2012, 2013 WL 2919062, at *6 (Sup. Ct. N.Y. Cnty. June 13, 2013); see also Syncora Guarantee Inc. v. EMC Mortg. LLC, No. 653519/2012, 2013 WL 4533591, at *4 (Sup. Ct. N.Y. Cnty. Aug. 21, 2013) (same).

When assessing a plaintiff's claims of justifiable reliance, New York law requires a "contextual view, focusing on the level of sophistication of the parties, the relationship between them, and the information available at the time of the operative decision." J.P. Morgan Chase Bank v. Winnick, 350 F. Supp. 2d 393, 406, 408 (S.D.N.Y. 2004). In particular,

> "[a] heightened degree of diligence is required where the victim of fraud had hints of its falsity." This rule applies where the "circumstances [are] so suspicious as to suggest to a reasonably prudent plaintiff that the defendants' representations may be false"; in such cases, a plaintiff "cannot reasonably rely on those representations, but rather must 'make additional inquiry to determine their accuracy."' Once the duty to inquire is triggered . . . a plaintiff is foreclosed from bringing a claim for false representations if no inquiry is made . . . .

Id. at 406, 408.

The Appealed Order ignores more than one hundred years of tort law in New York by holding that sophisticated insurers can recover damages even when they did not perform the reasonable investigations required of sophisticated parties in any other fraud action. Ambac recited reasonable reliance as an element of its claim (¶ 181) and expressly pled that it completed this reasonable investigation (¶¶ 110-116); it must now prove it.

C. Common Law Fraud and Breach of Contract Claims Require a Showing of Causation

This Court previously and correctly held in another monoline action that "[t]o demonstrate fraud, a plaintiff must show, inter alia, that a defendant's misrepresentations were the direct and proximate cause of the claimed losses." MBIA Ins. Corp. v. Countrywide Home Loans, Inc., 87 A.D.3d 287, 295 (1st Dep't 2011). Other RMBS cases state the same controlling rule in addressing claims of fraud by monoline insurers. See Assured Guar. Mun. Corp. v. DLJ Mortg. Capital, Inc., No. 652837/2011, 2014 WL 3288335, at *9 (Sup. Ct. N.Y. Cnty. July 3, 2014) (Kornreich, J.) ("Even though Assured does not have to parse out losses caused by non-conformance from losses caused by market forces, it still must prove that its losses were caused by non-conforming, as opposed to conforming loans."); Fin. Guar Ins. Co. v. Countrywide Home Loans, Inc., Index No. 650736/2009 (Sup. Ct. N.Y. Cnty. June 15, 2010) (Bransten, J.) ("To establish causation, plaintiff must show both that defendant's misrepresentation induced plaintiff to engage in the transaction in question (transaction causation) and that the misrepresentations directly caused the loss about which plaintiff complains (loss causation).") (emphasis in original) (quoting Laub v. Faessel, 297 A.D.2d 28, 31 (1st Dep't 2002)); see also Friedman v. Anderson, 23 A.D.3d 163, 167 (1st Dep't

2005) ("To establish a fraud claim, a plaintiff must demonstrate that a defendant's misrepresentations were the direct and proximate cause of the claimed losses.").

The same causation requirement applies to claims sounding in breach of contract. Kenford Co. v. County of Erie, 73 N.Y.2d 312, 319 (1989) ("It is well established that in actions for breach of contract, the nonbreaching party may recover general damages which are the natural and probable consequence of the breach."); Fruition, Inc. v. Rhoda Lee, Inc., 1 A.D.3d 124, 125 (1st Dep't 2003) (holding that breach of contract damages "are such as ordinarily and naturally flow from the non-performance" and "must be proximate and certain, or capable of certain ascertainment, and not remote, speculative or contingent").

D. The Insurance Law Must Be Read Narrowly and Cannot Change the Common Law of Fraud and Breach of Contract by "Implication"

New York statutes and Court of Appeals precedent mandate a narrow reading of the Insurance Law. On their face, Sections 3105 and 3106, relied upon by Ambac, apply to claims for rescission and cancellation only – specifically, when an insurer seeks to "avoid an insurance contract or defeat recovery thereunder." N.Y. Ins. Law § 3106(b). As noted, monoline insurers cannot rescind their RMBS policies by litigation. Rather, consistent with their core business model and the express terms of their agreements, they are obligated to make policy payments when due.

"Generally, statutes in derogation of the common law receive a strict construction." McKinney's Cons. Laws of N.Y., Book 1, § 301(a). "The common law is never abrogated by implication, but on the contrary it must be held no further changed than the clear import of the language used in a statute absolutely requires." Id., § 301(b). The Court of Appeals and the First Department hold that these principles apply to the Insurance Law. In re Midland Ins. Co., 16 N.Y.3d 536, 547 (2011) (applying § 301 to the Insurance Law, narrowly construing statute); LMWT Realty Corp. v. Davis Agency Inc., 205 A.D.2d 479, 479 (1st Dep't 1994) (applying § 301 and refusing to apply the Insurance Law to abrogate common law; "a long established . . . common-law rule . . . cannot be abrogated merely by implication").

The Appealed Order ignores and directly contravenes these authorities because its practical effect is to extend §§ 3105 and 3106 to abrogate the common law and create remedies where at common law there were none. It does so by stripping the fundamental element of causation from common law claims by implication based on an expansive reading of the statute. By applying the Insurance Law far outside of its unambiguous, limited scope, the Appealed Order contravenes fundamental principles of statutory interpretation, the black-letter elements of common law fraud and contract claims, and the controlling holdings of this Court.

Insurance Law §§ 3105 and 3106 provide no cause of action for damages. In fact, the Insurance Law's legislative history demonstrates that these provisions were intended as consumer protection laws, not as offensive weapons for an insurer. The legislature amended the Insurance Law in 1938 to "abolish the technical rule that an immaterial breach of warranty avoids an insurance contract," in order to protect insureds from improper policy cancellations. N.Y. Ins. Law § 150, Ins. Dep't Revision Note (McKinney 1949). Consequently, the New York cases invoking those provisions address cancellation or the refusal to pay (typically, under policies of life, health, or auto insurance), not an insurer's common law claims for breach of contract or fraud. The legislature did not intend to create a new cause of action for insurance companies or to ease their burden of proof.

For these reasons, most courts to squarely examine the issue hold that §§ 3105 and 3106 apply only when a party states a viable claim to rescission or defeating a claim under the policy. In GuideOne Specialty Mutual Ins. Co. v. Congregation Adas Yereim, 593 F. Supp. 2d 471, 486 (E.D.N.Y. 2009), the court held:

> In point of fact, § 3105(b) lacks any language creating causes of action relating to misrepresentations by an insured or defining any defenses to such an action . . . . Where an insurer complains solely about misrepresentations during contract formation, as GuideOne does here, New York law arms the insurer

> only with the hatchet of rescission and not the scalpel of unilateral modification. By its inconsistent conduct [i.e., the acceptance of premiums], GuideOne has forfeited its right to the hatchet – its only weapon under § 3105(b).

Id. (emphasis added); see also Gluck v. Exec. Risk Indem., Inc., 680 F. Supp. 2d 406, 418 (E.D.N.Y. 2010) ("The case that comes closest to addressing whether [3105's standard for] materiality applies to [policy] exclusions is [GuideOne] . . . . There, it was determined that Insurance Law § 3105 applies only when an insurer is seeking the remedy of rescission."). The Appealed Order thus cuts against both the letter and the spirit of the New York Insurance Law.

The approach that the trial court took to §§ 3105 and 3106 also threatens to disturb other common law claims in other contexts. Under the trial court's rationale, any number of statutes could "inform" the common law by eliminating essential elements of proof even though the New York Legislature expressed no intent to do so. Parties rely on the common law—and the role of *stare decisis* in interpreting the common law—to form their expectations and guide their course of dealings. Selectively using statutes enacted for other purposes to modify the elements of common law claims in isolated circumstances or when certain parties are involved introduces substantial uncertainty in the law that will lead to unnecessary disputes, protracted litigation, and frustrated commercial expectations. This is precisely the reason that courts construe statutes narrowly and do not presume modification to the common law absent express indication that result is what the legislature intended.

E. This Court Should Not Use the Insurance Law to Abrogate Long-Standing Elements of Fraud and Contract Claims and Contradict the Expectations of the Parties and Investors

1. Requiring Sophisticated Monoline Insurers to Prove Justifiable Reliance on Fraud Claims Meets Market Expectations

Under this Court's decisions, the precise contours of the monoline insurer's required investigation must be analyzed in light of the specific factual context. See CIFG Assur. N. Am., Inc. v. Goldman, Sachs & Co., 106 A.D.3d 437, 437-38 (1st Dep't 2013) (reasonableness of insurer's reliance involved "a question of fact" not resolvable at the pleading stage). But there can be no doubt that prudent due diligence is necessary for insurers unconditionally and irrevocably assuming billions of dollars of risk in complex financial products.

Ambac asserts that it should not have had to "go to great lengths to investigate the truth" of RMBS sponsor representations. Ambac Reply Br. at 25. It tries to reassure the Court that "[n]o reasonable insurer would take careless, unknowable risks of fraud in the hope that it can recover damages when faced with . . . losses." Id. at 26. But justifiable reliance is not about unknowable risks. Instead, New York law does require sophisticated parties to be careful—to only make unconditional, irrevocable contracts (and collect the corresponding benefits) in justifiable reliance on material representations. E.g., HSH Nordbank AG v. UBS AG, 95 A.D.3d 185, 195 (1st Dep't 2012) ("The principle that sophisticated parties have a duty to exercise ordinary diligence and conduct an independent appraisal of the risk they are assuming has particular application where, as here, the true nature of the risk being assumed could have been ascertained from reviewing market data or other publicly available information.") (internal citations, alterations and quotation marks omitted). Monoline insurers cannot have it both ways. When they choose not to perform that reasonable investigation into knowable risks, they cannot bring a common law fraud claim in New York.

By contrast, an insurer offering conditional and rescindable policies can use §§ 3105 and 3106 when rescinding or defeating claims. Certain rescindable life insurance policies are offered without requiring the insurer to conduct physical examinations or elaborate reviews of medical records. Certain rescindable property insurance policies are offered based on promises to maintain functioning fire safety measures like sprinkler systems or smoke detectors without requiring the insurer to conduct constant inspections. For these rescindable policies offered to consumers in high volumes at lower margins, not requiring reasonable investigations benefits the public by keeping investigation costs – and corresponding premiums – low and proportional to the risk assumed.

No such benefit would flow to the public if §§ 3105 and 3106 are judicially extended to low-volume, high-value non-rescindable RMBS guaranties.[21] The effect would be the opposite. Monoline insurers made extensive, repeated representations that they adopted prudent, conservative risk underwriting practices. The investors who purchased RMBS securities in reliance on the monoline insurers' vote of confidence are harmed if the insurers' failure to perform the reasonable review of the collateral they blessed receives judicial sanction.[22]

2. Requiring Monoline Insurers to Prove Loss Causation Comports with the Contractual Risk Allocation

Permitting monoline insurers to recover damages on conforming loans – loans that they admittedly assumed the risk on – turns the allocation of risk in RMBS contracts on its head.

The representations and warranties ubiquitous in RMBS securitizations are generally part of a "repurchase protocol," which in many cases provides the "sole remedy" available to certain transaction participants. See, e.g., Ambac Assur. Corp. v. EMC Mortg. LLC, 121 A.D.3d 514, 515-516 (1st Dep't 2014). Even where insurers are not held by contract to the "sole remedy" of repurchase and are

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[21] In one action, an RMBS sponsor has offered expert testimony that the cost of a review of 400 loan files would have been $80,000 in 2007, and that some monoline insurers did conduct reviews of selected loan files in the 2003-2007 time period. MBIA v. Credit Suisse, Index No. 603751/09, Dkt. No. 1043, Affidavit of Charles Grice, ¶¶ 3-4.

[22] For these reasons, motor vehicle insurance claims do not provide a "similar context," contrary to Ambac's contention. Ambac Reply Br. at 21.

entitled to assert claims for damages, monoline insurers are often permitted to assert repurchase claims and have aggressively pursued those contractual rights. See, e.g., Compl. ¶ 163 (alleging demand that Countrywide repurchase 5,734 allegedly defective loans). Ambac's complaint in this very action acknowledges the risk retention and allocation that underlies the repurchase protocols. Id. at ¶ 116 ("Countrywide accepted the risks that its broad and extensive representations were false, while Ambac accepted the risk that mortgage loans that conformed to Countrywide's representations and warranties would not perform as expected.").

The recognition of the risk allocation implemented by repurchase protocols is likewise reflected in the American Securitization Forum's ("ASF") model representations and warranties. The ASF includes Ambac and other monoline insurers among its participants.[23] In 2009, the ASF surveyed practices in the RMBS industry and published Model Representations and Warranties for future RMBS transactions. The ASF "continues to advocate that risk retention or skin in the game for originators and issuers of RMBS be implemented through the representations and warranties that originators and issuers provide with respect to the mortgage loans sold into the securitization trust coupled with meaningful

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[23] American Securitization Forum, "ASF Model RMBS Representations and Warranties" at 1, Dec. 15, 2009, available at http://www.americansecuritization.com/content.aspx?id=3461&terms=project%20restart (hereinafter, "ASF Model Reps"). Monoline insurers Ambac, MBIA, Assured, CIFG, and Syncora all are or were members of the ASF.

remedial [repurchase] mechanisms designed to ensure their enforcement." ASF Model Reps, supra n. 23, at 4. If permitted to stand, however, the Appealed Order marginalizes this regime in favor of a hybrid legal/equitable remedy that is flatly inconsistent with the parties' contractual rights.

Despite the admitted unavailability of rescission-type remedies and the acceptance of the risk allocation inherent in transactional repurchase protocols, Ambac seeks to achieve the very remedies monoline insurers surrendered in issuing irrevocable policies. The availability of this unintended remedy ensures one thing: that rather than comply with contractual repurchase standards, monolines will instead attempt to litigate and avoid their obligations entirely. If the law gives the monoline insurer the very tool that it contractually waived (the "hatchet" of rescission), the insurer will have no reason to use the tool that it contractually obtained (the "scalpel" of repurchase).

Monoline insurers admit that perfectly underwritten collateral will nevertheless incur some default. See, e.g., Financial Security Assurance (now Assured), "A Guide to Insured Asset-Backed Securities," October 1999, at 9 ("Asset risk is present because some losses are expected to occur in any large pool of receivables.").[24] Similarly, the securitization industry recognizes that not all origination defects result in defaults and, consequently, in losses. For example, the

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[24] Available at https://goo.gl/Zgf8WG.

ASF describes that "[g]enerally, if a borrower has been current for an extended period of time, the chances of the borrower defaulting due to a latent origination defect or the loan having been fraudulently originated become considerably smaller." ASF Model Reps at 6 (emphasis added). The Appealed Order would now permit monoline insurers to evade this reality by absolving them of the longstanding burden of proof of loss causation.

IV. THE INSURANCE LAW HAS NO IMPACT ON AN INSURER'S COMMON LAW CLAIMS SEEKING TO RECOVER CLAIMS PAYMENTS

This Court's 2013 decision in MBIA v. Countrywide included an internal inconsistency that has proved challenging for the trial courts to reconcile. There, the Court opined:

> [T]he motion court was not required to ignore the insurer/insured nature of the relationship between the parties to the contract in favor of an across the board application of common law. Although the Insurance Law provides for "avoid[ing]" and insurance policy (or rescission), it also mentions "defeat[ing] recovery thereunder," which, logically, means something other than rescission. Neither defendants, nor the federal cases on which they rely, explain why "defeat[ing] recovery thereunder" cannot refer to the recovery of payments made pursuant to an insurance policy without resort to rescission.

105 A.D.3d 412, 412 (1st Dep't 2013) (citations omitted).

On one hand, this decision appropriately dismissed the monoline insurer's request for "rescissory damages." That remedy, if allowed, would permit the monoline insurer to avoid its retained risk and its contractual obligations. In practical terms, this Court's rejection of rescissory damages recognized that a monoline insurer that cannot (and does not) seek rescission may not recover all claims payments made under its policies – including payments arising from conforming, non-breaching underlying loans that defaulted for reasons having nothing to do with any alleged fraud or breach of warranty.

On the other hand, the Court affirmed the trial court's ruling, as "informed by" Insurance Law §§ 3105-06, that the insurer is "not required to establish causation in order to prevail on its fraud and breach of contract claims." But the trial court's finding that the Insurance Law applies formed the analytical predicate for its holding – reversed by the decision – that rescissory damages were appropriate. Thus, MBIA v. Countrywide's holding on causation is inconsistent and irreconcilable with its rejection of rescissory damages.

Moreover, no prior case had held that Insurance Law §§ 3105-06 are applicable to common law causes of action for money damages, asserted by an insurer that continues to perform under its contracts, rather than rescinds or denies payments. MBIA v. Countrywide thus could be interpreted to support an unprecedented "insurer-only" rule for fraud and contract claims, relieving them of the common law burden to prove proximate cause applicable to all other plaintiffs. Changing that bedrock rule years after the transactions closed will prejudice securitization industry participants. The sophisticated parties to mortgage-backed securitizations negotiated and bargained for allocations of risk and loss by reference to the standards of the common law.

As demonstrated by the Appealed Order, trial courts have struggled with the questions left open MBIA v. Countrywide. For example, assuming that the Insurance Law could be construed to provide a streamlined cause of action for damages – what are the elements of this cause of action? The Appealed Order answered that the elements can be gleaned from the Insurance Law itself, without any reference to the common law. Slip op. at 5-6. Other Parts have disagreed. J.P. Morgan, 2014 WL 4797010, at *10; First Franklin, 2015 WL 5578267, at *4; MBIA v. Credit Suisse, supra p. 23. What is the measure of recovery of this hypothetical claim under the Insurance Law? MBIA v. Countrywide (correctly) declares "rescissory damages" unavailable, but what does the term "recovery of payments made pursuant to an insurance policy" entail? Ambac argues here that it means it can recover all of its claims payments, regardless of whether those payments are attributable to the allegedly breaching loans. This would constitute the exact rescissory damages that the Court held are unavailable and would strike the entire contractual allocation of risk in financial guaranty insurance in one fell swoop.

SIFMA respectfully submits that "defeat[ing] recovery thereunder" must be construed to mean what it says. An insurer may rely on that provision to rescind or deny payments under an insurance policy – the opposite of the facts here. Nothing in the Insurance Law supports an affirmative cause of action for damages in the amount of payments already made. The statute does not provide an alternative to the core proximate causation analysis for damages claims. Nor does it specify what might be required for any alleged "statutory" cause of action, even assuming one existed. Because MBIA v. Countrywide offers an unprecedented application of these Insurance Law provisions, and because the decision has import not only in this case but across the securitization industry, SIFMA respectfully requests that the Court reaffirm longstanding common law and reverse the Appealed Order.

CONCLUSION

For the reasons and upon the authorities set forth above, this Court should reverse the Appealed Decision insofar as it holds that a monoline insurer (i) is not required to prove justifiable reliance as an element of its fraudulent inducement claim for damages and (ii) is not required to prove loss causation on claims for damages for fraudulent inducement or breach of contract.

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