To Be Argued By:
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Court of Appeals

STATE OF NEW YORK

ACE SECURITIES CORP., HOME EQUITY LOAN TRUST, SERIES 2006-SL2, by HSBC BANK USA, NATIONAL ASSOCIATION, solely in its capacity as Trustee pursuant to a Pooling and Servicing Agreement, dated as of March 1, 2006,

Plaintiff-Appellant,

—against—

DB STRUCTURED PRODUCTS, INC.,

Defendant-Respondent.

REPLY BRIEF FOR PLAINTIFF-APPELLANT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

INTRODUCTION

DBSP's response brief reflects a vision of the governing Agreements that is fundamentally at odds with the basic bargain underlying them. According to DBSP, the cure or repurchase provision functioned not as a distinct obligation that DBSP agreed to undertake even as to errors and omissions that DBSP independently discovered, but rather as a dramatic restriction on the contractual rights investors otherwise would possess. In DBSP's view, this provision not only limited the relief that investors could obtain if DBSP's representations and warranties proved materially false, but also effectively shortened the applicable statute of limitations and imposed on investors and the Trust an extraordinary due diligence obligation on nearly 9,000 underlying loans, such that concerns with the veracity of representations or warranties and with the completeness of loan files must be brought to DBSP's attention within five years and nine months or not at all. In other words, according to DBSP, the cure or repurchase obligation, despite its reassuring connotation, is nothing more than a "liability-limiting" provision that left investors significantly *worse* off than they would have been without it.

DBSP does not and cannot explain how its self-serving vision of the clause is consistent with its text, which imposes a self-executing obligation on DBSP wholly apart from imposing a duty when defects were brought to its attention by others. Nor does DBSP explain why investors would have accepted such a one-sided bargain, or even attempt to reconcile its revisionist history with the realities of the particular commercial context at hand. This is not a situation in which a consumer is handed a product and is then better positioned than the manufacturer to ensure that all warranties about that product are accurate. Instead, as reflected throughout the Agreements themselves, neither the Trust nor its investors were in any economically or practically feasible position to reunderwrite the nearly 9,000 loans that DBSP securitized. No one, let alone DBSP, expected or wanted the Trust or investors to undertake that costly exercise, which would have radically depressed DBSP's return on its offering. To the contrary, DBSP's cure and repurchase obligation was designed to obviate the need for such expensive reunderwriting. DBSP's effort to reconstrue that obligation as a one-sided restriction on the contractual remedies of the Trust and investors strains credulity.

Implicitly recognizing the square conflict between the manifest intent of the parties and its remarkable view that its "role in the securitization" "was effectively complete at closing" (Resp. Br. 8), DBSP largely changes the subject, devoting the bulk of its brief to cataloguing all the important policy interests that statutes of limitations serve. But the only party questioning the end-point of the state-prescribed statute of limitations is DBSP, which suggests that the Trust and investors inadvertently bargained away the last 90 days of the state-prescribed limit. The relevant question here is when the statute of limitations began to run given the specific Agreements, claims, and commercial context at issue. Under the plain terms of the Agreements, the answer is clear: It began to run when DBSP failed to cure or repurchase within 90 days of learning of defective loans, not when the materially inaccurate representations or warranties were made.

Even if that were not the case, moreover, this action still would be timely, as it was commenced within six years of the date on which the representations and warranties were made. The plain language of the Agreements confirms that the certificateholders who commenced the suit were permitted to do so, but whether they ultimately were is irrelevant. So, too, is whether they were required to give DBSP the full 90 days to repurchase before filing suit (which, in DBSP's view, would have made it impossible for them to do so in a timely manner). Those are contractual defenses, not the kinds of jurisdictional defects that render a summons with notice a "nullity." Accordingly, the Trust was fully entitled to the benefit of the date on which the certificateholders filed the summons with notice on its behalf when it substituted in and filed the complaint.

ARGUMENT

I. THE TRUST'S CAUSE OF ACTION DID NOT ACCRUE UNTIL DBSP FAILED TO CURE OR REPURCHASE WITHIN THE CONTRACTUALLY SPECIFIED TIME PERIOD.

A. DBSP Undertook a Continuing Obligation to Cure or Repurchase Upon Discovery or Notice of a Materially Defective Loan.

Under the plain terms of the Agreements, DBSP is under an "obligation" to cure or repurchase a loan upon learning of any missing or defective document or materially inaccurate representation or warranty that adversely affected its value. (R.300 (MLPA § 7(a)).) The obligation is self-executing; it does not depend on the Trust or any other counterparty bringing the defect to DBSP's attention, but also applies to any defect DBSP discovers on its own. Yet, according to DBSP, this "Repurchase Obligation" is no obligation at all, but rather merely operates as a "liability-limiting" provision that eliminates contractual rights that investors otherwise would possess. (Resp. Br. 28.) DBSP attempts to derive this construction primarily from the provisions of the Agreements that "state that a 'breach' occurs whenever a representation or warranty is false" and refers to the obligation to cure or repurchase as "the sole remedy" for that "breach." (Resp. Br. 26-27.) But DBSP confuses a breach of the representations and warranties contained in the MLPA with a breach of the MLPA itself.

It is no accident that the Agreements refer to an inaccurate representation or warranty as a "breach of the representations and warranties," *not* as a breach of the

MLPA. (*See, e.g.*, R.300 (MLPA § 7(a)); R.121-22 (PSA § 2.03(a)).) The whole point of the cure or repurchase provision is to memorialize the parties' agreement that DBSP does not breach the Agreements unless and until it refuses to cure or repurchase a defective loan. *That* is the benefit for which DBSP bargained—the benefit of a reasonable time period in which to remedy a *breach of its representations and warranties* and avoid a *breach of contract* claim entirely. But the bargain was not entirely one-sided. Investors agreed to provide that benefit only in exchange for a benefit of their own—namely, a distinct, and distinctly enforceable, obligation to cure or repurchase defective loans upon discovery or notice.

That much is clear from the plain language of Section 7 of the MLPA, which expressly refers to DBSP's duty to cure or repurchase as an "obligation" that arises upon "discovery or … receipt of notice" of a condition requiring cure or repurchase. (R.300 (MLPA § 7(a)).) The obligation thus can arise wholly independent of any effort by the Trustee or investors to get DBSP to remedy a defect that the Trustee or investors have discovered, and the obligation does not arise at all until "discovery or … receipt of notice." It is also clear from Section 2.03(a) of the PSA, which not only refers to cure or repurchase as an "obligation," but also provides that the Trustee "shall *enforce* the[se] obligations," (R.121-22 (PSA § 2.03(a)) (emphasis added)), a command that would be nonsensical if

Section 7 imposed no obligation capable of being enforced and was merely a restriction on the ability of the Trustee to enforce the original representations and warranties. That these provisions also specify how much DBSP must pay if it discharges its obligation by repurchasing a loan hardly converts the distinct obligation into nothing more than a measure of "damages." (Resp. Br. 26.) DBSP's contrary argument ignores the fact that there *will* be no repurchase or "damages" if DBSP instead discharges its obligation by curing.

DBSP's argument also ignores the fact that the cure or repurchase obligation is specified as "the sole remedy" for things that are *not* described as a "breach," such as "discovery … of any materially defective document in … any Mortgage File," or "that any material document was not transferred … as part of any Mortgage file." (R.300 (MLPA § 7(a)); *see also id.* (MLPA § 7(c) ("the obligations of the Sponsor … to cure or repurchase … constitute the sole remedies … respecting *a missing document* or a breach of the representations and warranties") (emphasis added)); R.122 (PSA § 2.03(a) ("the obligation of the Sponsor to cure or to repurchase … shall constitute the sole remedy respecting such *omission, defect or breach*") (emphasis added)).) DBSP's effort to convert its cure and repurchase obligation into a restriction on the available remedies for breach of representations and warranties thus faces two distinct and insuperable obstacles. The obligation not only applies to defects independently discovered by

DBSP wholly apart from any effort by a counterparty to vindicate representations and warranties, but also applies to defects that are not themselves a "breach." DBSP's effort to join the cure or repurchase obligation and the breach of representations or warranties at the hip—or perhaps, more accurately, conflate the two—therefore cannot be reconciled with either the plain language or the nature of the obligation.[1]

What is more, DBSP's contrary argument is in serious tension with Section 2.03(c) of the PSA. Under Section 2.03(c), upon "discovery or receipt of … notice" "that any Mortgage Loan does not constitute a 'qualified mortgage' within the meaning of" the Internal Revenue Code, the loan must be substituted or, if it is too late to substitute, (*see* R.122-23 (PSA § 2.03(b))), repurchased within 90 days "in the same manner as set forth in Section 2.03(a)." (R.123 (PSA § 2.03(c)).) This obligation, which is critical to tax treatment, clearly is intended to continue throughout the life of the securitization, as evidenced by the fact that Section 2.03(c) requires repurchase of non-qualifying loans no matter the reason: "[I]f the affected Mortgage Loan's status as a non-qualified mortgage is or results from a

[1] DBSP notes that the Agreements do not "identify the failure to repurchase as a 'breach.'" (Resp. Br. 26-27, 51.) But the Agreements do not identify that failure as something *other* than a breach; they simply do not discuss the failure to repurchase, or the consequences that flow from it, at all—presumably because it is well settled that the failure to abide by a contractual obligation is, by definition, a breach of contract. *See, e.g.*, Restatement (Second) of Contracts § 235(2) (1981) ("When performance of a duty under a contract is due any non-performance is a breach."); 23 Williston on Contracts § 63:1 (4th ed.).

breach of any representation, warranty or covenant," then DBSP must repurchase, but if it results from something *other* than such a "breach," then the Depositor must repurchase. (*See id.* ("Such repurchase … shall be made by … the Depositor, if [it] does not result from a breach of a representation or warranty.").)

Since the *Depositor*'s obligation under Section 2.03(c) arises only if there was *not* a breach of a representation or warranty, presumably even DBSP would concede that it must be understood as a distinct obligation, not a remedy for a preexisting breach. But if that is so, then by DBSP's logic, the Depositor would be required to repurchase *whenever* it learns of a non-qualifying mortgage, while DBSP would be required to do so only for the first six years of the securitization (if that). Moreover, there would be an entire category of non-qualifying loans—those that "result[] from a breach of any representation, warranty or covenant" that DBSP neither discovers nor receives notice of during the first five years and nine months of the securitization—that *no one* is obligated to repurchase. That result is flatly inconsistent with the manifest intent of Section 2.03(c) to require repurchase of any and all non-qualifying loans. Yet there is no textual distinction that would support the notion that Section 2.03(c) imposes a continuing obligation while Section 2.03(a) does not. Section 2.03(c) therefore underscores what Section 2.03(a) already makes plain: The cure or repurchase obligation is an independent obligation triggered by notice or demand, not the mere making of representations and warranties.

Implicitly recognizing the daunting plain language problems it faces, DBSP devotes most of its energy to attempting to convince this Court that New York law somehow prohibits parties from agreeing to distinct and continuing obligations that operate to shift the risk of an injury that results from the breach of a representation or warranty.[2] *Bulova Watch Co. v. Celotex Corp.*, 46 N.Y.2d 606 (1979), is answer enough to that. There, the plaintiff sought to recover the cost of repairing its roof on theories that those costs were attributable both to the breach of an implicit warranty of fitness for use and to the breach of a distinct obligation to repair the roof on demand. *Id.* at 609. In rejecting the former but accepting the latter, this Court necessarily recognized that there is nothing inherently problematic about a distinct obligation to remedy conditions that may be attributable to a breach of

[2] DBSP also spends considerable time tallying up the courts that have ruled for and against its position. (Resp. Br. 40-48.) But many of those cases post-dated and simply applied the Appellate Division's decision in this case. DBSP also complains that some of the cases going the Trust's way relied on the district court's decision in *FDIC v. Key Fin. Servs.*, No. 86-2366, 1999 WL 34866812 (D. Mass. Dec. 23, 1999), even though the First Circuit "decline[d] to endorse" the district court's holding that the defendant's failure to abide by its repurchase obligation was an independent contractual breach. But the fact that the First Circuit did not reach that question does not make the district court's decision any less persuasive. Moreover, the First Circuit certainly had no problem endorsing the notion that the district court "was free to make [the plaintiff] whole" "[w]hether or not [the defendant] committed an independent breach by failing to repurchase." *Resolution Trust Corp. v. Key Fin. Servs., Inc.*, 280 F.3d 12, 18 (1st Cir. 2002). In doing so, the First Circuit specifically rejected the defendant's "cries of injustice," admonishing that the defendant "freely contracted for the obligations by which it now finds itself bound." *Id.* DBSP did the same here.

warranty. To the contrary, the Court made a point of emphasizing that the plaintiff's claim would survive *even if* it was covered by some other contractual guarantee that already had expired because "the defendants did not merely guarantee the condition or performance of the goods, but agreed to perform a service." *Id.* at 612.

So, too, here. DBSP did not simply make representations and warranties; it agreed to provide a service—cure or repurchase—whenever it was necessitated, whether it be by discovery or by notice, and whether the defect concerns a missing document, a defective document, or a breach of the representations and warranties. DBSP cannot now escape that distinct contractual obligation by recharacterizing it as a "liability-limiting" provision that operated solely for the benefit of DBSP.

Nor can DBSP escape the reality that the cure or repurchase obligation functioned as a "'special, separate and additional incentive'" by arguing that investors had "*no other rights or remedies* with respect to DBSP's representations and warranties." (Resp. Br. 30 (quoting *Bulova*, 46 N.Y.2d at 611).) That argument focuses on the wrong end of the stick. What matters is not whether investors had an alternative means of addressing faulty representations and warranties, but whether the cure and repurchase obligation operated independently of such a breach and imposed obligations on DBSP even when investors were not seeking to redress a faulty representation or warranty. It plainly did, as demonstrated above, which is enough to confirm its status as an independent obligation and distinguish most of the cases DBSP invokes. For example, DBSP relies on cases involving requirements for pre-suit notice, but such clauses are triggered exclusively by efforts to litigate and are nothing like the self-executing obligation here to cure or repurchase.

In all events, that investors' sole protection against faulty representations and warranties lies in the cure or repurchase obligation only underscores why that obligation *must* be interpreted to function as the incentive it was intended to be. Investors would not have given up their traditional rights and remedies with respect to DBSP's representations and warranties if the only thing they got in return was an additional condition on even the "sole remedy" they managed to preserve, in the form of an obligation to seek that remedy within five years and nine months of closing or forfeit it entirely. After all, it was DBSP that needed to attract investors, not the other way around.

DBSP nonetheless persists in arguing that anything labeled a "remedy" cannot possibly be understood as a distinct and continuing obligation. But DBSP does not cite a single decision from this Court holding as much—let alone doing so in the context of a contract that explicitly defines "remedy" as an "obligation" that can be enforced against the party that agreed to undertake it. Instead, DBSP cites only decisions from other courts to the effect that "promises to repair or to replace are generally viewed as specifications of a remedy rather than as an independent or separate warranty" when made as part of a unified products or parts warranty. *New Eng. Power Co. v. Riley Stoker Corp.*, 477 N.E.2d 1054, 1058 (Mass. App. Ct. 1985). (*See also* Resp. Br. 32-33.)[3] DBSP itself ultimately concedes, however, "[t]hat a different contract could hypothetically have included similar provisions as the performance due rather than a remedy." (Resp. Br. 35.) In other words, even DBSP recognizes that contracting parties are not powerless to structure agreements to include continuing obligations that allocate risk, even where those obligations relate at least in part to representations and warranties. It simply disputes whether that is what the parties to these Agreements did.

In the end, then, this case boils down to whether the Agreements' language characterizing cure or repurchase as a "remedy" nullifies their countervailing language characterizing it as an "obligation" that DBSP must perform and the Trustee must "enforce" even in circumstances where there is no "breach" of representations or warranties (*i.e.*, when the problem is a missing or defective

[3] Contrary to DBSP's contentions, the Trustee is not trying to "transform repair or replace remedies into future performance warranties." (Resp. Br. 31-33.) That said, the fact that repair or replace agreements and future performance warranties are commonplace and routinely enforced only underscores that there is nothing inherently problematic about a contract that requires the seller to repair or replace whenever a breach of the original warranty reveals itself. After all, whether it is characterized as a distinct contractual obligation or a warranty of future performance, an agreement to repair any leaks in a roof for 20 years is nothing more than an agreement to remedy a breach of the underlying warranty—a leak-proof roof—for 20 years rather than six.

document) and even when DBSP, rather than any counterparty, discovers the defect. The text alone makes clear that the cure or repurchase obligation is always an obligation, and only sometimes a remedy. But the specific commercial and contractual context at hand only underscores the commercial reasonableness of that interpretation. This is not a case in which the seller was warrantying the quality of its *own* products. In fact, it is precisely the opposite—DBSP readily conceded that the representations and warranties contained in the MLPA were made by third-party originators in the first instance and may not even have been independently verified by DBSP. (*See*, *e.g.*, R.300 (MLPA § 7(a) (acknowledging existence of "representations and warranties … as to which the Sponsor has no knowledge")).)

This also is not a case in which the purchasers were in a realistic position to verify the accuracy of those representations and warranties themselves. This context is far removed from one in which the consumer purchased a tangible product and then is better positioned than the manufacturer to ensure that the warranties were accurate. Here, neither the Trust nor investors were in any position to effectively reunderwrite *nearly 9,000* loans, and forcing them to do so is the last thing DBSP wanted or expected since that prohibitive undertaking would have made the investment unmarketable. The Agreements themselves provided the answer by imposing a cure or repurchase obligation that ensured that the loans undergirding the investment would be supported by the requisite paperwork and consistent with the representations and warranties made. That cure or repurchase obligation was necessary to attract investors in the first place. DBSP should not be able to pull the rug out from under them at this late stage by converting a necessary protection that reflected the commercial reality into a unique disability on investors that makes both the representations and warranties and the cure or repurchase obligation worthless after five years and nine months.[4]

B. The Condition Precedent Doctrine Underscores that No Suit Could Be Brought Unless and Until DBSP Failed to Cure or Repurchase Within 90 Days.

DBSP fares no better with its attempt to get out from under the condition precedent doctrine. As the cases explaining that doctrine confirm, even assuming failure to cure or repurchase within 90 days was not a distinct contractual breach, it certainly was a condition that had to come to pass before a breach of contract claim could accrue. Indeed, it is well settled that a contract under which a party is entitled to a specific time period in which to respond to something that triggers an obligation to act imposes a substantive condition precedent that is essential to the accrual of any claim based on the failure to do so. Because the Agreements here

[4] The First Department recently doubled-down on its ruling in this case, declining to reconsider its decision without any further analysis and making crystal clear that, in its view, it is impossible to file a timely lawsuit when a materially inaccurate representation or warranty is brought to DBSP's attention more than five years and nine months after the representations and warranties were made. *See U.S. Bank Nat'l Ass'n v. DLJ Mortg. Capital, Inc.*, Index No. 650369/2013, 2014 WL 5334039 (1st Dep't Oct. 21, 2014) ("[T]he demand to cure may render a claim untimely, but cannot make it timely." (citation omitted)).

expressly entitled DBSP to 90 days after notice or discovery of a defect, omission, or breach in which to decide whether to cure the defect, omission, or breach or repurchase the adversely affected loan, the Trust's claim did not accrue until that 90-day period lapsed with no action by DBSP.

That much is clear from *Continental Casualty Co. v. Stronghold Ins. Co.*, 77 F.3d 16 (2d Cir. 1996), in which the Second Circuit concluded that a claim for breach of a reinsurance contract did not accrue until the reinsurers not only were given notice of their obligation to indemnify, but also failed to indemnify within a reasonable time period following that demand. *See id.* at 21 ("Continental's actual losses were not due and payable until a reasonable period of time elapsed *after it gave notice* of them.") (emphasis added). That is because the parties entered into a contract under which the reinsurers were entitled not just to a pre-suit demand, but to a *substantive right triggered by* that demand—namely, "time to investigate and pay the claim." *Id.* at 20. And the insured, in turn, "was entitled—indeed probably obligated—to wait a reasonable time for the reinsurers to decide whether they would pay." *Id.*

DBSP attempts to distinguish *Continental Casualty* as a case in which no cause of action *could have* accrued until a demand was made and refused. (*See* Resp. Br. 50-51.) In fact, the Second Circuit said precisely the opposite. As the court explained, because "[r]einsurance policies are express contracts for indemnity against loss," a failure-to-indemnify "claim generally accrues when the indemnitee actually suffers a loss"—*i.e.*, when it begins to make "payments … on its underlying insurance policies." *Continental Casualty*, 77 F.3d at 19-20.[5] The court therefore recognized that, but for the contract's notice provision, the insured's claim would have accrued when it *could* have sought payment, rather than when the reinsurers refused to pay after it did so. But the court then went on to recognize that "parties are free, within limits of public policy, to agree upon conditions precedent to suit" that *change* a "general" accrual rule. *Id.* at 19. And the court concluded that the parties before it did so by contracting for an express "notice provision" that entitled the reinsurers to notice and a reasonable time period in which to respond, and prevented the insured from commencing any suit for indemnification until *both* of those things came to pass. *Id.* at 20.

That is exactly how this Court characterized *Continental Casualty* in distinguishing it in *Hahn Auto. Warehouse, Inc. v. Am. Zurich Ins. Co.*, 18 N.Y.3d 765 (2012). As the Court explained, *Hahn* did not differ from *Continental Casualty* because indemnity claims inherently contemplate time to investigate while payment claims do not. It differed because "the relevant policies" in *Hahn*

[5] Notwithstanding DBSP's attempt to confuse the issue, (*see* Resp. Br. 53), this discussion of "claims" is plainly a discussion about causes of action, not claims under an insurance policy. The sentence regarding when "the claim generally accrues" is immediately preceded and followed by citations and parentheticals about when "a cause of action accrues." *See Continental Casualty*, 77 F.3d at 19-20.

"contain[ed] no condition precedent and Zurich did not need to give Hahn any time to investigate." *Id.* at 772 n.5. In other words, the Court just distinguished the two contracts based on the terms for which the parties bargained—the reinsurer in *Continental Casualty* bargained for notice and time to respond, but the defendant in *Hahn* did not. If *Hahn* had adopted a blanket rule that pre-suit demand-and-response periods cannot be substantive unless they are a necessary component of *the underlying cause of action*, then *Hahn* would have rejected *Continental Casualty* rather than distinguishing it.[6]

Continental Casualty is hardly the only case in which a court has applied New York law to conclude that a contractually agreed-upon time period in which to perform (or cure a failure to do so) is a substantive condition precedent. *Russack v. Weinstein*, 291 A.D.2d 439 (2d Dep't 2002), involved a contract under which the parties agreed to make certain payments within 60 days of notice of an event requiring them. *Id.* at 440. The court concluded that a claim for breach of that obligation accrued not when the event triggering the payment obligation occurred, or when notice of that triggering event was given, but when 60 days passed *after* that notice without the defendant making the payment. *Id.* at 441.

[6] DBSP faces the same problem in attempting to distinguish *John J. Kassner & Co. v. City of N.Y.*, 46 N.Y.2d 544 (1979). The parties there surely *could* have entered into a contract under which payment was due as soon as the work was completed. The audit was a substantive condition precedent because the parties made it one, not because audits are a necessary element of all breach of contract claims involving payment for services.

Likewise, *Craven v. Rigas*, 71 A.D.3d 1220 (3d Dep't 2012), involved a note that defined an "Event of Default" as requiring both a failure to pay principal or interest when it became due *and* a failure to remedy that "default" within 10 days of receiving notice of its existence. *Id.* at 1222. The court concluded that, "under the specific terms of the note, plaintiff's cause of action did not accrue until 10 days after plaintiff sent notice of the default," even though the default itself had occurred much earlier. *Id.* These cases stand in marked contrast to the cases cited by DBSP, none of which involves a contract that included a designated time period in which to perform or remedy any default. *See, e.g.*, *Robb v. Low*, 99 A.D.3d 614 (1st Dep't 2012); *Woodlaurel, Inc. v. Wittman*, 199 A.D.2d 497 (2d Dep't 1993); *Sutton v. Burdick*, 75 A.D.3d 884 (3d Dep't 2010).[7]

DBSP attempts to distinguish cases like *Russack* as cases in which "the demand … served to trigger the party's *performance* under the contract." (Resp. Br. 59.) But that distinction does not explain the results that these cases reached.

[7] The only cases DBSP cites involving designated periods in which to perform or cure involve statutory, not contractual, conditions. *See Westminister Props., Ltd. v. Kass*, 163 Misc. 2d 773, 775 (1st Dep't 1995) (10-day cure period under Rent Stabilization Code was procedural, not substantive, condition of bringing suit); *Dickinson v. Mayor of City of N.Y.*, 92 N.Y. 584, 589 (1883) (statute providing that "no action shall be maintained against the mayor, aldermen and commonalty of the city of New York unless the claim on which the action is brought has been presented to the comptroller, and he has neglected for thirty days after such presentment to pay the same" was procedural, not substantive, condition of bringing suit). How the courts decided to interpret those statutory conditions, both of which were wholly extrinsic to the asserted claims, says very little about what private parties can or cannot agree to make a substantive condition of a breach of contract claim.

If the fact that a *demand* was necessary to trigger performance in *Russack* were all that mattered, then the claim should have accrued when the demand was made, not when 60 days passed without performance. *But see Russack*, 291 A.D.2d at 441 ("the applicable six-year statute of limitations did not begin to run until *60 days after* the plaintiff's written demand for payment") (emphasis added). Likewise, in *Continental Casualty*, the claim should have accrued when the insured provided notice of the losses, not, as the Second Circuit actually held, when "a reasonable period of time elapsed *after* it gave notice." 77 F.3d at 21 (emphasis added). And in *Craven*, it should have accrued—at the very *latest*—when the notice of default was given, not when the 10 days in which to cure it expired. *But see Craven*, 71 A.D.3d at 1222.

As *Craven* confirms, DBSP's related attempt to distinguish demands for "performance" from demands "to provide a 'remedy' for a pre-existing 'breach' of contract" (Resp. Br. 58), is every bit as meritless. This Court has recognized for more than a century that a demand to "cure" a preexisting failure to perform can operate as a substantive condition precedent. *Fisher v. City of N.Y.*, 67 N.Y. 73 (1876), involved a statute that required the city to compensate any party whose property was condemned within four months of the condemnation, and entitled the injured party to sue if, "after application first made," the city failed to provide the compensation due. *Id.* at 75. Although DBSP erroneously describes this Court's decision as having held that the party's claim accrued once "the City failed to pay within the four month period" (Resp. Br. 59 n.32), that actually is, once again, the *exact opposite* of what the Court held. In fact, the Court concluded that "[t]here must, *in addition*, have been an application to the city for payment, *after the expiration of the four months*, by the party entitled, before the right of action accrues." *Fisher*, 67 N.Y. at 75 (emphasis added). In other words, the Court concluded that even though the city violated its statutory obligation when the four months passed without payment, the claim did not accrue until the plaintiff asked the city to *cure* that violation.

As all of these decisions reflect, DBSP's attempt to derive some sort of blanket rule as to whether parties may bargain for pre-suit performance or cure periods is deeply misguided. So, too, is its attempt to distinguish demands to "perform" from demands to "remedy." It has long been settled law that "parties are free, within limits of public policy, to agree upon conditions precedent to" the accrual of a breach of contract claim. *Continental Casualty*, 77 F.3d at 19. Neither "public policy" nor anything else prohibits them from making one of those conditions a designated time period in which to perform after being asked to do so, or to cure a breach after learning of its existence. And whether the parties have bargained for that kind of substantive condition precedent to suit depends on the specific terms of the contract at hand, not wooden application of assumptions about what kinds of agreements contracts should or should not include. *See id.* at 21 ("New York courts do not instinctively apply CPLR § 206(a) in every case where a demand is a predicate to suit.").

Here, it is crystal clear that the parties agreed that DBSP would be entitled to 90 days to cure or repurchase if it discovered or was notified of any defect, omission, or material breach.[8] Indeed, DBSP itself is adamant that no suit could be initiated before this 90-day period expired—even if waiting the full 90 days would (at least under DBSP's view) have made the suit untimely. (Resp. Br. 60.) DBSP cannot have it both ways. If the Agreements entitled it to 90 days in which to cure or repurchase (which they plainly did), then they necessarily entitled—in fact, obligated—the Trustee to wait until 90 days passed without DBSP doing so before bringing suit. Any other conclusion would, once again, result in Agreements under which DBSP managed to unilaterally constrict the otherwise-applicable statute of limitations without having given the Trust or investors any corresponding benefit in return.

[8] DBSP makes the dubious argument that no claim could possibly accrue based on its failure to a cure or repurchase following a defect, omission, or breach that it discovered on its own. But if any inquiry into whether or when DBSP discovered a defect, omission, or breach were too "convoluted, subjective, and fact-intensive" to undertake, (Resp. Br. 61-62), then DBSP's explicit obligation to cure or repurchase upon either notice *or* its own discovery would be meaningless, as it would be impossible to enforce. Moreover, DBSP ignores the possibility that it could discover a problem, announce an intent to cure or repurchase some loans but not others, and litigation could then ensue. Certainly there is no reason to construe DBSP's express promise to cure or repurchase upon discovery of a defect as either illusory or, worse still, something that permits DBSP to conceal that discovery from the other parties to the Agreements.

Contrary to DBSP's contentions, that does not mean that the Trust may indefinitely delay accrual of a breach of contract claim by sitting on its rights. The Agreements explicitly contemplate and address this concern by requiring any party that discovers a defect, omission, or breach to "promptly notify" DBSP. (R.300 (MLPA § 7(a) ("Upon discovery … of any materially defective document … or that any material document was not transferred … or of any breach of any representation or warranty … the party discovering … shall give prompt written notice to the Sponsor.")); R.121 (PSA § 2.03(a) ("[u]pon discovery … the Trustee shall promptly notify the Sponsor and the Servicer of such defect, missing document, or breach")).) *See also Continental Casualty*, 77 F.3d at 21 ("once Continental suffered losses on the underlying policies, it could not unreasonably delay reporting those losses to the reinsurers").

DBSP complains that the Agreements do not obligate the Trust to promptly *discover* defects, omissions, or breaches. But that is simply a reflection of the parties' mutual and quite understandable agreement not to impose on the Trustee an obligation to reunderwrite nearly 9,000 loans. The parties specifically agreed that the Trust's right to demand cure or repurchase "shall not be impaired by … any failure on the part of … the [Trust] to review or examine such documents." (R.300 (MLPA § 7(a)); *see also* R.292 (MLPA § 4(e) ("[t]he fact that the Purchaser … has failed to conduct any partial or complete examination of the

Mortgage Files shall not affect the right of the Purchaser … to demand repurchase")).)[9]

II. THIS ACTION WAS TIMELY COMMENCED NO MATTER WHEN THE CLAIM ACCRUED.

A. Certificateholders Can Enforce DBSP's Repurchase Obligation.

As explained in the Trustee's opening brief, (*see* Opening Br. Part II), this suit was timely even under DBSP's preferred accrual rule, as the certificateholders that commenced suit on behalf of the Trust did so within six years of the closing of the Agreements. DBSP's contention that the PSA's "no-action" clause deprived them of "standing" to do so is meritless.

According to DBSP, the certificateholders lacked standing because the no-action clause prohibits certificateholder suits except where there has been a "default under the PSA" (Resp. Br. 70), which DBSP conveniently interprets to exclude defaults by DBSP. The problem with this argument is obvious at the outset: The no-action clause does not say that certificateholders must give "written

[9] DBSP's attempts to refute this commonsense point miss the mark. Whether undertaken by investors, the Trustee, or "distressed-debt hedge funds," (Resp. Br. 64), underwriting thousands of loans is an exceedingly expensive and burdensome task—particularly when, as the Agreements here expressly contemplate and experience has confirmed, many of the documents needed to do so are either defective or missing from the loan files. That the investors who initiated this litigation were able to purchase RMBS certificates for much less than their initial value is a reflection not of some understanding that they were unlikely to recover on the massive losses that DBSP caused but of the reality that doing so would require an extraordinary expenditure of resources on their part. And, of course, if the Trustee's suit is allowed to proceed, it will benefit all investors.

notice of default *under the PSA*." Nor does it say that certificateholders must give "written notice of a Servicer Event of Default or Master Servicer Event of Default." It simply says that they must give "written notice of default," full stop. (R.214 (PSA § 12.03).) If the only defaults that counted were those specifically delineated in the PSA's Servicer and Master Servicer default provisions, it would have been easy enough to say so. The parties instead conditioned the certificateholders' right to bring suit on behalf of the Trust only on (among other things not relevant here) "written notice of default." (*Id.*)

DBSP nonetheless insists that "default" must be construed as excluding defaults by DBSP because "the purpose of having 'defaults' under the PSA is to trigger the ability of certificateholders to ask the Trustee to bring suit on their behalf for violations under that agreement." (Resp. Br. 72 n.46.) But that is exactly what the certificateholders did when they asked the Trustee to bring suit on their behalf for DBSP's violation of its repurchase obligation (or, as DBSP would have it, its breach of its representations and warranties). DBSP cannot possibly mean to suggest that certificateholders may not even *ask* the Trustee to bring such a suit. Nor can it possibly mean to suggest that such a suit is entirely outside the scope of the PSA. After all, DBSP may not be a party to the PSA for all purposes, but it certainly is a party for some—including Section 2.03, which is specifically incorporated into Section 7 of the MLPA. (*See* R.300 (MLPA § 7(a)).)

Indeed, if a claim to enforce DBSP's obligations did not arise under the PSA at all, then the no-action clause would not apply in the first place, as the clause limits certificateholders' rights only as to "any suit, action or proceeding in equity or at law upon or under or *with respect to this Agreement*." (R.214 (PSA § 12.03) (emphasis added).) Of course, no one has suggested that this language should be interpreted so narrowly as to permit certificateholders to sue DBSP without even complying with the no-action clause. But if the no-action clause must be read as establishing the circumstances under which suits against DBSP are prohibited, then it ought to be read as establishing the circumstances under which such suits are permitted as well. There is no textual or logical reason for reading the clause's *restrictions* on certificateholder suits broadly to ensure that they *do* cover suits against DBSP, then reading its *permissions* on certificateholder suits narrowly to ensure that they *do not*.

DBSP also ignores the anomalous results that its reading of the no-action clause would produce. For instance, in addition to obligating DBSP to cure or repurchase any breach of *its* representations or warranties, Section 2.03 obligates the Servicer to do the same with respect to the representations, warranties and covenants that *it* has made in Section 2.05 of the PSA. (*See* R.123 (PSA § 2.03(e)); R.124-26 (PSA § 2.05).) DBSP presumably would concede that certificateholders may bring suit against the Servicer if it fails to abide by this obligation and the requirements of the no-action clause are satisfied, as the failure to do so is defined by the PSA as a "Servicer Event of Default." (*See* R.195 (PSA § 8.01(a)(ii)).)[10] But that means that, under DBSP's reading, certificateholders could maintain a suit against the Servicer for failing to remedy its breaches, but not against DBSP for failing to do the same. Nothing in the two provisions provides any basis for drawing that distinction; to the contrary, each explicitly characterizes its obligation as a remedy "available to the Trustee *and the Certificateholders*." (R.121-22 (PSA § 2.03(a)) (emphasis added); *see also* R.124-26 (PSA § 2.05 (cure is "available to the Certificateholders, the Depositor or the Trustee on behalf of the Certificateholders")).) Section 2.03(a)'s reference to "Certificateholders" would be entirely superfluous if, as DBSP insists, the universe of cases in which certificateholders could obtain this remedy were a null set.

DBSP attempts to justify all of this by declaring it "well-settled" that the "'primary purpose of a no-action clause [ ] is to protect issuers,' *i.e.*, defendants like DBSP." (Resp. Br. 77 (quoting *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 565 (2014) (alteration in original)).) But no-action clauses surely are not special protections for "issuers" vis-à-vis *other* potential defendants to a suit

[10] This readily defeats DBSP's suggestion that neither a breach of representations and warranties nor a failure to comply with a contractual obligation to remedy that breach may constitute a "default." (*See* Resp. Br. 75.) If both are treated as defaults when committed by the Servicer, then they are surely defaults when committed by DBSP as well.

initiated by certificateholders. Moreover, DBSP's self-serving assertion omits the critical second half of the statement it quotes. As this Court actually said in *Quadrant*: "[L]imitations on individual securityholder suits serve the primary purpose of a no-action clause, which is 'to protect issuers from the expense involved in defending [individual] lawsuits *that are either frivolous or otherwise not in the economic interest of the corporation and its creditors*.'" *Quadrant*, 23 N.Y.3d at 565 (quoting *Feldbaum v. McCrory Corp.*, 18 Del. J. Corp. L. 630, 642 (Del. Ch. 1992)). *That* interest is already served by the conditions the no-action clause imposes, which ensure that they certificateholders may initiate suits only after taking certain enumerated steps.[11] DBSP does not and cannot explain why those steps are sufficient to protect the Servicer and Master Servicer but not DBSP.

At bottom, nothing in the no-action clause supports the dubious notion that the parties wanted *DBSP alone* walled off from all certificateholder suits, even when the conditions that the no-action clause imposes are satisfied. DBSP's argument that the clause barred certificateholders from initiating this action on the Trust's behalf is therefore just another attempt to read into the Agreements special protections for DBSP that the parties neither contemplated nor intended.

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[11] And it is served twice-over in this case, as the Trustee confirmed that the suit is in the interest of certificateholders by substituting in. No-action clauses are designed to discourage suits "that most bondholders would consider not to be in their collective economic interest," not to "prevent the prosecution of meritorious suits." *Feldbaum*, 18 Del. J. Corp. L. at 641-42.

B. The Trustee's Complaint Benefits From The Summons With Notice Filing Date.

In all events, any purported "defect" in the certificateholders' standing did not prevent their summons with notice from validly commencing this suit. There can be no serious dispute that the summons with notice was served "in compliance with the statutory mandate as to substance and content" and gave DBSP "'at least basic information concerning the nature of plaintiff's claim and the relief sought.'" *Parker v. Mack*, 61 N.Y.2d 114, 117 (1984). That is all that is required under CPLR § 304 for an action to be commenced and jurisdiction over the defendant acquired by service of a summons with notice. *Id.* Whether the certificateholders who filed the summons with notice "provide[d] adequate pre-suit notice" or "lack[ed] … standing under the no-action clause" (Resp. Br. 78), is therefore beside the point, as neither is the kind of defect that would render the properly served summons with notice, or the lawsuit that it commenced, a nullity.

Whatever else may be said about DBSP's "standing" argument, it is not one that could have prevented the court from "obtaining jurisdiction over the person of the defendant." *Parker*, 61 N.Y.2d at 118. The certificateholders certainly did not lack "standing" to sue in a jurisdictional sense, as they undisputedly have a legal stake in the outcome of this litigation. *See Cmty. Bd. 7 of Borough of Manhattan v. Schaffer*, 84 N.Y.2d 148, 154 (1994) ("'Standing' is an element of the larger question of 'justiciability.'"); *Sec. Pac. Nat'l Bank v. Evans*, 31 A.D.3d 278, 279

(1st Dep't 2006) ("The most critical requirement of standing … is … 'injury in fact—an actual legal stake in the matter being adjudicated.'"). DBSP's arguments are instead only about their "standing" *under the Agreements*. But that is a contractual defense that DBSP could assert once the action was underway (and could forfeit by not raising), not a basis for declaring the action a "nullity" at the outset. *See Sec. Pac.*, 31 A.D.3d at 280 ("the Supreme Court always had the power to hear the foreclosure action, including any issues regarding the defense of lack of capacity or standing and waiver, had those issues been timely raised"); *see also HSBC Guyerzeller Bank AG v. Chascona N.V.*, 42 A.D.3d 381, 389 (1st Dep't 2007) (McGuire, J., concurring).

The same is true of DBSP's "adequate pre-suit notice" argument. Whether the certificateholders were required to wait 90 days before suing, once again, has nothing to do with whether the court "obtain[ed] jurisdiction over the person of the defendant." *Parker*, 61 N.Y.2d at 118. It is just an argument that DBSP could have raised as to why the suit could not be sustained consistent with contract. Indeed, as this Court has emphasized, even a "lack of subject matter jurisdiction" does not have "[t]he fatal consequence of a lack of jurisdiction over the person of the defendant," which is the only kind of defect that matters where a summons with notice is concerned. *Id.* That "fatal consequence" results only from defects in the summons with notice itself, such as failure to accompany the summons with the statutorily prescribed notice (as in *Parker*), or defects in the manner in which it was served. DBSP does not and cannot contend that either exists here.

Because this suit was validly "commenced" by the summons with notice, the Trust was entitled to benefit of the date on which the certificateholders filed the summons with notice when the Trustee substituted in and filed the complaint. As DBSP concedes, "substitution and relation-back have been permitted where the parties are closely related" (Resp. Br. 80), which they plainly are here. DBSP attempts to limit that principle to "corporate affiliates," on the theory that they "are effectively under common control." (Resp. Br. 81.) But the same thing can be said of a trust and its certificateholders. Indeed, if anything, the relationship between the latter is closer, as a trust is *obligated* (within the confines of the governing contract, of course) to act at the direction and in the interest of its certificateholders.

The relationship between a trust and its certificateholders is surely as "close," moreover, as that of a shareholder and corporation, and courts have long recognized that a corporation may substitute in when a shareholder brings suit derivatively on its behalf. *See, e.g., Lazar v. Merchs. Nat'l Props., Inc.*, 22 A.D.2d 253, 253-56 (1st Dep't 1964); 20 Carmody-Wait 2d § 121:207 ("upon demonstrating a strong probability that the defendant corporation will prosecute the action in good faith, an order granting the corporation's motion for substitution as the plaintiff and eliminating it as a defendant may be made”). DBSP does not even acknowledge this directly on-point comparison, let alone attempt to distinguish it.

DBSP alternatively contends that substitution and relation-back are unavailable because “[n]o mistake is alleged.” (Resp. Br. 81.) But the very case DBSP relies upon for that contention refutes it. *Frankart Furniture Staten Island, Inc. v. Forest Mall Assocs.*, 159 A.D.2d 322, 323 (1st Dep’t 1990), involved a claim commenced by a furniture store to recover for damages to furniture that was owned by another party and being sold by the store on consignment. When the actual owner attempted to substitute in, the defendant objected on grounds that the case was not validly commenced because the original plaintiff (*i.e.*, the furniture store) “had no standing to bring the lawsuit.” *Id.* at 323. The court readily rejected that argument, concluding that “leave to amend should be freely given in the absence of prejudice to the other party,” which it found lacking in light of the fact that, *inter alia*, the defendant “was always aware of the claims against it and had time to prepare its defense.” *Id.*

The situation is precisely the same here. To the extent there was any “defect” in the initiation of this suit, it was simply a matter of who should have been the party to serve the summons with notice. DBSP does not and cannot claim that it suffered any prejudice on account of it being served by the certificateholders rather than the Trustee. Instead, DBSP cites inapposite cases in which the new party and the original party did not even share the same interests. *See, e.g.*, *15 E. 11th Apt. Corp. v. Elghanayan*, 232 A.D.2d 289 (1st Dep't 1996) (court did not abuse discretion by denying leave to intervene where proposed interveners were "not 'united in interest' with the original plaintiffs"); *EverHome Mortg. Co. v. Charter Oak Fire Ins. Co.*, No. 07-cv-989, 2012 WL 868961, at *11-12 (E.D.N.Y. Mar. 14, 2012) (relation-back unavailable where parties were "neither 'related' nor 'united in interest'"). That is certainly not a concern here, where the action was initiated from the outset as a "derivative action" seeking relief "on behalf of the Trust and all of the Certificateholders." (R.26.)

In any event, even if there were some defect in the summons with notice (and there was not), that still would not have prevented the Trustee from curing that defect through its complaint because the case was still pending, and not subject to a motion to dismiss, when the Trustee did so. *See Snay v. Cohoes Mem'l Hosp.*, 110 A.D.2d 1021, 1022 (3d Dep't 1985); *cf. Burwell v. Yonkers Gen. Hosp.*, 6 A.D.3d 478, 481 (2d Dep't 2004). DBSP derides these cases as "misinterpret[ing]" this Court's decisions addressing CPLR § 205(a) (Resp. Br. 84), but they do no such thing. *Snay* simply recognized that, because this Court has made clear that a defect in capacity when a summons with notice was served can be cured by commencing a new action under CPLR § 205(a), *see Carrick v.*

Cent. Gen. Hosp., 51 N.Y.2d 242 (1980), there is no point in forcing the plaintiff to commence an entirely new action when the defect has been cured through a complaint filed before the defendant even moved to dismiss. *Snay*, 110 A.D.2d at 1022; *see also HSBC Guyerzeller*, 42 A.D.3d at 390 (McGuire, J., concurring).[12]

Finally, to the extent DBSP contends that CPLR § 205(a) is *not* available to the Trustee (Resp. Br. 86-88), it is manifestly wrong. The Appellate Division did not dismiss this action for neglect to prosecute or any other exclusion enumerated in CPLR § 205(a). It dismissed only based on its (mistaken) belief that the certificateholders lacked standing under the PSA and failed to comply with a condition precedent. As DBSP itself is forced to concede (Resp. Br. 60 n.34), even the First Department has held that when an action is dismissed for failure to comply with a condition precedent, CPLR § 205(a) remains available. *See S. Wine & Spirits of Am., Inc. v. Impact Env't Eng'g, PLLC*, 104 A.D.3d 613 (1st Dep't 2013). And this Court's decisions in *Carrick* and its progeny conclusively refute any suggestion that CPLR § 205(a) may not be used to cure a defect in capacity, so

[12] Nonetheless, the Trustee, in an abundance of caution, also has initiated a new action pursuant to CLPR § 205(a) that has been stayed pending resolution of this appeal. *See ACE Secs. Corp. v. DB Structured Prods. Inc.*, Index. No. 651854/2014, (Doc. No. 15), Stipulation & Order (Sup. Ct. N.Y. Cty. Aug. 27, 2014).

long as "it is the same person or entity whose rights are sought to be vindicated in both actions." *Reliance Ins. Co. v. PolyVision Corp.*, 9 N.Y.3d 52, 57 (2007).[13]

Because the Trustee could have cured any defect by filing a new action pursuant to CPLR § 205(a), it also was entitled to do so by substituting in and filing a complaint before DBSP moved to dismiss. Any other result would produce nothing more than a supreme waste of judicial resources.

In short, there is no basis for accepting DBSP's final plea to convert a cure or repurchase obligation into a provision that effectively means that no party may sue DBSP even within the six-year statute of limitations. DBSP's position boils down to the proposition that once five years and nine months passed, the investors and the Trust were powerless to do anything to address either the breaches of representations or warranties or the failure to cure or repurchase. That cannot be correct. Even if a suit needed to be commenced within six years, it was. That DBSP might have had contractual defenses to the suit as initially filed is of no moment, as those defects have long since been cured.

[13] DBSP's contention that "HSBC, as Trustee, is not Fir Tree or Värde in a different capacity," (Resp. Br. 88), ignores the fact that Fir Tree and Värde commenced this suit as a "derivative action on behalf of the Trust." (R.26.) Accordingly, in both the summons with notice and the complaint, "it [wa]s the same … entity whose rights [we]re sought to be vindicated." *Reliance Ins.*, 9 N.Y.3d at 57.

CONCLUSION

For the foregoing reasons, and the reasons set forth in the Trustee's opening brief, the judgment of the Appellate Division, First Department, should be reversed.

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October 28, 2014

Respectfully submitted,

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