

# Court of Appeals

STATE OF NEW YORK

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DDJ CAPITAL MANAGEMENT, LLC, DDJ TOTAL RETURN  
LOAN FUND, L.P., GMAM INVESTMENT FUNDS TRUST II,  
and AIRLIE OPPORTUNITY MASTER FUND, LTD.,

*Plaintiffs-Appellants,*

—against—

RHONE GROUP L.L.C., RHONE CAPITAL I L.L.C., RHONE OFFSHORE PARTNERS  
L.P., RHONE PARTNERS L.P., CCT LOAN ACQUISITION L.L.C., CAR COMPONENT  
TECHNOLOGIES DELAWARE HOLDINGS, LLC, RHONE CAPITAL L.L.C.,  
M. STEVEN LANGMAN, ROBERT W. CHAMBERS, ALEXANDER DULAC, THREE  
CITIES RESEARCH, INC., THREE CITIES FUND II, L.P., THREE CITIES OFFSHORE II,  
C.V., WILLEM F.P. DE VOGEL, J. WILLIAM UHRIG, SCOTT DUNCAN, QUILVEST  
S.A., QUILVEST AMERICAN EQUITY LTD., THREE CITIES HOLDINGS LIMITED,  
and JOHN JENDRZEJEWSKI,

*Defendants-Respondents.*

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## BRIEF OF *AMICI CURIAE* IN SUPPORT OF PLAINTIFFS-APPELLANTS AND IN SUPPORT OF REVERSAL

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ELLIOT GANZ  
LOAN SYNDICATIONS AND  
TRADING ASSOCIATION  
366 Madison Avenue  
New York, New York 10017  
Telephone: (212) 880-3000  
Facsimile: (212) 880-3040

JAMES H. MILLAR  
JANET R. CARTER  
WILMER CUTLER PICKERING HALE  
AND DORR LLP  
399 Park Avenue  
New York, New York 10022  
Telephone: (212) 230-8800  
Facsimile: (212) 230-8888

TRISTAN C. SNELL  
WILMER CUTLER PICKERING HALE  
AND DORR LLP  
60 State Street  
Boston, Massachusetts 02109  
Telephone: (617) 526-6000  
Facsimile: (617) 526-5000

*Attorneys for Amicus*  
*Loan Syndications and Trading Association*  
*(Additional Counsel Listed on Inside Cover)*

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JONATHAN N. HELFAT  
RICHARD G. HADDAD  
OTTERBOURG, STEINDLER, HOUSTON  
& ROSEN, P.C  
230 Park Avenue  
New York, New York 10169  
Telephone: (212) 661-9100  
Facsimile: (212) 682-6104

*Attorneys for Amicus  
Commercial Finance Association*

JOSEPH R. ALEXANDER  
THE CLEARING HOUSE  
ASSOCIATION L.L.C.  
450 West 33rd Street  
New York, New York 10001  
Telephone: (212) 612-9234  
Facsimile: (212) 612-9253

*Attorneys for Amicus  
The Clearing House*

RICHARD M. KOHN  
GOLDBERG KOHN BELL BLACK  
ROSENBLOOM & MORITZ, LTD.  
55 East Monroe Street  
Chicago, Illinois 60603  
Telephone: (312) 201-4000  
Facsimile: (312) 332-2196

*Attorney for Amicus  
Commercial Finance Association*

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## PRELIMINARY STATEMENT

The Loan Syndications and Trading Association (“LSTA”), the Commercial Finance Association (“CFA”), and The Clearing House Association L.L.C. (“TCH”) submit this Brief of *Amici Curiae* in support of Plaintiffs-Appellants, DDJ Capital Management, LLC, *et al.*, and supporting reversal. Pursuant to New York Court of Appeals Rule of Practice 500.1(f), a disclosure statement is attached hereto as Exhibit A.

The decision below threatens serious disruption to the vast amount of commercial lending that occurs in or is governed by the laws of New York. When advancing credit, lenders base their decisions in large part on prospective borrowers’ financial statements. Because those statements are normally audited only once per year, unaudited financial statements will frequently be the only available sources of information on a borrower’s recent financial performance. Thus lenders commonly make loans in reliance not only on the most recent audited statements but also on unaudited statements covering the period since that audit—coupled with representations and warranties from the borrower that those unaudited statements are accurate and were prepared in accordance with generally accepted accounting principles (“GAAP”), consistently applied.

The First Department’s decision introduces substantial uncertainty into this common practice among lenders. It holds, as a matter of law, but contrary to

precedent, that a lender does not act reasonably in relying on unaudited financial statements warranted to be accurate by the borrower. Instead, the court held that in every case, for a lender's reliance on the borrower's warranties to be deemed reasonable, the lender must negotiate for and conduct its own examination of the borrower's books and records for the period since the last audit. A borrower's warranties are, in effect, to be disregarded. The court's rule thus upsets lenders' settled expectations in countless existing loan obligations and imposes novel and burdensome investigatory obligations at a time when commercial lending is already painfully restricted. Indeed, the court imposes obligations that are directly contrary to the Second Circuit's applications of New York law over the past thirty years. This Court's reversal of the First Department's decision is thus of singular importance to *amici curiae* and their members.

*Amici curiae* thus respectfully request this Court to adopt the following rule of law: It is not per se unreasonable for a commercial lender entering into a financing transaction to accept and rely upon a representation and warranty by a prospective borrower as to the accuracy of the borrower's unaudited financial statements and other books and records. Because representations and warranties are bargained for in sophisticated business transactions, reliance on such representations and warranties is justifiable without further investigation—a legal principle long recognized by settled precedents of New York law.

## **INTEREST OF *AMICI CURIAE***

The Loan Syndications and Trading Association is the trade association for all segments of the corporate loan market. With 302 members, including broker-dealers, commercial banks, investment banks, mutual funds, merchant banks, fund managers, and other major financial organizations worldwide, the LSTA undertakes a wide variety of activities to foster the development of policies and market practices designed to facilitate loan origination and the purchase and sale of loans in the secondary markets. Since 1995, the LSTA has developed standardized practices, procedures, and documentation to enhance efficiency, transparency and certainty in the loan market. In this regard, its standardized documents specify that New York law governs. Additional information about the LSTA may be found at [www.lsta.org](http://www.lsta.org).

The Commercial Finance Association is the national trade association for financial institutions that provide asset-based financing and factoring services to commercial borrowers. The nearly 300 lenders that are members of CFA include substantially all of the major money-center banks, regional banks, and other large and small commercial lenders engaged in asset-based lending. Financing by CFA members comprises a substantial portion of the United States credit market, approaching \$600 billion in outstanding loans. CFA members provide asset-based financing to businesses on an international, national, regional, and local scale.

Asset-based financing provided by CFA members allows borrowers the opportunity to use their assets to obtain financing that they might not otherwise be able to obtain, particularly during the current global credit crisis and economic downturn. Over ten percent of the nation's asset-based loans are made in New York, and an even greater percentage of commercial finance transactions call for the application of New York law.

The Clearing House Association L.L.C. is an association of leading commercial banks dedicated to promoting the interests of its members and the commercial banking industry. It often presents the views of its members on important public policy issues that affect the commercial banking industry. Currently, its members are ABN AMRO Bank N.V., Bank of America, N.A., The Bank of New York Mellon, Citibank, N.A., Deutsche Bank Trust Company Americas, HSBC Bank USA, N.A., JPMorgan Chase Bank, N.A., UBS AG, U.S. Bank, N.A., and Wells Fargo Bank, N.A.

As leading trade associations for the industry, *amici* are uniquely positioned to address the impact that the First Department's decision would have on commercial lending if left undisturbed. The new rule of law proposed by the First Department would directly impact the ability of members to employ generally accepted commercial practices in making commercial loans in this State. Unless reversed, the First Department's decision threatens to make commercial lending

more expensive, and less available to prospective borrowers, by imposing an unprecedented duty upon lenders to examine the prospective borrower's books and records, notwithstanding the borrower's warranties as to their accuracy. It would have a chilling effect upon commercial lending in the midst of what is still the worst liquidity crisis in 80 years. It would encourage lenders to rely on the laws and forums of other jurisdictions, contrary to the policy—reflected in legislative enactments such as New York General Obligations Law §§ 5-1401 and 5-1402—that promotes New York as the commercial capital of the United States.<sup>1</sup>

## ARGUMENT

### **I. The First Department's Proposed Rule Is Contrary to Longstanding Public Policy Governing Commercial Transactions.**

#### **A. The First Department's rejection of the generally accepted practice followed by Plaintiffs-Appellants threatens to throw commercial lending into turmoil.**

Plaintiffs-Appellants followed generally accepted commercial practices in making their \$40 million loan to ARI Holdings, Inc. in March 2005. As alleged in the complaint, they required the borrower to provide an unqualified audit report for the borrower's financial statements for 2003, the most recent period for which

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<sup>1</sup> See, e.g., *Credit Francais Int'l, S.A. v. Sociedad Financiera De Comercio, C.A.*, 128 Misc. 2d 564, 570, 490 N.Y.S.2d 670, 676 (Sup. Ct. 1985) (“New York, as the center of international trade and finance, has expressly recognized, as a service to the business community, that its courts will be hospitable to the resolution of all substantial contractual disputes in which the parties have agreed beforehand that our neutrality and expertise should govern their relationships. Just as the dollar has become the international standard for monetary transactions, so may parties agree that New York law is the standard for international disputes.”).

audited financial statements were available. *In addition*, they required the borrower to provide unaudited financial statements for 2004, *and* to represent and warrant that the unaudited financial statements for the most recent period were true and accurate and had been prepared in accordance with generally accepted accounting principles (“GAAP”) consistently applied. These are common everyday requirements in commercial loans, and commercial lenders regularly rely upon such audited and unaudited (but warranted) financial statements in making commercial loans.

It is not common practice, however, for commercial lenders to audit or to conduct an examination of the books and records of borrowers before making commercial loans. Commercial lenders are not auditors of their prospective borrowers, or purchasers of the borrowers’ businesses, and, in general, are not equipped to undertake such costly and time-consuming examinations before making loans.

The rule announced by the First Department in this case fails to take into account the realities of commercial lending. Most businesses maintain their books and records on a calendar year basis. An audit of any substantial business enterprise takes months to perform, and, in the case of any loan, a period of time necessarily elapses between the date of the borrower’s last audited financial statement—typically prepared by an independent auditing firm once a year—and

the making of the loan. When, as in the present case, the loan is made during the first quarter of a given year, the borrower's auditor will not yet have had the opportunity to issue its audit report on the most recently concluded calendar year. Given that commercial lenders are not in the business of performing audits and do not employ personnel trained to perform audits, the First Department's holding will operate to discourage commercial lending during the first, third and fourth quarters of any given year. This will promote bizarre market dynamics by tending to concentrate lending in the second quarter—when such audits are customarily concluded and accompanying audited financial statements are finalized and delivered.

Moreover, given the fact that it takes time for an auditor to conduct and to report upon *any* audit, inevitably there exists a period of time between the last audited period and the making of a loan. Even when a loan is made in the second through fourth quarters, there is almost invariably a period immediately before the making of the loan for which the lender must rely upon the borrower's unaudited financial statements. In all such instances, lenders protect themselves against receiving fraudulent financial statements, as in the present case, by requiring that borrowers represent and warrant as to the accuracy of the unaudited statements for the most recent period. Yet the decision below would strip away that protection by prohibiting lenders from relying upon those representations and warranties.

The serious practical repercussions of the First Department’s proposed rule, if left undisturbed, would not only be prospective but also retrospective as well. Lenders have made thousands of loans in reliance on the effectiveness of warranties, like those obtained by the Plaintiffs-Appellants from ARI, to protect them from fraud, and would now find themselves suddenly unprotected. Worse, the parties who would benefit from the First Department’s ruling are those who have committed or abetted fraud. Such parties would no longer be subject to liability for fraud for deliberately misrepresenting borrowers’ financial conditions when loans are made absent a recently completed audit. Honest borrowers, along with lenders, would suffer from the substantially increased costs of borrowing, as lenders will either have to acquire or hire the expertise needed to conduct extensive and time-consuming audits—or otherwise require increasingly arduous lending terms that will be unacceptable to borrowers. Meanwhile, as both lenders and borrowers are forced to undergo such a wrenching transition in their standard business practices and to absorb the costs necessary for that transition, the flow of commercial lending, already seriously constricted, would diminish even further—at a crucial moment for the nation’s economy.<sup>2</sup> Averting these dire consequences requires this Court’s immediate reversal.

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<sup>2</sup> Though the U.S. economy shows some signs of recovery, liquidity has yet to return. Former Federal Reserve Bank Chairman Alan Greenspan recently noted that “because [financial institutions] don’t believe they have adequate capital, they

**B. The First Department’s Novel Rule Would Vitate Longstanding Precedents of New York Law.**

The ruling below not only threatens the edifice of New York finance but also its longstanding legal precedents. The law of New York regarding the purpose and function of warranties would be rendered pointless by the First Department’s novel rule. Judge Learned Hand wrote that a “warranty is an assurance by one party to a contract of the existence of a fact upon which the other party may rely. It is intended precisely to relieve the promisee of any duty to ascertain the fact for himself... To argue that the promisee is responsible for failing independently to confirm [that fact], is utterly to misconceive its office.” *Metropolitan Coal Co. v. Howard*, 155 F.2d 780, 784 (2d Cir. 1946) (citations omitted). This definition of a warranty has been affirmed by New York state courts ever since. *See, e.g., CBS Inc. v. Ziff-Davis Publ’y Co.*, 75 N.Y.2d 496, 502, 553 N.E.2d 997, 1000-1001, 554 N.Y.S.2d 449, 452-53 (1990); *Pramco III, LLC v. Partners Trust Bank*, 16 Misc. 3d 351, 356, 842 N.Y.S.2d 174, 180 (Sup. Ct. 2007); *see also Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171 (2d Cir. 2007), discussed in Part II, *infra*. The ruling below—which entirely disregards the extensive warranties

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have not yet begun to lend freely. It is one thing for an institution to be solvent and quite another to be lending freely. We are not there yet.” Gavin Finch, *Libor-OIS Spread Narrows to Pre Credit-Crisis Average*, Bloomberg.com, Sept. 15, 2009. Any recovery of liquidity is thus precarious at best. Lender confidence and certainty in the future are still in short supply in the credit markets, and thus the First Department’s disturbance to the well established anti-fraud protections of New York law would be especially destructive right now.

obtained and relied upon by the Plaintiffs-Appellants in making the loan to ARI— falls squarely within Judge Hand’s warning against “misconceiv[ing]” the essence of a warranty. The First Department, directly contrary to Judge Hand’s ruling, places the onus of independent investigation and confirmation on lenders, even in the presence of express warranties by borrowers. Such a reversal of longstanding precedent undermines the very purpose and function of representations and warranties in the business of lending and should not be allowed to stand.

**II. The First Department’s Harsh Bright-Line Rule Is Not Supported By Its Prior Cases and Conflicts With Persuasive Second Circuit Case Law.**

**A. The Appellate Division case law cited by the court below does not support its extreme result.**

Though the ruling below is mistaken, there is no mistaking the breadth of that ruling. The issue now before this Court reached the First Department on appeal from a motion to dismiss—and thus on the pure legal issue of whether the allegations in the complaint stated a claim on which relief could be granted. The court began with the proposition that, “[a]s a matter of law,” a sophisticated plaintiff cannot establish justified reliance on misrepresentations if the plaintiff “failed to make use of the means of verification that were available to it,” and the plaintiff “must have discharged [its] own affirmative duty to exercise ordinary intelligence and conduct an independent appraisal of the risks [it is] assuming.” Slip Op. 7-8 (citing *UST Private Equity Investors Fund, Inc. v. Salomon Smith*

*Barney*, 288 A.D.2d 87, 88, 733 N.Y.S.2d 385, 386 (1st Dep’t 2001); *Global Minerals & Metals Corp. v. Holme*, 35 A.D.3d 93, 100, 824 N.Y.S.2d 210, 216 (1st Dep’t 2006), *leave denied*, 8 N.Y.3d 804 (2007); *Abrahami v. UPC Constr. Co.*, 224 A.D.2d 231, 234, 638 N.Y.S.2d 11, 14 (1st Dep’t 1996)) (internal quotation marks omitted).

Notwithstanding the complaint’s unmistakable allegations that the Plaintiffs-Appellants obtained representations and warranties from the borrower as to the accuracy of the unaudited financial statements, the court held that the Plaintiffs-Appellants “never conducted *any* due diligence as it related to” those financial statements, Slip Op. 8 (emphasis added), and “failed to make *any* such effort to evaluate the risk for themselves,” *id.* at 8-9 (emphasis added). Thus the court held, contrary to settled New York law, that lenders cannot discharge the “affirmative duty” requirement through the common and accepted approach of requiring representations and warranties as to the accuracy of financial statements.

Instead, the court proposed that lenders be required to conduct *their own* review of a borrower’s books and records: “Here, plaintiffs never conducted any due diligence as it related to ARI’s 2004 financial statements, on which plaintiffs primarily relied in making the loan to ARI. *That is*, plaintiffs never looked at ARI’s books and records....” *Id.* at 8 (emphasis added). The court’s discussion of the fraud claim never focuses on—or even mentions—any of the borrower’s

business, industry, or finances. Nor does the court set forth the steps actually taken by the Plaintiffs-Appellants prior to the making of the loan to protect themselves from fraudulent conduct. The First Department's decision, if left undisturbed, would thus require commercial lenders *themselves* to audit the books and records of *every* prospective borrower, or else forfeit the anti-fraud protections previously offered by New York law.

This onerous result is not only contrary to settled New York law, it is not even supported by the case law on which the First Department purported to rely. None of the cited decisions involved the particular issue addressed here—the use of warranties to justify reliance on unaudited financial statements. In fact, not a single case cited by the First Department stands for the rule of law announced by the court—that it is somehow unreasonable as a matter of law to rely on a counterparty's warranty that its financial statements are accurate. And other cases cited by the First Department are inapposite as warranties were not at issue there.

In the first case relied on by the court below, *UST Private Equity Investors Fund, Inc.*, investors brought fraud claims against investment banking firms that had prepared an offering memorandum for a company that manufactured a medical device. 288 A.D.2d at 87-88, 733 N.Y.S.2d at 386. The device had not received FDA approval in the form in which the company distributed it, and the company went bankrupt. *Id.* at 88, 733 N.Y.S.2d at 386. The investors alleged that the

offering memorandum contained inaccurate statements and that letters that would have revealed that the lack of FDA approval had been concealed from them. *Id.* The First Department affirmed the grant of a motion to dismiss, concluding that the investigation described in the plaintiffs' allegations was inadequate because the investment banking firms had *disclaimed* their ability to guarantee the accuracy of the statements in the offering memorandum, and the plaintiffs had obtained in due diligence a document that referred to the supposedly concealed letters but did not ask to see them. *Id.* There was no suggestion in the case that the plaintiffs had obtained warranties of the truth of the material fact—whether or not the FDA had approved the device—and thus the case says nothing about whether obtaining such warranties constitutes due diligence.

The other three cases on which the First Department relied are similarly devoid of support for the rule it announced. *Global Minerals & Metals Corp.* involved allegations that a settlement with an investor in a closely-held company was tainted by fraud, as the defendant investor had improperly concealed actions he had taken in violation of fiduciary duties to the company, owning stock in a competitor and stealing business. 35 A.D.3d at 97-98, 824 N.Y.S.2d at 213-14. The court concluded that the plaintiffs had not established justifiable reliance, observing that they had considerable information regarding the fiduciary violations but had not pursued obvious leads. *Id.* at 100-01, 824 N.Y.S.2d at 216-17. Again,

the plaintiffs there had not obtained from the defendant a warranty as to the absence of fiduciary breaches, and so the court did not (and could not) hold that warranties can never constitute diligence. There were likewise no such warranties at issue in *Abrahimi*, 224 A.D.2d 231, 638 N.Y.S.2d 11. There, investors alleged that financial information they had received before investing was false, and the court concluded that they had not justifiably relied on the rosy financial statements when an initial report indicated that the company had all of \$54 cash on hand; plus a memorandum the investors received specified that new investors would conduct an audit. *Id.* at 234, 638 N.Y.S.2d at 14. Again, these facts stand in sharp contrast to those in the case now before the Court.

The final case on which the court below relied, *Permasteelisa, S.p.A. v. Lincolnshire Management, Inc.*, 16 A.D.3d 352, 793 N.Y.S.2d 16 (1st Dep't 2005), not only lacked warranties as to the accuracy of the information later alleged to have been false; it suggested that insisting on warranties would have rendered the plaintiffs' reliance reasonable. *See id.* at 352, 793 N.Y.S.2d at 17 (concluding that plaintiff could not show reasonable reliance where it did not seek examination of the books and records of the company it was acquiring, relying on an unaudited financial statement that allegedly proved inaccurate, and "*failed to seek the insertion of a prophylactic provision in the purchase agreement to ensure against*

*the possibility of misrepresentation.*” (emphasis added)).<sup>3</sup> Once again, the precedents relied upon below were simply inapposite, as none of them involved the type of warranty that the borrower in this case granted.

**B. The decision below conflicts with a well-reasoned and oft-cited Second Circuit decision**

In addition to its tension with *Permasteelisa*, the decision below directly conflicts with an authoritative Second Circuit opinion interpreting New York law, *Merrill Lynch & Co. v. Allegheny Energy, Inc.*, 500 F.3d 171 (2d Cir. 2007). The defendant in *Merrill Lynch*, Allegheny Energy, had purchased Merrill Lynch’s energy commodities trading business for \$490 million on the basis of unaudited financial summaries that Merrill Lynch had prepared and delivered to Allegheny Energy during the negotiations. *Id.* at 175. Allegheny required Merrill Lynch to warrant in the purchase agreement that the financial records it had provided “are in all material respects true, complete and correct.” *Id.* at 177. After the purchase, Allegheny discovered serious flaws in the summaries in that they “reflected

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<sup>3</sup> In their reply brief to the First Department, Defendants-Respondents argued that this passage in *Permasteelisa* merely indicated that the court believed that the plaintiff could have required the representations in order to create for itself a *contractual* remedy in the event that the representations were false. *See* Reply Br. of Defendants-Appellants Rhone Group L.L.C. et al., at 12, dated Nov. 7, 2008. That is an implausible reading of the First Department’s decision. The court’s observation regarding a “prophylactic provision” appears in its discussion of the absence of reasonable reliance in the plaintiff’s fraud claim—and, indeed, in a sentence the remainder of which (on Defendants-Respondents’ own account, *see id.* at 12, 19) describes actions the plaintiff should have taken in order to render its reliance reasonable. *See Permasteelisa*, 16 A.D.3d at 352, 793 N.Y.S.2d at 16.

substantially higher revenues and net income ... than was reflected on Merrill Lynch's books and records," and that the summaries were not prepared by Merrill Lynch's finance department. *Id.* at 175-76. In addition, the CEO of the energy trading division subsequently "admitted to knowingly providing Allegheny with inaccurate information." *Id.* at 176. Merrill Lynch sued Allegheny for failing to meet certain post-closing obligations, and Allegheny countersued for fraud. *Id.* at 177. After a non-jury trial on the counterclaim, the trial judge entered judgment for Merrill Lynch, holding that Allegheny's reliance upon the misrepresentations regarding the energy trading division's finances was unreasonable. *Id.* at 180-81.

The Second Circuit reversed. It acknowledged that New York courts "are generally skeptical of claims of reliance asserted by 'sophisticated businessmen engaged in major transactions [who] enjoy access to critical information but fail to take advantage of that access,'" and it declared that both parties, as "sophisticated business entities," are "held to a high standard of conduct in the events leading up to the sale and purchase." *Id.* at 181 (citation omitted). Nevertheless, the court held that the purchaser met that high standard—because representations and warranties Allegheny had secured from Merrill Lynch could render its reliance justified without any further investigation:

In assessing whether defendant met its burden in showing justifiable reliance, we look to a number of factors including the content of its agreement with plaintiff. The warranties [Merrill Lynch made] imposed a duty on Merrill Lynch to provide

accurate and adequate facts and entitled Allegheny to rely on them without further investigation or sleuthing. *See Metropolitan Coal Co. v. Howard*, 155 F.2d 780, 784 (2d Cir. 1946) (L. Hand, J.) (“A warranty ... is intended precisely to relieve the promisee of any duty to ascertain the fact for himself.”). Further, as Judge Friendly instructs, New York authority follows a two-tier standard in assessing the duty of the party claiming fraud, according to whether the misrepresentations relate to matters peculiarly within the other party’s knowledge. If so, the wronged party may rely on them without further investigation. *See Mallis v. Bankers Trust Co.*, 615 F.2d 68, 80-81 (2d Cir. 1980). Merrill Lynch’s warranties in effect represent contractual stipulations that the facts covered by them be treated as information exclusively within Merrill Lynch’s knowledge.

*Id.* at 181-82 (citations omitted).<sup>4</sup>

The carefully reasoned decision in *Merrill Lynch* is a correct expression of New York law and is directly contrary to the decision of the First Department in this case. The purchaser in the *Merrill Lynch* case satisfied the standard of due diligence because it exacted representations and warranties regarding the seller’s unaudited financial information, which a reasonable purchaser could ordinarily

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<sup>4</sup> The court acknowledged that reliance on the warranties would not have been reasonable if Allegheny knew or should have known that the representations made in those warranties were false. *See id.* at 182. Here, nothing in the facts alleged suggests that Plaintiffs-Appellants knew that ARI’s warranties were false or that Plaintiffs-Appellants were willfully blind to their falsity, and this limitation on the reasonableness of reliance is radically narrower than the one adopted by the court below. Nor can the Second Circuit have meant, in discussing what a plaintiff should have known, to impose a blanket duty on the plaintiff to *investigate*. To draw that inference from the court’s language would run afoul of the its express conclusion that “[t]he warranties [Merrill Lynch made] imposed a duty on Merrill Lynch to provide accurate and adequate facts and *entitled Allegheny to rely on them without further investigation or sleuthing.*” *Id.* at 181 (emphasis added).

rely upon with confidence. Moreover, the seller knew that its representations and warranties had two legal and mercantile effects: (1) to establish the misrepresented unaudited financial information as “matters peculiarly within the [seller’s] knowledge” and (2) to justify the purchaser’s reliance upon that information “without further investigation.”

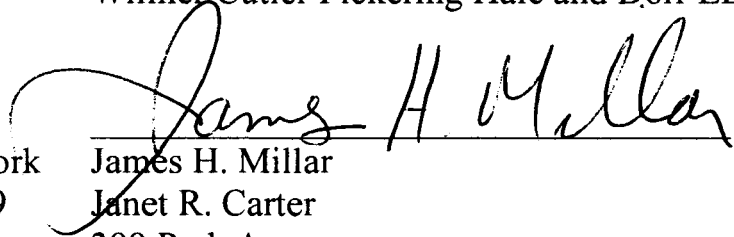
If anything, the present case, which takes place in the context of loan transactions by groups of lenders, presents even more compelling circumstances than *Merrill Lynch* for applying the same well-established rule of New York law. Plaintiffs-Appellants were not purchasers of ARI. They did not assume a business to run. The economics and time constraints of lending transaction are fundamentally different than those involved in acquisition of business. Plaintiffs-Appellants followed generally accepted and common loan practices for commercial lenders by both obtaining the borrower’s latest audited financial information and by insisting upon a strong set of representations and warranties as to the accuracy of the borrower’s latest financial information for which audited statements were not available. Under the rule of the *Merrill Lynch* case, and under the New York precedent that it appropriately applies, the facts averred in the complaint in this case were more than sufficient to demonstrate the exercise of due diligence on the part of the lenders here, and it was error for the First Department to hold otherwise as a matter of law.

**CONCLUSION**

This Court should reverse the decision of the First Department.

Respectfully submitted,

Wilmer Cutler Pickering Hale and Dorr LLP



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James H. Millar  
Janet R. Carter  
399 Park Avenue  
New York, N.Y. 10022  
(212) 230 8800

Tristan C. Snell  
Wilmer Cutler Pickering Hale and Dorr LLP  
60 State Street  
Boston, MA 02109  
(617) 526 6000

Elliot Ganz  
Loan Syndications and Trading Association  
366 Madison Avenue  
New York, NY 10017  
(212) 880 3000  
*Attorneys for Amicus Curiae Loan  
Syndications and Trading Association*

Jonathan N. Helfat  
Richard G. Haddad  
Otterbourg, Steindler, Houston & Rosen, P.C.  
230 Park Avenue  
New York, NY 10169  
(212) 661 9100  
Richard M. Kohn

Goldberg Kohn Bell Black Rosenbloom &  
Moritz, Ltd.  
55 East Monroe Street  
Chicago, IL 60603  
(312) 201 4000  
*Attorneys for Amicus Curiae Commercial  
Finance Association*

Joseph R. Alexander  
The Clearing House Association L.L.C.  
450 West 33rd Street  
New York, NY 10001  
(212) 612 9234  
*Attorneys for Amicus Curiae The Clearing  
House Association L.L.C.*

## **EXHIBIT A**

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