

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: Hon. Melvin L. Schweitzer Justice PART 45

Nomura Asset Capital and Asset Securitization Corporation,
Plaintiffs,
Cadwalader, Wickersham & Taft LLP,
Defendant.

INDEX NO. 116147/2006
MOTION DATE _____
MOTION SEQ. NO. 001
MOTION CAL. NO. _____

The following papers, numbered 1 to _____ were read on this motion to/for _____

	PAPERS NUMBERED
Notice of Motion/ Order to Show Cause — Affidavits — Exhibits ...	_____
Answering Affidavits — Exhibits _____	_____
Replying Affidavits _____	_____

Cross-Motion: Yes No

Upon the foregoing papers, it is ordered that this motion is granted in part to the extent that the second cause of action is dismissed, and is otherwise denied as set forth in the attached Decision and Order of the Court;
Defendant is directed to serve an answer to the complaint within 20 days after service of a copy of the Decision and Order with Notice of entry.

MOTION/CASE IS RESPECTFULLY REFERRED TO JUSTICE DATED: _____ J.S.C.

Dated: April 28, 2009

Melvin L. Schweitzer J.S.C.

Check one: FINAL DISPOSITION NON-FINAL DISPOSITION

Securitization Corporation (ASC), pursuant to a Mortgage Loan Purchase and Sale Agreement (the MLPSA) dated as of October 24, 1997. In the MLPSA, Nomura made various representations and warranties concerning the Loans to ASC. ASC, in turn, entered into a Pooling and Servicing Agreement (the PSA) with LaSalle Bank National Association, formerly known as LaSalle National Bank (LaSalle), also dated as of October 24, 1997, pursuant to which ASC deposited the Loans into a trust fund (the D5 Trust), of which LaSalle was the trustee; made certain representations and warranties concerning the Loans to LaSalle; and assigned to LaSalle all of its right, title and interest in and to the Loans and its rights under the MLPSA, including the representations and warranties contained therein, indicating its intent to sell fractional interests in the D5 Trust to investors. In the PSA, ASC also warranted that all of the representations and warranties made by Nomura in the MLPSA with respect to each of the Loans were true and correct as of the date when the PSA was executed (*see* PSA, § 2.03 [b] [v]). The MLPSA and the PSA each provided that if there was a breach of certain of the representations and warranties concerning a Loan, Nomura and/or ASC were required within 90 days of notice thereof either to promptly cure the breach or to repurchase the Loan at a “Repurchase Price,” which included the unpaid principal and interest on the Loan and any expenses arising out of the enforcement of the repurchase obligation (PSA, § 1.01 at 52-53; *see also* PSA, § 2.03 [d], [e]; MLPSA, ¶ 3 [b]).

After various defaults in repayment of the Loans occurred, LaSalle commenced two actions against Nomura and ASC in which it alleged breaches of certain of the representations and warranties contained in the MLPSA. The first action, commenced in the United States District Court for the Southern District of New York on or about November 14, 2000 (the

Federal Action) concerned a mortgage Loan in the amount of \$50 million (the Doctors Hospital Loan) which was secured by Doctors Hospital in Chicago, Illinois. The second action, commenced in the Supreme Court of the State of New York on October 23, 2003 (the State Action), concerned each of the 155 other Loans which comprised the D5 Trust.

In the action here, Nomura and ASC assert three causes of action which allege that Cadwalader committed malpractice in connection with, respectively: (1) the Doctors Hospital Loan; (2) four Loans involving properties leased by Kmart Corporation and/or its affiliates; and (3) a Loan in the amount of \$2.55 million to the owner of a Best Western Old Hickory Inn.

DISCUSSION

“On a motion to dismiss pursuant to CPLR 3211, the pleading is to be afforded a liberal construction (*see*, CPLR 3026)” (*Leon v Martinez*, 84 NY2d 83, 87 [1994]). “We accept the facts as alleged in the complaint as true, accord plaintiffs the benefit of every possible favorable inference, and determine only whether the facts as alleged fit within any cognizable legal theory” (*id.* at 87-88). “Under CPLR 3211 (a) (1), a dismissal is warranted only if the documentary evidence submitted conclusively establishes a defense to the asserted claims as a matter of law” (*id.* at 88). “In assessing a motion under CPLR 3211 (a) (7), however, ... the criterion is whether the proponent of the pleading has a cause of action, not whether he has stated one” (*id.* [citation and internal quotation marks omitted]).

“In order to prevail on a claim for legal malpractice, a party must establish that the attorney failed to exercise that degree of care, skill and diligence commonly possessed and exercised by a member of the legal community, that such negligence was a proximate cause of

the loss in question, and that actual damages were sustained” (*Barbara King Family Trust v Voluto Ventures LLC*, 46 AD3d 423, 424 [1st Dept 2007]). “Proximate cause requires a showing that ‘but for’ the attorney’s negligence, the plaintiff would either have been successful in the underlying matter or would not have sustained any ascertainable damages” (*id.*; *see also Rudolf v Shayne, Dachs, Stanisci, Corker & Sauer*, 8 NY3d 438, 442 [2007]).

The Doctors Hospital Loan

The D5 Trust was intended to be operated as a Real Estate Mortgage Investment Conduit (REMIC), in order that it would qualify for an exemption from having to pay federal income tax at the trust level. Plaintiffs’ first cause of action alleges that Cadwalader committed malpractice in connection with the Doctors Hospital Loan relating to two representations and warranties contained in the MLPSA which were intended to ensure the D5 Trust satisfied Internal Revenue Service requirements for classification as a REMIC.

Each of the mortgage loans in a REMIC trust must be a “qualified mortgage,” a term which subsection 860G (a) (3) (A) of the Internal Revenue Code (26 USC § 860G [a] [3] [A]) defines to include “any obligation ... which is principally secured by an interest in real property,” and which satisfies certain other criteria not relevant here. A mortgage loan is deemed to be “principally secured by an interest in real property,” in general terms, only if (a) the fair market value of the real property securing the loan is equal to at least 80% of the amount of the loan or (b) substantially all of the proceeds of the loan are used to purchase or improve the underlying real property (*see* 26 CFR 1.860G-2 [a] [1]).

Plaintiffs allegedly engaged Cadwalader to represent them in connection with the D5 Securitization and, more specifically, to advise Nomura as to how to originate certain of the Loans in order to comply with REMIC regulations, to draft the MLPSA and the PSA, and to render a legal opinion that the D5 Trust qualified as a REMIC. Cadwalader allegedly advised Nomura that it needed to obtain an MAI appraisal of each of the properties securing the Loans in order to demonstrate the values of the properties were sufficient to satisfy REMIC regulations. Nomura obtained an appraisal for the property which secured the Doctors Hospital Loan, dated August 28, 1997 (the Appraisal), which concluded that the property had a total market value of \$68 million, comprised of components attributable to land, improvements, equipment and intangibles. Cadwalader allegedly issued an opinion letter (the First Opinion Letter) on October 24, 1997, the date of the closing on the D5 Securitization (Closing Date), stating that the D5 Securitization was REMIC-qualified for federal income tax purposes. The complaint alleges Cadwalader issued the First Opinion Letter without having reviewed the Appraisal.

The MLPSA contains two representations and warranties relating to the D5 Trust's qualification as a REMIC which warrant that:

- (1) each Loan "is directly secured by a Mortgage on a commercial property or multifamily residential property," and "the fair market value of such real property as evidenced by an MAI appraisal conducted within 12 months of the origination of the Mortgage Loan, was at least equal to 80% of the principal amount of the Mortgage Loan" (MLPSA, ¶ 2 [b] [xxix]; hereinafter, the 80% Warranty); and

(2) “[e]ach Mortgage Loan constitutes a ‘qualified mortgage’ within the meaning of Section 860G (a) (3) of the [Internal Revenue] Code ...” (*id.*, ¶ 2 [b] [xxx]); hereinafter, the Qualified Mortgage Warranty).

The borrower on the Doctors Hospital Loan filed a bankruptcy petition and defaulted on that Loan. On June 1, 2000, LaSalle provided ASC with written notice of breach of representation and warranty claiming that the Loan was not a “qualified mortgage” because the value of the real property set forth in the Appraisal for REMIC purposes was only \$30.96 million, or approximately 60% of the amount of the loan proceeds paid to the borrower at the closing, rather than the required 80%; and the proceeds of the Loan had not been used to purchase or improve the underlying real property.

Cadwalader then allegedly issued to ASC another opinion letter dated June 29, 2000 (the Second Opinion Letter) which ASC, in turn, provided to LaSalle. Cadwalader stated it had reviewed the Appraisal and a supplemental letter from the appraiser dated June 29, 2000 (the Appraisal Supplement) which was attached to the Second Opinion Letter. The Appraisal Supplement set forth the meaning of the term “real property” under the REMIC regulations and indicated that of the \$68 million total market value ascribed to the Doctors Hospital property in the Appraisal, \$45.08 million was attributable to property qualifying as real property under the REMIC regulations (*see Stovall Affirm.*, Ex. C). In the Second Opinion Letter Cadwalader opined that, based upon its review of the Appraisal and the Appraisal Supplement, the Doctors Hospital Loan was a “qualified mortgage” under subsection 860G (a) (3) of the Internal Revenue Code both at the time when it was contributed to the D5 Trust and as of the date of the Second Opinion Letter (*see id.*).

LaSalle commenced the Federal Action on or about November 14, 2000, which alleged that Nomura and ASC had breached three of the representations and warranties in the MLPSA regarding the Doctors Hospital Loan, the 80% Warranty; the Qualified Mortgage Warranty; and a third warranty which provides that, “[w]ith respect to each Mortgage Loan originated by [Nomura], no fraudulent acts were committed by [Nomura] during the origination process of such Mortgage Loan and the origination, servicing and collection of each Mortgage Loan is in all respects legal, proper and prudent in accordance with customary industry standards (MLPSA, ¶ 2 [b] [xix] [A]; hereinafter, the Origination Warranty).

The District Court granted a motion by Nomura and ASC for summary judgment dismissing LaSalle’s claim for breach of the three representations and warranties. The court found there had been no breach of the Qualified Mortgage Warranty because, first, Nomura and ASC were entitled to the benefit of a “safe harbor” provision contained in the REMIC regulations in that, based on Cadwalader’s advice, they reasonably and in good faith believed the Doctors Hospital Loan satisfied the applicable REMIC requirements; and, second, Nomura and ASC had cured the breach by furnishing to LaSalle the Second Opinion Letter (*see LaSalle Bank Natl. Assn. v Nomura Asset Capital Corp.*, 2004 WL 2072501, *7-*8 [SD NY Sept. 14, 2004], *affid in part, vacated in part and remanded* 424 F3d 195 [2d Cir 2005]). The court also found the 80% Warranty did not have any significance distinct from, nor did it warrant anything more than, the Qualified Mortgage Warranty (*see id.* at *8-*9).

On appeal, the Second Circuit affirmed the District Court’s determination that there had been no breach of the Origination Warranty but vacated the District Court’s judgment with regard to the 80% Warranty and the Qualified Mortgage Warranty (*see LaSalle Bank Natl. Assn.*

v Nomura Asset Capital Corp., 424 F3d at 199, 212-213). The Second Circuit determined that the 80% Warranty had significance as a warranty distinct and independent from the Qualified Mortgage Warranty; there was an issue of fact whether the 80% Warranty had been breached because it was unclear whether the fair market value of the real property which secured the Doctors Hospital Loan, as evidenced by the Appraisal, was at least 80% of the \$50 million amount of the Loan; and there also was an issue of fact whether the Qualified Mortgage Warranty had been breached because the safe harbor provision was inapplicable to protect Nomura and ASC and because neither entity had cured the breach simply by providing LaSalle with the Second Opinion Letter, and finally because it remained unclear whether the fair market value of the real property satisfied the 80% Warranty (*id.* at 209-210). The Second Circuit remanded the latter issue to the District Court, noting that “the evidence submitted by both sides is at odds on the question of which of the appraisal’s values for various components of the Doctors Hospital property corresponds to the fair market value of the ‘real property’ that is relevant for purposes of the eighty percent warranty” (*id.* at 208). Plaintiffs allege that in view of the Second Circuit’s determinations they had no viable alternative but to settle the Federal Action before trial for approximately \$67.5 million.

Plaintiffs’ first cause of action alleges Cadwalader committed malpractice in connection with the Doctors Hospital Loan by (1) including the separate 80% Warranty in the MLPSA even though inclusion of that warranty was not necessary to ensure the D5 Trust satisfied REMIC requirements; and (2) failing to perform the necessary due diligence prior to Cadwalader’s issuance of the First Opinion Letter which allegedly stated the D5 Securitization was REMIC-qualified for federal income tax purposes, and failing to advise plaintiffs that the property

appraisals which plaintiffs obtained could only include property that was defined as “real property” under the REMIC regulations.

The term “real property” is defined in REMIC regulations to include “land or improvements thereon, such as buildings or other inherently permanent structures thereon,” and to exclude “assets accessory to the operation of a business, such as machinery, ... transportation equipment which is not a structural component of the building, office equipment, ... etc., even though such items may be termed fixtures under local law” (26 CFR 1.856-3 [d]). In concluding that the Doctors Hospital property had a total market value of \$68 million, the Appraisal indicated \$37.04 million of that amount was attributable to equipment and intangibles. Plaintiffs allege that for purposes of determining whether the Doctors Hospital Loan was a “qualified mortgage” under the REMIC regulations, the \$37.04 million attributable to equipment and intangibles should have been excluded from the fair market valuation and the qualifying valuation was only \$30.96 million, i.e., “approximately \$10 million less than the \$40 million needed for the loan to be secured 80% by the fair market value of the real property as defined under [the] REMIC [regulations]” (Complaint, ¶ 27).

Cadwalader argues the first cause of action should be dismissed because (1) plaintiffs cannot establish the alleged misconduct amounted to negligence; (2) plaintiffs cannot establish the alleged misconduct was the proximate or “but for” cause of Nomura’s purported injury; and (3) the claim is barred by the applicable statute of limitations. Dismissal of the first cause of action is not warranted on any of these grounds.

According to Cadwalader, plaintiffs’ claim it was negligent is precluded by the doctrine of judicial estoppel or estoppel against inconsistent positions because the claim is contradicted by

assertions and representations plaintiffs themselves made in the course of litigating the Federal Action. In the Federal Action, plaintiffs allegedly asserted to the effect that Cadwalader's conduct was not negligent in that (a) similarities in the wording of the 80% Warranty and certain REMIC regulations clearly indicated the 80% Warranty was not intended to have any independent significance from, or to warrant anything in addition to, the Qualified Mortgage Warranty; (b) inclusion of the 80% Warranty in the MLPSA was consistent with standard practice in the commercial mortgage backed securities (CMBS) industry; (c) warranties such as the 80% Warranty were understood throughout the CMBS industry not to warrant anything beyond the warranty set forth in the Qualified Mortgage Warranty; (d) the Doctors Hospital Loan was, and at all times had been, a "qualified mortgage"; (e) in determining whether a loan was REMIC-qualified, the CMBS industry generally relied on appraisals of the overall market value of properties rather than specific valuations of REMIC-qualified real property; and (f) the procedure which Cadwalader used for determining the Loan was REMIC-qualified followed standard CMBS industry practice.

"Judicial estoppel, or the doctrine of inconsistent positions, precludes a party who assumed a certain position in a prior legal proceeding and who secured a judgment in his or her favor from assuming a contrary position in another action simply because his or her interests have changed" (*Ford Motor Credit Co. v Colonial Funding Corp.*, 215 AD2d 435, 436 [2d Dept 1995]). The doctrine is not applicable to preclude a party's claim where the party did not secure a judgment in his or her favor in the prior proceeding (*see e.g. Angel v Bank of Tokyo-Mitsubishi, Ltd.*, 39 AD3d 368, 371 [1st Dept 2007]; *Baje Realty Corp. v Cutler*, 32 AD3d 307, 310 [1st Dept 2006]) or, at the very least, the party did not succeed in having the allegedly inconsistent