

# **Bond Case Briefs**

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## **BONDS - NEW YORK**

### **Monterey Bay Military Housing, LLC v. Ambac Assurance Corporation**

**United States District Court, S.D. New York - March 31, 2021 - F.Supp.3d - 2021 WL 1226984**

Military base housing projects brought action in Northern District of California against loan originator, bond insurer, their managing directors, and others for conspiracy and substantive violations of Racketeer Influenced and Corrupt Organizations Act (RICO), as well as state-law claims including breach of fiduciary duty and aiding and abetting breach of fiduciary duty.

After originally denying insurer's motion to transfer venue, the United States District Court for the Northern District of California denied defendants' motions to dismiss second amended complaint for failure to state a claim, but sua sponte reconsidered its prior denial of transfer motion and transferred action to Southern District of New York for lack of personal jurisdiction over all but one defendant. Defendants moved for reconsideration.

The District Court held that:

- Transferor court's determination that it lacked personal jurisdiction over most defendants precluded it from denying those defendants' motions to dismiss for failure to state a claim;
- Projects adequately alleged special circumstances giving rise to fiduciary relationship between them and loan originator under New York law;
- Projects did not have inquiry notice triggering application of four-year statute of limitations under RICO;
- Allegations of scheme to defraud projects through issuance of bonds would not support securities fraud enforcement action;
- Projects' allegations satisfied horizontal and vertical relatedness requirements for RICO enterprise claims;
- Projects adequately alleged bond insurer knowingly and intentionally participated in mail and wire fraud; and
- Projects adequately alleged that purchaser of loan originator and purchaser's affiliated entities entered into RICO conspiracy.

District court's determination that it lacked personal jurisdiction over all but one defendant in developers' action under Racketeer Influenced and Corrupt Organizations Act (RICO) precluded district court from denying defendants' motions to dismiss for failure to state a claim; personal jurisdiction over defendants was necessary before district court could adjudicate arguments presented by those defendants in motions to dismiss for failure to state a claim, at least to extent that district court ruled against such defendants.

Military housing projects' allegations that bond insurer, loan originator, their managing directors, and others engaged in mail and wire fraud as predicates for Racketeer Influenced and Corrupt Organizations Act (RICO) enterprise and conspiracy claims were premised on each defendant's

knowing or intentional participation in scheme to defraud, and, thus, projects were not required to plead defendants had fiduciary duty giving rise to obligation to disclose any omitted facts, where projects alleged that originator, insurer, and their directors made affirmative representations to private developers and to consultant regarding financing of housing projects, including that insurer would act in projects' best interests to obtain highest possible rating from rating agencies.

Housing projects adequately alleged special circumstances giving rise to fiduciary relationship between loan originator and its managing director on the one hand and projects on the other, as necessary to support projects' claims against originator and director for breach of fiduciary duty under New York law, even though loan agreements did not purport to create fiduciary relationship, where projects alleged that originator and its director promised to provide fiduciary services beyond typical lender role in connection with financing projects, including by serving as financial advisor and as projects' agent in negotiating term loans and surety bonds, and that projects relied on representations in agreeing to work with originator rather than other lenders.

Allegations that bond insurer, through its managing director, told private developers and consultant for housing projects on military bases that insurer would act in projects' best interest to obtain highest possible rating from ratings agencies and would operate as projects' "fiduciary and agent" were insufficient, under New York law, to plausibly allege fiduciary relationship between insurer or its managing director and projects, as necessary to support projects' claims against insurer and managing director for breach of fiduciary duty, in the absence of specific allegations regarding nature of relationship between insurer and projects.

Clause in agreements that mortgage company entered into in connection with financing for housing projects on military bases, in which mortgage company disclaimed "financial advisor or fiduciary relationship role" in relation to developers, applied solely to mortgage company, not to entities affiliated with mortgage company, and, thus, under New York law, disclaimer clause did not preclude developers' action for breach of fiduciary duty against affiliated entities, where clause only specified that mortgage company would not be agent or fiduciary of developers or assume advisory or fiduciary responsibility in favor of developers.

Clause in agreements that mortgage company entered into in connection with financing for housing projects on military bases, in which mortgage company disclaimed "financial advisor or fiduciary relationship role" in relation to developers, did not preclude developers' claims against company under New York law for breach of fiduciary duty, where developers alleged that financial advisor who engaged in tortious conduct in breach of his fiduciary obligations was acting as agent of company and within scope of his employment with entity affiliated with company, such that company and entity were allegedly vicariously liable for financial advisor's conduct, as well as that company and financial advisor procured developers' agreement to disclaimer clause by fraud.

In considering whether, based on allegations of second amended complaint, military base housing projects had inquiry notice of allegedly fraudulent conduct on the part of loan originator, insurer, and others that would trigger four-year statute of limitations on projects' claims under Racketeer Influenced and Corrupt Organizations Act (RICO), trial court was not required to consider allegation contained only in first amended complaint that development consultant had noticed originator's preference for using insurer on projects; statement in first amended complaint did not directly contradict allegations of second amended complaint.

Allegations in housing projects' complaint against loan originator, insurer, and others for mail and wire fraud under Racketeer Influenced and Corrupt Organizations Act (RICO) were sufficient to establish that projects engaged in reasonably diligent inquiry, such that four-year limitations period on RICO claims did not begin to run based on inquiry notice, even if consultant's observation that

originator seemed partial to using insurer for credit enhancement triggered projects' duty to inquire, where consultant allegedly insisted that originator competitively bid out credit enhancement, indicating some inquiry had occurred, and insurer and originator responded by concealing insurer's role in development project financing, such that further inquiry would not have discovered alleged fraud.

Consultant's observation that loan originator was partial to using insurer for credit enhancement in connection with military base housing project financing was insufficient to show that a reasonable plaintiff with such knowledge would have been aware of existence of fraud, and, thus, did not put projects, which brought civil claim under Racketeer Influenced and Corrupt Organizations Act (RICO) against originator and insurer based on mail and wire fraud, on inquiry notice that would trigger four-year limitations period for civil RICO claims; originator's pattern of business dealings with same insurer, in and of itself, did not indicate alleged schemes to inflate credit spread and manipulate insurer ratings.

Military base housing projects' questioning of managing director of loan originator about funding structure did not establish that projects were on notice of director's alleged fraud in obtaining financing, and, thus, did not preclude doctrine of fraudulent concealment from delaying application of four-year statute of limitations on projects' civil Racketeer Influenced and Corrupt Organizations Act (RICO) claims against director, originator, and others, in the absence of allegations about circumstances that prompted projects to ask such questions.

Consultations between housing project developers and managing director of loan originator about effect on projects of downgrade in insurer's rating did not suggest that developers were aware of alleged fraudulent scheme for insurer to secretly participate in certain projects, and, thus, did not preclude doctrine of fraudulent concealment from delaying limitations period on developers' claims against director, originator, insurer, and others under Racketeer Influenced and Corrupt Organizations Act (RICO); it would have been reasonable for developers to have concerns about insurer's downgrade in connection with projects for which insurer openly provided credit enhancement, as opposed to projects for which developers were allegedly unaware of insurer's involvement.

Military housing projects' allegations that loan originator, bond insurer, and others engaged in scheme to defraud projects, as bond issuers, by falsely representing bonds' interest rates would be set at market, allowing originator to keep undisclosed profits from sales at above-market rates, would not have supported a securities fraud enforcement action brought by Securities and Exchange Commission (SEC), and, thus, securities-fraud bar to actions under Racketeer Influenced and Corrupt Organizations Act (RICO) did not preclude projects from basing RICO claims on alleged scheme; projects alleged that participants made misrepresentations and caused harm to them as bond issuers, which did not implicate SEC's authority to protect securities market or securities investors such as bond holders.

Military housing projects' allegations that loan originator, bond insurer, and originator's managing director, among others, engaged in scheme of mail and wire fraud in connection with project financing satisfied horizontal relatedness requirement for Racketeer Influenced and Corrupt Organizations Act (RICO) enterprise claim, where various alleged acts of fraud had same or similar purposes and results, namely, obtaining undisclosed and unlawful profits in connection with providing financing through projects, alleged scheme shared same participants as well as many same victims, including Army and its consultant, and predicate acts shared methods of commission, including director's role as financial advisor and misrepresentations regarding nature and structure of financial transactions.

Alleged misrepresentations that loan originator, its managing director, bond insurer, and others made to military housing projects, Army, and its consultant regarding nature of transactions undertaken to finance projects related to activities of alleged Racketeer Influenced and Corrupt Organizations Act (RICO) enterprise, as necessary to satisfy requirement of vertical relatedness for RICO enterprise claim, where misrepresentations allegedly benefited originator, director, and other participants in alleged scheme of mail and wire fraud by allowing them to reap undisclosed profits at projects' expense, such as through issuance of high-interest bonds, or to prevent projects from uncovering enterprise's scheme, such as through concealing insurer's involvement.

Military base housing projects adequately alleged that bond insurer knowingly and intentionally participated in mail and wire fraud scheme to obtain credit enhancement fees from projects without projects' knowledge that insurer was participating in financing, as necessary to plead insurer's mail and wire fraud as predicate acts under Racketeer Influenced and Corrupt Organizations Act (RICO), even though insurer did not make any misrepresentations or omissions to projects, where projects alleged that originator, director, and insurer intentionally concealed that insurer was providing credit enhancement in exchange for high fees, despite representations that project loans would not have credit enhancement and despite providing project with certain documents omitting insurer's role.

Military housing projects adequately alleged that purchaser of loan originator and purchaser's affiliated entities entered into conspiracy with originator, originator's managing director, and bond insurer to defraud projects in securing financing, as necessary to support Racketeer Influenced and Corrupt Organizations Act (RICO) conspiracy claim, where projects alleged that during due diligence process preceding acquisition of originator's business, purchaser and affiliates learned that originator and others engaged in enterprise to reap profits through making misrepresentations to projects regarding bond insurance rates and credit enhancement services, and purchaser proceeded with acquisition and hired managing director, then made their own financing-related misrepresentations to projects.

Military housing projects' complaint against loan originator, purchaser of originator, purchaser's affiliated entities, and others for Racketeer Influenced and Corrupt Organizations Act (RICO) enterprise and conspiracy adequately explained specific role of purchaser and each of its affiliates in alleged scheme to defraud projects in connection with financing, as necessary to satisfy requirement of pleading fraud with particularity as to each defendant, where complaint alleged each entity's role in financing of projects, alerted each entity to theory of liability against it, including theory of purchaser's successor liability, and alleged that entities had intertwined operations making it difficult to tell which entity took which actions.