APL-2014-00156
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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.

BRIEF OF *AMICUS CURIAE* THE ASSOCIATION OF MORTGAGE INVESTORS IN SUPPORT OF PLAINTIFF-APPELLANT'S MOTION FOR LEAVE TO APPEAL

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<u>STATEMENT OF INTEREST OF *AMICUS CURIAE*</u>

The Association of Mortgage Investors ("AMI") is a Washington, D.C.-based non-profit (I.R.C. § 501(c)(6)) organized as the primary trade association representing investors in mortgage-backed securities, including public pension funds, unions, university endowments, and private retirement systems. AMI was founded to play a primary role in the analysis, development, and implementation of mortgage and housing policy to help keep homeowners in their homes and provide a sound and transparent framework that promotes continued home purchasing.

Since its formation, AMI has been developing a set of policy priorities that it believes contributes to achieving this goal. AMI educates policy-makers and government authorities on housing finance and mortgage issues, by, among other things, regularly addressing the U.S. Congress, federal regulatory agencies, and state and local governments. It is an investor-only group comprised of a significant number of substantial institutional investors who collectively manage more than $1 trillion in residential mortgage-backed securities ("RMBS").

As the leading representative of holders of RMBS, AMI has a substantial interest in ensuring that the parties responsible for the creation of RMBS live up to the contractual obligations set forth in the documents that structure these transactions. AMI, therefore, has a substantial interest in this lawsuit, in particular the First Department's December 19, 2013 Decision and Order (the "SOL

Decision") concerning the statute of limitations defense that many RMBS sponsors and mortgage loan sellers have asserted in an effort to avoid their contractual obligations. The outcome of this Appeal will therefore affect the rights of RMBS investors like AMI's members and their interests in more than $1 trillion in RMBS. AMI thus respectfully requests that the Court consider its views as *amicus curiae* in connection with the pending appeal.

PRELIMINARY STATEMENT

Defendant-Respondent DB Structured Products, Inc. ("DBSP") is one of many loan sellers who intend to use the SOL Decision to avoid liability for widespread breaches of their obligation to repurchase loans sold to RMBS trusts in violation of contractual representations and warranties. To assure investors that the loans sold to a trust were as advertised, loan sellers like DBSP made representations and warranties regarding the character and quality of the loans. The investors had no opportunity to verify information about the loans provided in offering materials. Therefore, in agreements governing the trusts, loan sellers struck a simple bargain: each time the seller or another party discovered that a loan did not conform to those representations and warranties, the seller would cure that deficiency within a set time period from when it discovered or received notice of the breach. And if the seller failed or elected not to do so, it would buy the loan back from the trust at a specified purchase price. This repurchase protocol creates a continuing obligation and the IAS Court correctly held that a cause of action for the seller's failure to cure or repurchase accrues each time the loan seller fails to perform. The First Department's contrary conclusion runs counter to the terms of the contracts, the expectations of market participants, New York law, and sound policy.

First, the SOL Decision runs counter to the RMBS contracts. The plain language of the governing agreements is clear: the obligation to repurchase arises only *if* the loan seller fails to cure the representation and warranty breach, and the obligation to cure arises only *after* the loan seller discovers the breach (either independently or through notice from another party). This unequivocally creates an ongoing process through which the parties address deficiencies in the mortgage pool on a loan-by-loan basis as issues arise. As DBSP asserts, other causes of action and remedies may be available for investors to address certain instances of demonstrable fraud. But the continuing repurchase obligation is a central component to the bargained-for allocation of risk between loan sellers and investors—and it places the risk of fraudulent or defective loans squarely *on the sellers*. Undermining this bargained-for obligation improperly shifts the associated risks *to the investors* who had little choice but to rely on the representations and warranties provided by the sellers. Furthermore, without the continuing repurchase obligation—which ensures that loan sellers remain responsible for the concealed risk inherent in loans that only they are in a position to evaluate, and for which they provide representations and warranties—sellers will be perversely incentivized to ignore prudent lending standards in an effort to sell more loans.

Second, the SOL Decision runs counter to the expectations of market participants. Loan sellers like DBSP have *for years* publicly taken the position, in filings with the Securities and Exchange Commission and elsewhere, that their repurchase obligation continues for the duration of the transaction and that, in the words of loan seller Wells Fargo, trustees "***may demand repurchase at any time***." That these financial institutions described the continuing nature of their repurchase obligation in such unequivocal terms, despite an obvious incentive to construe the agreements as DBSP does now, is telling.

Third, the SOL Decision runs counter to New York law. Sellers have consistently taken the position that their opportunity to cure is a condition precedent to the obligation to repurchase. Indeed, DBSP made this point to the IAS Court in this case—that the Appellant had no right to sue *until* DBSP discovered and failed to cure the representation and warranty breach. This Court has made clear that when a contractual obligation is subject to a condition, the obligation "arises and the cause of action accrues, only when the condition has been fulfilled." *John J. Kassner & Co. v. City of New York*, 46 N.Y.2d 544, 550 (1979). And as the IAS Court concluded, because the ability of trustees to enforce sellers' cure or repurchase obligations hinges on the repurchase process, the claims cannot accrue until that process is completed. The SOL Decision squarely conflicts with this Court's decision in *Kassner*.

Fourth, the SOL Decision runs counter to sound public policy. The result urged by DBSP in this case would unfairly deprive investors of important contractual rights, undermine the allocation of risk that was agreed to and understood by all parties to RMBS securitizations, and create the risk of an unintended and unfair market-wide windfall to loan sellers such as DBSP at the expense of investors like AMI's members. The SOL Decision would create the same type of moral hazard that led to the financial crisis. A central contributing factor to the financial crisis was lenders' failure to apply prudent lending standards to the loans they originated. Because loan sellers securitized their loans, they no longer bore the risk that the loan would default; that risk was passed to investors. Underwriting guidelines and other credit criteria (the very facts addressed in representations and warranties) were abandoned because, by undercutting or ignoring those credit criteria, the seller could sell more loans while passing the increased risk to investors. If, as DBSP argues, the statute of limitations cuts off a loan seller's obligation to repurchase noncompliant loans just six years after the securitization's closing date (despite the expressly contemplated 20-30 year life of RMBS and the loans in the mortgage pool), this moral hazard is not held in check.

Indeed, the cure or repurchase obligation would have no meaning if trustees and investors were compelled to conduct comprehensive due diligence on the loans after the transaction closed as a preventive measure to preserve claims. The proper application of the statute of limitations is critical to ensuring loan sellers retain risk in the loans they sell, which will in turn facilitate prudent lending and bolster confidence in future securitizations.

DBSP and its supporters argue that the SOL Decision should stand because they envision a flood of litigation if this Court reverses the ruling. That is unlikely to occur. Many loan sellers are bankrupt. Many others have reached settlements covering claims for hundreds of trusts. And dozens of litigations have already been filed. In any event, AMI submits that this Court should not foreclose valid claims that arise from bargained-for agreements simply on the ground that those wronged might seek a remedy. This Court has expressed a similar view: "It suffices that if a cognizable wrong has been committed that there must be a remedy, whatever the burden of the courts." *Tobin v. Grossman*, 24 N.Y.2d 609, 615 (1969). As alleged in the First Amended Complaint, DBSP breached its clear contractual obligations and (as numerous government investigations have concluded) helped spur the worst financial crisis since the Great Depression. Trustees and investors should not be denied a remedy in the name of judicial economy.

The SOL Decision should be reversed.

BACKGROUND

I. Mortgage Securitization.

RMBS are obligations, called certificates, secured by a pool of mortgage loans held by a trust for the benefit of investors. A sponsoring financial institution (or sponsor) first originates the loans itself or acquires loans from other loan originators. The loans are then pooled together and the sponsor sells the pool of loans to a special purpose entity (typically affiliated with the sponsor), called the depositor, pursuant to a mortgage loan purchase agreement ("MLPA"). The depositor then deposits the loans into the trust, which issues the certificates to the depositor, pursuant to a pooling and servicing agreement ("PSA"). Securities underwriters then offer the certificates for sale to investors pursuant to a prospectus and prospectus supplement. Investors who purchase the certificates are then entitled to monthly distributions from the cash flow generated from borrowers' mortgage payments, paid out over the thirty-year life of the loans.

Securitization provided significant benefits. It allowed banks to increase lending activity beyond deposits because they could sell the loans, which removed them from their balance sheets and freed up capital to issue more loans.[1] It

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[1] *See* Office of the Comptroller of the Currency, Credit Risk Retention Report Soliciting Comments on Proposed Rules to Implement the Credit Risk Retention Requirements of Section 15G of the Securities and Exchange Act of 1934, 12 (2011) (hereafter "OCC Credit Risk

allowed "non-bank lenders to originate at competitive prices without deposit funding, thereby reducing barriers to entry and increasing lending competition."[2] Borrowers obtained more affordable mortgage financing as a result.[3] Investors gained access to securities that were more easily traded than individual loans; securities that often carried triple-A credit ratings, and which were supposed to have provided long-term cash flows.

Securitization also carried with it two primary risks for investors.

First, investors faced the ordinary risk that borrowers would default on their mortgages and trust distributions would be inadequate to provide anticipated returns on the RMBS. Investors could reasonably assess this risk assuming

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Retention Report") ("The securitization markets are an important source of credit to U.S. households and businesses and state and local governments.").

[2] Timothy Geithner, Financial Stability Oversight Council, *Macroeconomic Effects of Risk Retention Requirements* 9 (Jan. 2011) (hereafter "Macroeconomic Effects"), *available at* http://www.treasury.gov/initiatives/wsr/Documents/Section%20946%20Risk%20Retention%20Study%20%20(FINAL).pdf.

[3] "When properly structured, securitization provides economic benefits that lower the cost of credit to households and businesses." OCC Credit Risk Retention Report, *supra* note 1, at 13. Indeed, securitization has, according to some estimates, funded 59% of outstanding home mortgages. Testimony of George P. Miller, Executive Director, American Securitization Forum before the Senate Banking, Housing and Urban Affairs Subcommittee on Securities, Insurance and Investment 3 (Oct. 7, 2009) (hereafter "Miller Testimony"), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=ce52591a-8855-48b2-8bb7-e31ee80d0428. *See generally* OCC Credit Risk Retention Report, *supra* note 1, at 13 n.7 (explaining how securitization decreases the cost of funding loans for sellers); Report to Congress on Risk Retention, Board of Governors of the Federal Reserve System 8 (Oct. 2010) *available at* http://federalreserve.gov/boarddocs/rptcongress/securitization/riskretention.pdf.

disclosures regarding the securitized mortgage pool were accurate and, as the beneficial owners of the loans, it made sense to allocate this risk to investors.

Second, investors faced the more problematic risk that the loans contained hidden defects as a result of failures in the origination process. Such latent defects—for example, that the originator did not comply with its underwriting guidelines, did not properly appraise the property, failed to follow relevant required disclosures, violated predatory lending or other consumer finance laws, or did not properly assign the mortgage upon sale—materially increased the risk that a loan might default or be unenforceable. Moreover, many of these defects would not become apparent until years later. For example, if a loan was missing or had incorrect documentation, this may not be realized until the servicer is unable to foreclose on the defaulted loan and notices that documents are missing and that the foreclosure could not be completed. Similarly, a balloon loan may not have balloon payments due until long after the securitization closes. This origination risk was particularly problematic because, unlike the loan seller, investors cannot verify information regarding the quality of the loans.[4] Instead, they had to rely on the promises made by the seller. Additionally, as part of the securitization process, sponsors obtain the basic documentation ("loan files") supporting the loans (including the borrower's loan application, credit report, income, asset and

[4] "An originator has more information about the ability of a borrower to repay than an investor, because the originator is the party making the loan." Macroeconomic Effects, *supra* note 2, at 9.

employment verifications, disclosures, property appraisal, etc.) they purchase from others and conduct due diligence on them to assess the lender's compliance with, among other things, underwriting guidelines and applicable lending laws.[5] Sponsors therefore also have distinct informational advantages over investors.[6] In fact, without such advanced knowledge, sponsors would not have been able to reliably make the representations and warranties. In contrast, investors have no access to the loan files prior to purchasing RMBS.[7] Investors are provided a prospectus and prospectus supplement, as well as certain limited data concerning the loans (such as property location, property type, borrower FICO score, and loan-to-value ratio), but are not afforded the opportunity to, and therefore cannot, verify

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[5] Financial Crisis Inquiry Commission, The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States 165 (2011) (hereafter "FCIC Report"), *available at* http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

[6] Adam B. Ashcraft & Til Schuermann, *Understanding the Securitization of Subprime Mortgage Credit*, Federal Reserve Bank of New York Staff Report No. 318, at 6 (Mar. 2008), *available at* http://www.newyorkfed.org/research/staff_ reports/sr318.pdf.

[7] "[I]nvestors have few of the rights that owners of property should possess. It is difficult for investors to examine even basic documents regarding their property to see if they were defrauded when the purchased the securities. . . . The agreement that binds their relationship with the servicer, the Pooling and Servicing Agreement (PSA), was normally drafted before investors purchased their securities, and so was offered to the investors on a 'take it or leave it basis.'" Testimony of Prof. Kurt Eggert, Chapman University School of Law, *Problems in Mortgage Servicing from Modification to Foreclosure, Part II: Hearing before the U.S. Senate Committee on Banking, Housing, and Urban Affairs* 4 (Dec. 1, 2010), *available at* http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=2ab0a78e-12ee-4cf8-bb70-745d0d0372ab.

that information.[8] And given the thousands of loans in each securitization trust, investors would have had no practical method of conducting full due diligence even if every potential investor was offered full access to the thousands of pages of loan files for each securitization.[9]

Without any offsetting contractual rights protecting investors, securitization would provide lenders with an incentive to issue loans that are unsuitable for the borrower and far riskier for investors. Traditionally, originators retained ownership of the loans they originated, and thus bore the risk of loss if the borrower defaulted.[10] As a result, originators had a strong economic incentive to apply prudent underwriting standards to verify the borrower's creditworthiness. Securitization changed that incentive because, once the loans are sold, the default risk shifted to investors. As the Senate Permanent Subcommittee on Investigations

[8] Letter from the Ass'n of Institutional Investors to the Bureau of Consumer Financial Protection dated July 9, 2012, at 5 ("[I]nvestor access to data is extremely limited and incomplete with respect to the mortgage loans in non-agency RMBS."), *available at* http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0022-0140.

[9] *See* Macroeconomic Factors, *supra* note 2, at 9 ("Additionally, the large number of assets and the disclosures provided to investors may not include sufficient information on the quality of the underlying financial assets for investors to undertake full due diligence on each asset that backs the security."). Indeed, the difficulty of reviewing loan files was a contributing factor in the recent $10 billion settlement between federal banking regulators and fourteen banks regarding foreclosure practices. Jessica Silver-Greenberg, *Deal Expected on Past Abuses in Home Loans*, N.Y. Times, Dec. 31, 2012, at A1 ("Pressure to reach a settlement with the banks has been building, particularly within the Office of the Comptroller of the Currency, amid widespread frustration that the banks' mandatory review of loan files was arduous and expensive . . . .").

[10] FCIC Report, *supra* note 5, at 89 ("As subprime mortgage securitization took off, [sponsors] undertook due diligence on their own or through third parties on the mortgage pools that originators were selling them.").

concluded, "[w]hen lenders kept on their books the loans they issued, the creditworthiness of those loans determined whether the lender would turn a profit. Once lenders began to sell or securitize most of the loans, volume and speed, as opposed to creditworthiness, became the keys to a profitable securitization business."[11] By undercutting or ignoring the lender's underwriting guidelines and other criteria that were intended to ensure creditworthiness, lenders could sell more loans. Because they could pass the risk on to investors, who would have difficulty detecting the defective underwriting, loan sellers had little incentive to ensure the mortgages' credit quality.[12] The agreements governing RMBS transactions therefore had to impose the correct incentives.

II. Loan Sellers' Obligation to Cure or Repurchase Noncompliant Loans Is Critical to Minimizing Loan Sellers' Motive and Opportunity to Conceal Risks in RMBS.

The agreements governing the sale and securitization of the loans protect investors from these asymmetries by imposing repurchase obligations on the loan

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[11] United States Senate Permanent Subcommittee on Investigations, Wall Street and the Financial Crisis: Anatomy of a Financial Collapse 24 (2011) (hereafter "SPSI Report"), *available at* http://www.hsgac.senate.gov/download/report-psi-staff-report-wall-street-and-the-financial-crisis-anatomy-of-a-financial-collapse; *see also* Macroeconomic Effects, *supra* note 2, at 3 ("The originate-to-distribute model, as it was conducted, exacerbated this weakness by compensating originators and securitizers based on volume, rather than on quality.").

[12] Macroeconomic Effects, *supra* note 2, at 10-11. "Solid and consistent underwriting is key to secondary mortgage market development. Investors must have confidence that lenders are properly judging risk and using a consistent set of criteria in evaluating loans." Michael J. Lea, *The Role of the Primary Mortgage Market in the Development of a Successful Secondary Mortgage Market* 7 (Jan. 2000), *available at* http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.200.696&rep=rep1&type=pdf.

seller. These obligations were intended to incentivize loan sellers toward prudent lending and fair disclosure.

First, to address investors' informational disadvantages, loan sellers make express representations and warranties concerning the quality and characteristics of the loans.[13] Generally, the representations and warranties cover matters such as "the mortgaged property securing the loan, the documentation for the loan, the manner in which the loan was originated and its compliance with applicable law."[14] Representations and warranties do not guaranty safe or low-risk loans; rather, they are "important to ensure, among other things, that the securitization trust contains mortgage loans having *expected* characteristics and terms."[15] These representations and warranties are central to understanding the credit risk that investors assume when they purchase RMBS; the "nature and type" of the

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[13] When the sponsor and the originator are not the same entity, the originator typically makes representations and warranties to the sponsor. The sponsor then either assigns its rights as against the originator to the trust, repeats or "re-reps" the originator's representations and warranties to the trust, or makes its own representations and warranties to the trust.

[14] Testimony of Tom Deutsch, Exec. Director of the American Securitization Forum, *The State of the Securitization Markets: Hearing before the Senate Comm. on Banking, Housing, and Urban Affairs, Subcomm. on Secs., Ins., and Investment* 6 (May 18, 2011), *available at* http://www.americansecuritization.com/uploadedFiles/ASF_Senate_Banking_Securitization_Testimony_5-18-11.pdf).

[15] *Id.* at 6 (emphasis added); *accord* Talcott J. Franklin & Thomas F. Nealon III, *Mortgage and Asset Backed Securities Litigation Handbook* § 1:12, at 1-26 (West 2012) (hereafter "MBS Litigation Handbook").

representations and warranties can impact the price investors were and are willing to pay for their securities.[16]

Second, to incentivize loan sellers toward prudent lending practices and appropriate due diligence—similar to what they would have used if they continued to own the loans themselves—loan sellers are required to cure any breach of any representation and warranty that materially and adversely affects the value of the loan or the interests of investors. If the loan seller is unable to cure the breach within a specified period of time (typically 60 or 90 days), it must repurchase the loan. The seller's repurchase obligation is triggered on an ongoing basis either when a loan seller itself discovers defects in certain loans, or when the loan seller receives notice from the trustee or another party.[17] The repurchase obligation thus allocates the origination risk of defective mortgage loans to the issuers of securities and not to the investors who purchase them.[18]

Third, each transaction party—including the loan seller itself—is required to provide the trustee with notice of a breach promptly upon that party's discovery of

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[16] Joseph Philip Forte, *Wall Street Remains a Key Player In Commercial Real Estate Financing Despite Capital Market Fluctuations*, 73 N.Y. St. B.A.J. 34, 38 (July/Aug. 2001).

[17] This loan-by-loan repurchase process has its limitations in the face of wholesale breaches of representations and warranties concerning the mortgage loans. AMI does not address here the alternative remedies New York law provides for such pervasive misconduct.

[18] American Securitization Forum, ASF Project RESTART, ASF Model RMBS Representation and Warranties at 2 (Dec. 15, 2009). "Issuers . . . have always had retained risk through representations and warranties and through implicit recourse." *Standard and Poor's Conference Comment, Report from Am. Securitization Forum Conference 2010*, at 12 (Feb. 9, 2010).

it. The trustee must then provide prompt notice of the breach to the loan seller, assuming the loan seller was not the discovering party.[19] The notice obligation is a key component of the protections provided to investors because it ensures that (1) the loan seller's obligation to cure is triggered and (2) the trustee is in a position to enforce the loan seller's repurchase obligation if the seller fails to cure the breach. Imposing a contractual obligation to provide notice is particularly important because the transaction parties with the most information about the loans—the sponsor and the originator—have the least incentive to speak up since doing so will require them to repurchase the loan. Moreover, the governing agreements provide that the trustee is not obligated to conduct any investigation relating to the trust unless there is an event of default, as defined in the PSA. Thus, the parties agreed to a structure in which they all knew that the trustee would be unlikely to discover representation and warranty breaches on its own.

With these three components, the repurchase obligation allocates origination risk to the party best able to assess and bear it: the seller. Loan sellers retain "skin in the game" by assuming the risk that the loans are not of the character and quality reflected in the representations and warranties and described in the securitization offering materials.[20] Because of their greater access to information about the loans

[19] In the governing agreements for many RMBS trusts, the discovering party must provide notice to all transaction parties directly.

[20] Miller Testimony, *supra* note 3, at 20.

and the borrowers, loan sellers are best able to assume "undisclosed origination risk."[21] Investors, as the beneficial owners of the loans with the right to cash flows from those loans, assume the "normal risks of loan ownership, such as deterioration of the borrower's credit due to loss of employment or other 'life events.'"[22] Investors also assume the counterparty risk that the loan seller will become insolvent and be unable to repurchase loans in the future. Assessing these risks is complex; investors have "to calculate the statistical probabilities that certain kinds of mortgages might default, and to estimate the revenues that would be lost because of those defaults."[23] An accurate assessment of risk is particularly important for RMBS investors like pension funds and university endowments which have to carefully protect their investment principal. Investors therefore have to be confident of the key qualities and characteristics of mortgages included in a particular mortgage pool that allow them to assess the risks prior to purchase of the securities. Representations and warranties are a foundational aspect of that understanding. The repurchase protocol is thus "a critical mechanism within the securitization model. [Representations and warranties] provide assurance to investors that they are getting the deal for which they bargained" and that is

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[21] *Id.*

[22] *Id.*

[23] FCIC Report, *supra* note 5, at 43.

described in the prospectus and prospectus supplement.[24] Or, as the IAS Court described it, the cure and repurchase obligations "functioned as insurance" against "the risk of non-complying loans."[25]

III. The Obligation to Cure or Repurchase Is Continuing.

Loan sellers' obligation to cure or repurchase noncompliant loans must exist for the life of the trust to maintain the allocation of risk necessary to RMBS transactions. The representations and warranties are provided because investors are unable to conduct detailed, loan-by-loan due diligence with respect to the thousands of mortgages in the trust prior to purchasing certificates. If the repurchase protocol was not a perpetual shield against undisclosed origination risk, trustees and investors would be forced to conduct prophylactic due diligence swiftly after the transaction closed. Not only would such an obligation be sufficiently burdensome to make RMBS securitizations economically unviable, as the due diligence would render them cost-prohibitive, but the concept of such a "needle-in-the-haystack" endeavor runs contrary to the expressed intent of the parties, as reflected in the contract terms typical for RMBS transactions, and the common practices of loan sellers.

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[24] MBS Litigation Handbook, *supra* note 15, § 1:12, at 1-26.

[25] R. 15.

The agreements governing RMBS trusts permit the parties to address particular identified loans on an ongoing basis without impairing the rights of the trust. For example, pursuant to most MLPAs and PSAs, the cure or repurchase obligation does not arise until the loan seller discovers a representation and warranty breach, or another party provides notice thereof to the loan seller. Until that time, loan sellers typically agree (as DBSP did here)[26] that no failure to review loan files will impair the representations and warranties provided to the trust (or to the depositor and assigned to the trust). The loan seller has an obligation to repurchase a defective loan only *after* the bargained-for time to cure any identified breaches has run. In most circumstances, such provisions provide an efficient mechanism to address identified breaches on a case-by-case basis while avoiding the burden and expense of a roving, unfocused investigation of the entire mortgage pool.

This clear, straightforward reading of the governing agreements was not lost on loan sellers. In disclosures to shareholders, discussions with market analysts, and court filings, major loan sellers have consistently characterized their repurchase obligations as ongoing. For example, Citigroup explained that its representations and warranties are not subject to "stated limits in amount or *time of*

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[26] R. 300 (MLPA § 7(a)).

coverage."[27] Wells Fargo warned its shareholders that RMBS investors "may demand repurchase *at any time*."[28] Brian Moynihan, Bank of America's President and CEO, explained that "there's no technical statute of limitations from a standpoint on the repurchase."[29] These acknowledgements by loan sellers with some of the highest d isclosed repurchase exposures in the industry accurately reflect the nature and structure of RMBS transactions and the expectations of market participants with respect to their ongoing, life-of-trust obligations to repurchase defective loans.

The continuing nature of loan sellers' repurchase obligations is so fundamental to the bargain struck in RMBS transactions that, as trustees have filed litigation to enforce repurchase claims, loan sellers have unavoidably reaffirmed their public statements in court. DBSP and others have routinely emphasized in motion papers that trustees have no cause of action—no right to demand repurchase through litigation—unless and until the loan seller has had an

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[27] Citigroup Inc., Annual Report (Form 10-K), at 110 (Feb. 25, 2011), *available at* http://sec.gov/Archives/edgar/data/831001/000120677411000316/citigroup_10k.htm; *see also* H&R Block, Inc., Annual Report (Form 10-K), at 66 (Jun. 29, 2009) (same), *available at* http://sec.gov/Archives/edgar/data/12659/000095012309018620/ c51997e10vk.htm.

[28] Wells Fargo & Co., Quarterly Report (Form 10-Q), at 38 (Nov. 5, 2010) (emphasis added), *available at* http://sec.gov/Archives/edgar/data/72971/000095012310101484/f56682e10vq.htm.

[29] Bank of America Corporation, Transcript of Q3 2010 Earnings Call held Oct. 19, 2010, *available at* http://www.morningstar.com/earnings/18372176-bank-of-america-corporation-q3-2010.aspx.

opportunity to cure the identified representation and warranty breaches and has failed to do so. For example:

- **DBSP:** "[T]he whole purpose of the repurchase protocol is for the trustee to give us notice of 90 days to effect a repurchase, and ***only at that point is the trustee authorized to seek to enforce the repurchase protocol.***" (R. 1173.)

- **JPMorgan:** "[JPMorgan] understands ***how the statute of limitations works: it begins to run when there is a breach of an access, notice or repurchase obligation.***"[30]

- **Bank of America:** "[T]he deal documents . . . repeatedly emphasize the Trustee's obligation to provide notice of breaches and allow Countywide a 90-day period in which to cure those breaches before seeking to enforce any repurchase obligation that might apply. . . ***That such notice and opportunity to cure stand as a condition precedent to suit is spelled out clearly.***"[31]

- **Citigroup:** "There is no controversy for the Court to resolve [until] CGMRC is given notice of a purported breach and an opportunity to cure."[32]

- **DLJ Mortgage Capital (Credit Suisse):** "Under the repurchase protocol, the Trustee may not turn to the courts until DLJ's 120-day period for repurchase expires."[33]

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[30] *Deutsche Bank Nat'l Trust Co., as Trustee for the Trusts listed in Exhibits 1-A and 1-B v. FDIC*, No. 09-1656 (RMC), Dkt. No. 59, Reply Mem. of Law in Further Support of JPMorgan Chase Bank, N.A. and Washington Mutual Mortgage Securities Corp.'s Motion to Dismiss and Motion for Partial Summary Judgment at 12 (D.D.C. Feb. 11, 2011) (emphasis added).

[31] *U.S. Bank Nat'l Ass'n v. Countrywide Home Loans, Inc.*, Index No. 652388/2011, Dkt. No. 11 Defendants' Memorandum of Law in Support of Motion to Dismiss at 17 (Sup. Ct. N.Y. Cty. May 21, 2012) (emphasis added).

[32] *Citigroup Mortg. Loan Trust 2007-AMC3 v. Citigroup Global Markets Realty Corp.*, No. 13 Civ. 2843, Dkt. No. 13 Memorandum of Law in Support of Citigroup Global Markets Realty Corp.'s Motion to Dismiss the Complaint at 21 (S.D.N.Y. July 17, 2013).

[33] *Home Equity Mortg. Trust Series 2006-1 v. DLJ Mortg. Capital Inc.*, Index No. 156016/2012, No. 37, Defendant DLJ Mortgage Capital, Inc.'s Memorandum of Law in Support of its Motion

- **Morgan Stanley:** "[T]he MLPA expressly requires that upon discovery of any breaches of representations or warranties that materially affect the value of the loans, the trustee is required to give 'prompt written notice' of the particular allegations to MSMC, following which MSMC has 90 days to 'cure such defect . . .' The ***parties' agreements do not permit an investor to evade this contractually prescribed procedure and to seek repurchase in this litigation of loans as to which it never gave MSMC notice and an opportunity to cure.***"[34]

- **WMC Mortgage (GE Capital):** "The MLPA conditions WMC's obligation to repurchase on BoNY's 'prompt written notice' to WMC of 'a breach.' This provision allows WMC the opportunity to cure the breach or repurchase the loan before it is put to the burden of litigation with BoNY. . . . ***Accordingly, notice and an opportunity to cure is a condition precedent*** . . . "[35]

These repeated assertions that loan sellers must have an opportunity to cure identified breaches before a trustee may seek relief in court reflect the commercial bargain inherent in the repurchase protocol. Before the contractual obligation to repurchase a loan could accrue, loan sellers wanted the opportunity to fix the problem and avoid the expense of repurchase. That purpose could only be fulfilled, however, if the loan seller could address problems on an ongoing, loan-by-loan basis as it discovered the problems or received notice from the trustee (or

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to Dismiss and Motion to Strike Pursuant to CPLR Rules 3211 and 3024, at 14 (Sup. Ct. N.Y. Cty. Mar. 29, 2013).

[34] *Morgan Stanley Mortg. Loan Trust 2006-14SL v. Morgan Stanley Mortg. Capital Holdings LLC,* Index No. 652763/2012, Dkt. No. 11, Memorandum of Law in Support of Motion to Dismiss Plaintiffs' Complaint at 18 (Sup. Ct. N.Y. Cnty. Oct. 9, 2012) (emphasis added).

[35] *Bank of New York Mellon, solely as Trustee for GE-WMC Mortg. Secs. Trust 2006-1 v. WMC Mortg., LLC and GE Mortg. Holding, LLC,* 12-cv-07096 (KBF), Dkt. No. 40, WMC Mortgage, LLC's Memorandum of Law in Support of its Motion to Dismiss Plaintiffs' First Amended Complaint at 15 (S.D.N.Y. July, 10, 2013) (emphasis added).

another party to the transaction). When loan sellers like DBSP argue that the statute of limitations should run from the date of the initial transaction, rather than from the date that their contractual agreement to repurchase is triggered, they effectively assert that the claims against them frequently cannot be ripe until such time as the claims are time-barred. That position is plainly disingenuous and untenable, yet it is supported and approved by the SOL Decision.

IV. Loan Sellers' Race to the Bottom, the Financial Crisis and Investors' Remedial Efforts.

The widespread falsity of sellers' representations and warranties and the increased risks those representations and warranties concealed were substantial contributing causes of the financial crisis. As the Financial Crisis Inquiry Commission ("FCIC") determined, "collapsing mortgage-lending standards and the mortgage securitization pipeline lit and spread the flame of contagion and crisis."[36] The FCIC also found that, as a result of the due diligence that major financial institutions conducted on the loans they securitized, they knew that "a significant percentage" of the loans "did not meet their own underwriting standards or those of the originators."[37] Nonetheless, they sold the loans to RMBS trusts and then sold the securities to investors.[38] In an effort to compete and expand market

[36] FCIC Report, *supra* note 5, at xxiii.

[37] *Id.* at xxii.

[38] *Id.*

share, loan sellers "set the bar so low that lenders simply took eager borrowers' qualifications on faith, often with a willful disregard for a borrower's ability to pay."[39] These shoddy origination and securitization practices, the ripple effects of which led to trillions of dollars of losses throughout the economy,[40] necessarily resulted in tens of thousands of loans being submitted for repurchase.

Loan sellers have refused to repurchase all but a fraction of the breaching loans. Indeed, one loan seller, GE Capital subsidiary WMC Mortgage, boasted to its shareholders that it "refute[s] *every* loan."[41] A "wave of litigation," the Securities Industry and Financial Markets Association put it,[42] ensued. Yet that wave likely crested its high water mark last year and already has begun to recede for at least four reasons.

First, RMBS issuances all but ceased in 2008 as a result of the financial crisis.[43] The RMBS trusts that might end up in litigation, therefore, are generally limited to RMBS issued in the 2005-2007 time period.

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[39] *Id.* at xxiii.

[40] FCIC Report, *supra* note 5, at xv-xvi; SPSI Report, *supra* note 11, at 1-2.

[41] GE Capital Investor Webcast (Dec. 7, 2010) (emphasis added), *available at* http://www.ge.com/investor-relations/ir-events/ge-capital-investor-webcast.

[42] Brief for *Amicus Curiae* the Securities Industry and Financial Markets Association at 12, *ACE Secs. Corp. v. DB Structured Prods., Inc.*, Index No. 650980/2012 (1st Dep't filed Sept. 26, 2013).

[43] Mark Zandi, *Resurrection of RMBS*, Moody's Analytics (June 2013), *available at* https://www.economy.com/mark-zandi/documents/2013-06-26-Resurrection-of-RMBS.pdf.

Second, to date, trustees and investors have already filed litigation concerning loans in no fewer than two hundred RMBS trusts. One lawsuit filed by Deutsche Bank National Trust Company against JPMorgan and the FDIC concerning RMBS sponsored by Washington Mutual, by itself, involves 100 trusts with an original value of approximately $165 billion.[44] Monoline insurers, which issued financial guaranty insurance policies that covered shortfalls in schedule payments to RMBS investors and have rights as third party beneficiaries under the governing agreements, have filed similar claims concerning dozens more trusts. DBSP complains that this suit was initiated by distressed debt investors.[45] But even if the identity of directing investors is relevant at all (it is not), repurchase actions are hardly the exclusive province of distressed debt investors.[46] At least one third of filed repurchase lawsuits were initiated not by hedge funds, but by the Federal Housing Finance Agency, as conservator of Freddie Mac.

Third, trustees and major institutional investors—including the Federal Reserve Bank of New York, Federal Home Loan Bank of Atlanta, asset managers

[44] *Deutsche Bank Nat'l Trust Co. v. FDIC*, Amended Complaint ¶¶ 2-4, Docket No. 32 (D.D.C. filed Sept. 9, 2008).

[45] Resp. Br. at 11.

[46] Of course, the identity of investors is irrelevant to the legal issues before the Court. The claims at issue are for breach of contract. The rights under the governing agreements are assigned to the trustee and exist for the benefit of the trust and *all* certificateholders. This is, in part, precisely what makes certificates marketable securities.

BlackRock and PIMCO, Freddie Mac and others[47]—have reached settlements with several of the largest loan sellers involving virtually all of the trusts in those loan sellers' portfolios:

- In 2011, a group of investors, trustee The Bank of New York Mellon and Bank of America reached a settlement of repurchase claims relating to 530 Countrywide-sponsored RMBS trusts with an aggregate initial value of over $420 billion.[48] The order approving this settlement was just affirmed by the Appellate Division.[49]

- In 2012, Ally Financial-subsidiary Residential Capital ("ResCap") and a group of investors and trustees reached a settlement with respect to well over 350 RMBS trusts with an aggregate initial value of over $220 billion.[50]

- In 2013, JPMorgan and an investor group reached a settlement of JPMorgan's repurchase liability relating to over 200 RMBS trusts with an initial principal value of over $95 billion.[51] The trustees of these trusts

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[47] *See, e.g.*, Bloomberg, "New York Fed Backing Boosts Pimco Push for Mortgage Buybacks," *available at* http://www.bloomberg.com/news/2010-10-20/new-york-fed-adds-weight-to-mortgage-bond-investors-seeking-loan-relief.html. ("The Federal Reserve Bank of New York joined with the biggest bond investors in the U.S. in seeking to force Bank of America Corp. to buy back bad home loans packaged into securities as the battle over who will bear mortgage losses intensifies. The institution joined a group including Pacific Investment Management Co., BlackRock Inc and Freddie Mac . . . .").

[48] Steve Schaefer, *Bank of America Takes $14B Hit To Settle Countrywide Claims*, Forbes (June 29, 2011), *available at* http://www.forbes.com/sites/steveschaefer/2011/06/29/bank-of-america-takes-billions-in-losses-to-settle-claims-on-424b-in-countrywide-mortgage-deals/.

[49] *Matter of Bank of N.Y. Mellon*, 2015 N.Y. App. Div. LEXIS 1833, at *2 (1st Dep't Mar. 5, 2015).

[50] Steven Church, *ResCap Offers Investors $8.7 Billion Bankruptcy Claim*, Bloomberg.com (June 12, 2012), *available at* http://www.bloomberg.com/news/articles/2012-06-12/rescap-offers-investors-8-7-billion-bankruptcy-claim.

[51] *See* JPMorgan Chase & Co. RMBS Settlement Offer website, www.rmbstrusteesettlement.com.

accepted the proposed settlement for the overwhelming majority of the trusts in 2014 and are currently seeking court approval.

- In 2014, Citigroup reached an agreement with RMBS trustees and an investor group to resolve repurchase claims relating to 68 RMBS trusts with an initial principal value of approximately $59.4 billion. The trustees are currently seeking court approval of the settlement.[52]

Rather than unleashing a wave of new lawsuits, reversal of the SOL Decision likely will simply encourage settlement.

Fourth, the financial crisis swept numerous loan sellers into bankruptcy, including major loan sellers like Lehman Brothers, Washington Mutual, New Century Financial and IndyMac Bancorp. These entities provided the representations and warranties and agreed to cure or repurchase noncompliant loans in hundreds of billions of dollars of RMBS. For example, trustees filed proofs of claim in the Lehman bankruptcy relating to repurchase claims in approximately 300 trusts securitized between 2004 and 2007.[53] Litigation concerning bankrupt loan sellers' liability for noncompliant loans is thus unlikely to occur in the future (or would occur, if at all, in the pending bankruptcy proceedings).

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[52] *See* Citigroup Inc. RMBS Proposed Settlement website, www.citigrouprmbstrusteesettlement.com.

[53] *See* Ex. A to Motion pursuant to Section 8.4 of the Modified Third Amended Joint Chapter 11 Plan of Lehman Brothers Holdings Inc. and its Affiliated Debtors and Sections 105(a), 502(c) and 1142(b) of the Bankruptcy Code To Estimate the Amounts of Claims Filed by Indenture Trustees on behalf of Issuers of Residential Mortgage-Backed Securities for Purposes of Establishing Reserves, *In re Lehman Bros. Holdings Inc.*, No. 08-bk-13555, Dkt. No. 24254 (Bankr. S.D.N.Y. filed Jan. 12, 2012).

Thus, in the aggregate, bankruptcies and the remedial efforts of investors, trustees and monoline insurers have already placed at issue, or resolved, repurchase claims for a substantial portion (likely well over $1 trillion in initial principal value) of RMBS securitizations. The time and resources necessary to develop and pursue these claims through the repurchase protocol reflect investors' and trustees' good faith efforts to comply with the governing agreements despite the virtual across-the-board "repudiation" of those agreements by loan sellers, including DBSP. Order at 8 (R. 17).

ARGUMENT

I. A Trustee's Cause of Action Accrues When the Loan Seller Fails to Cure or Repurchase.

The statute of limitations for breach of contract is six years and begins to run from the "time the cause of action accrues." C.P.L.R. § 203. The cause of action accrues "when all of the facts necessary to the cause of action have occurred so that the party would be entitled to obtain relief in court." *Aetna Life & Cas. Co. v. Nelson*, 67 N.Y.2d 169, 175 (1986). In breach of contract cases, the cause of action accrues when the contract is breached. *Ely-Cruikshank Co. v. Bank of Montreal*, 81 N.Y.2d 399, 402 (1993). The accrual of the cause of action is thus dependent on the terms of the contract, because those terms define the obligations of the parties and when a party must perform its obligations or be in breach.

This conclusion flows naturally from New York contract law, which encourages contracting parties to "intelligently negotiate and order their rights and duties." *In re Southeast Banking Corp.*, 93 N.Y.2d 178, 184 (1999). Conditions to a contracting party's obligations are no exception to this bedrock principle. *Continental Casualty Co. v. Stronghold Insurance Co.*, 77 F.3d 16, 19 (2d Cir. 1996) ("[P]arties are free, within the limits of public policy, to agree upon conditions precedent to suit."). The necessary consequence is that those conditions will impact when a claim for breach of the conditional obligation accrues. Thus, when a party's obligation is subject to a condition, the breach occurs and the cause of action accrues "only when the condition has been fulfilled." *John J. Kassner & Co. v. City of N.Y.*, 46 N.Y.2d 544, 550 (1979); *accord Hahn Auto. Warehouse, Inc. v. Am. Zurich Ins. Co.*, 18 N.Y.3d 765, 771 (2012).

This is true even though, absent the condition, the cause of action would have accrued earlier. New York law is replete with decisions reflecting this distinction. *Compare Kassner*, 46 N.Y.2d at 550 (claim for failure to pay under construction contract did not accrue until completion of comptroller's audit because the audit was a condition precedent to defendant's obligation to pay), *with Grace Indus., Inc. v. N.Y.C. Dep't of Transp.*, 22 A.D.3d 262, 263 (1st Dep't 2005) (distinguishing *Kassner* and finding claim for failure to pay under a construction contract accrued upon substantial completion of the work because the contract at issue contained no condition precedent); *and Continental,* 77 F.3d at 20 (finding claim under reinsurance contract did not accrue until after notice was provided because notice was a condition precedent to reinsurer's obligation to pay), *with Hahn*, 18 N.Y.3d at 771-72 (distinguishing *Continental* because, unlike in *Continental*, the insurance agreement at issue contained no "contract language unambiguously conditioning [Zurich's] right to payment on its own demand").

Until the First Department's decision in this case, the Appellate Divisions consistently drew the same distinction for limitations purposes between contract claims that are subject to a condition precedent and those that are not. *See*, *e.g.*, *Zere Real Estate Servs., Inc. v. Parr Gen. Contracting Co.*, 102 A.D.3d 770, 771 (1st Dep't 2013) (plaintiff-broker's claim did not accrue until condition precedent occurred, because "only then does the broker possess a legal right to demand payment"); *Craven v. Rigas*, 71 A.D.3d 1220, 1222 (3d Dep't 2010) (cause of action did not accrue until plaintiff sent notice of default and waited the contractually required ten-day period); *Julias A. Nasso & Assocs. Concrete Corp. v. Trataros Constr., Inc.*, 79 A.D.3d 471, 471 (1st Dep't 2010) (where contract conditioned payment on "processing and disposition of payment claims," the breach of contract claim did not accrue until "the payment claims were finally processed and defendants failed to pay the liquidated amounts"); *In re Bombardier Transp. (Holdings) USA, Inc.*, 14 A.D.3d 358, 358 (1st Dep't 2005) (respondent's breach of contract claim accrued "when petitioner refused a demand for payment"); *Russack v. Weinstein*, 291 A.D.2d 439, 439 (2d Dep't 2002) (claim for failure to repay "excess advance[s]" within sixty days of receiving notice did not accrue until the defendant received notice and failed to make payment within sixty days).

This Court recently reaffirmed *Kassner* in its 2012 decision in *Hahn Automotive*. *Hahn* involved counterclaims for breach of an insurance agreement under which the insurer, Zurich, alleged the insured, Hahn Automotive, had failed to pay amounts due periodically over the life of the insurance policies. *Hahn*, 18 N.Y.3d at 768. Hahn argued that the claims were time-barred because they were filed more than six years from the dates the amounts became due. Relying on *Kassner*, Zurich argued that its claims did not accrue until it demanded payment. This Court held *Kassner* did not apply to the insurance contract at issue because there was no "contract language unambiguously conditioning [Zurich's] right to payment on its own demand." *Id.* at 771-72.

For the same reason, *Hahn* approved of but distinguished the Second Circuit's decision in *Continental*. As the Court explained, *Continental* involved a reinsurance agreement in which "the reinsured's obligation to give notice to the reinsurers of the underlying claims was a condition precedent to payment" that permitted the reinsurer "'time to investigate and pay the claim.'" *Hahn*, 18 N.Y.3d at 772 n.5 (quoting *Continental*, 77 F.3d at 20). In contrast, the contract in *Hahn* "contain[ed] no condition precedent and Zurich did not need to give Hahn any time to investigate." *Id.* Thus, *Hahn* and *Kassner* draw a bright line for purposes of claim accrual between claims that are subject to a condition precedent and claims that are not.[54]

The contracts governing RMBS transactions are structured to fit squarely within the *Kassner* rule. The repurchase provision at issue here, for example, makes clear that DBSP's liability is conditioned on its right to cure or repurchase within 90 days of discovery of receipt of notice of a defect: "*[I]n the event* the Sponsor . . . cannot cure such defect or breach, the Sponsor shall . . . repurchase the affected Mortgage Loan at the Purchase Price."[55] MLPA § 7(a) (emphasis added) (R. 300). This is "unmistakable language of condition." *MHR Cap. Partners LP v. Presstek, Inc.*, 12 N.Y.3d 640, 645 (2009); *accord Ginett v. Computer Task Group,*

[54] Indeed, although *Hahn* was a 4-3 decision, the Court was unanimous in its adherence to the rule in *Kassner* that conditions precedent must be satisfied before a breach of contract claim can accrue. The *Hahn* dissent simply believed that the insurance agreement at issue contained the necessary language of condition to delay accrual of Zurich's claims. "Zurich was not in a position under the contracts to demand payment until it determined that Hahn owed additional moneys. And this determination was based on computations carried out by Zurich in conformity with the complex claims adjustment formulae specified in the contracts. By their very nature and structure, then, these contracts conditioned payment upon demand; otherwise, there was no way for Hahn to know whether or how much additional moneys it owed." *Id.* at 773-74.

[55] The PSA echoes this conditional obligation: "*[I]f the Sponsor does not . . . cure such defect or breach* in all respects during such [sixty-day] period, the Trustee shall enforce the obligations of the Sponsor under the [MLPA] to repurchase such Mortgage Loan . . . at the Purchase Price within ninety (90) days after the date on which the Sponsor was notified of such . . . breach." PSA § 2.03(a) (emphasis added) (R. 121).

Inc., 962 F. 2d 1085, 1100 (2d Cir. 1992) (applying New York law) ("Parties often use language such as 'if,' 'on condition that,' 'provided that,' 'in the event that,' and 'subject to' to make an event a condition . . . ."). DBSP's assertion that the MLPA at issue here "does not create a condition at all," Resp. Br. at 53, is refuted by the plain language of the contract. It is also contrary to the purpose of the repurchase provision. Loan sellers are not subject to immediate liability for defects in the origination of the loans they sell. Rather, they bargained for a repurchase protocol that conditions liability on the seller's knowledge of defects in particular loans (through either its own discovery of representation and warranty breaches or notice from another transaction party) so that they can first attempt to cure the breaches before being exposed to a repurchase obligation.

The SOL Decision that the Trustee's claims accrued on the closing date of the transaction is squarely at odds with *Kassner* and its progeny. Although the First Department recognized that the "MLPA and PSA provided that the trustee was not entitled to sue or to demand that defendant repurchase defective mortgage loans until [the defendant] discovered or received notice of a breach *and* the cure period lapsed," it nevertheless held that the Trustee's claims accrued on the closing date of the MLPA, "when any breach of the representations and warranties contained therein occurred." Order at 27. Yet the loan seller's obligation to cure identified breaches is precisely the type of condition precedent that must be satisfied before the claim can accrue—one that permits the loan seller to "investigate and pay the claim." *Continental*, 77 F.3d at 20; *accord Kassner*, 46 N.Y.2d at 547-48 (claim for breach of construction contract did not accrue until comptroller was permitted to audit and review invoice).

The Order does not cite *Kassner* or *Hahn*, let alone distinguish them. Instead, the First Department relied on *Structured Mortg. Trust 1997-2 v. Daiwa Financial Corp.*, 2003 U.S. Dist. LEXIS 2677 (S.D.N.Y. Feb. 25, 2003). Order at 27. But the contract at issue in *Daiwa* did not condition the defendant's repurchase obligation on the completion of a specified cure period as do the contracts at issue here (and in most RMBS securitizations).[56] The demand at issue in *Daiwa* was a demand on the trustee to file suit, a requirement of the pooling agreement's no-action clause. *Daiwa*, 2003 U.S. Dist. LEXIS 2677, at *6. The plaintiff (a certificateholder) argued that its repurchase claims did not accrue until it had made a demand on the trustee to pursue the claims. *Id.* But for a certificateholder to demand that the trustee file a lawsuit, *a fortiori* a claim on which to sue must already exist at the time the demand is made. The same is simply not true with respect to the repurchase protocol, which requires the loan seller to have an opportunity to cure or repurchase before a claim for breach of the obligation to

[56] *See* R. 975-76 (*Daiwa* Pooling Agreement). Though not fully described in the *Daiwa* court's opinion, the contract at issue in *Daiwa* is part of the Record on Appeal.

cure or repurchase exists. Because *Daiwa* did not involve a condition to the defendant's repurchase obligation, it provides no support for the SOL Decision.[57]

DBSP attempts to salvage the First Department's reasoning, by arguing that the only contract provision it can breach for purposes of accrual is a representation and warranty in Section 6 of the MLPA. (Resp. Br. 25-26). But even accepting DBSP's proposition that there is a "single contract claim" (Resp. Br. at 26), that single breach must be of the repurchase provision. As the SOL Decision recognizes, by holding that the cure period must run for a claim to be ripe, a loan may breach a Section 6 representation and warranty and yet not trigger DBSP's repurchase obligation.[58] Section 7(a) requires DBSP to repurchase loans that: (1) breach a Section 6 representation and warranty; *and* (2) that "materially and adversely affect[] the value of [the] Mortgage Loan or the interest therein of the Purchaser or the Purchaser's assignee"; *and* (3) that cannot be cured within the specified time period. MLPA § 7(a) (R. 300). As the IAS Court explained, "the mere fact that a Representation is false does not mean that DBSP 'breached' the PSA. Under the PSA, DBSP has no duty to ensure that the Representations are

[57] The Order also cited *Ely-Cruikshank Co.*, 81 N.Y.2d at 402, and *Varo, Inc. v. Alvis Plc*, 261 A.D.2d 262, 267-68 (1st Dep't 1999). Order at 27. Neither of these cases involved or addressed conditions precedent.

[58] And as Appellant points out, DBSP may be required to repurchase a loan that complies with the representations and warranties. App. Reply Br. at 6-7.

true." IAS Order at 6 (R. 16). Upon learning of a defective loan, "DBSP's obligation is to follow the Repurchase Protocol." *Id.*

DBSP cannot avoid this logic. In its effort to explain away the conditional language in the MLPA and PSA, it argues that the use of "an 'if/then' framework merely reflects the fact that the sole repurchase remedy . . . applies only 'if' there is a breach." Resp. Br. at 53. That conclusion follows only if the "breach" arises within the if/then framework of the repurchase provision. As both the MLPA and PSA make clear, the obligation to cure or repurchase arises only upon discovery or notice. The breach of that obligation, therefore, must arise upon the expiration of the cure or repurchase period. And under *Kassner* and *Hahn*, the limitations period begins to run upon satisfaction of that condition precedent.[59]

This measure of accrual is not only well-established in this Court's jurisprudence, but also in loan sellers' own understanding of their obligations. As

[59] The cases on which DBSP relies do not address the statute of limitations, let alone the impact of a condition precedent on the accrual of a claim, and are therefore inapposite. *See* Resp. Br. at 53-54 (citing *Rubenstein v. Rubenstein*, 23 N.Y.2d 293 (1968), and *Deutsche Lufthansa AG v. The Boeing Co.*, 2006 U.S. Dist. LEXIS 79337 (S.D.N.Y. Oct. 30, 2006)). Nor can DBSP find any solace in CPLR 206(a). Resp. Br. at 54-56. Set aside the fact that a trustee cannot enforce the repurchase obligation until *after* the seller has failed to cure or repurchase within 90 days. CPLR 206(a) is irrelevant to the claims at issue here because the condition precedent that establishes the time of accrual is not a demand, but DBSP's failure to cure or repurchase. And DBSP's cure or repurchase obligation arises not as a result of a demand, but as a result of its discovery of a defective loan, either on its own *or* through notice from the trustee. Notice from the trustee is not the condition precedent. *See MASTR Asset Backed Secs. Trust 2006-HES v. WMC Mortg., LLC*, No. 12-2149, slip op. at 22 (D. Minn. Sept. 30, 2013) (applying New York law and finding that "[b]ecause EquiFirst was obligated to cure without notice if it discovered a breach, the Court finds that timely notice is **not** a condition precedent").

described above, *see supra* pp. 18-20, loan sellers routinely and publicly stated that their cure and repurchase obligations last for the life of the trust, and uniformly argue in court that the opportunity to cure or repurchase is a condition precedent to a claim for breach of contract, and that trustees are not authorized "to seek to enforce the repurchase protocol" (in DBSP's words) until those conditions have been met. In light of these consistent and categorical statements that compliance with the repurchase protocol is a prerequisite to commence suit, it is untenable for loan sellers like DBSP to argue that the trustee somehow had the ability, let alone the right, to enforce the repurchase obligation on the date the representations and warranties were made.

The fundamental point is that—as loan sellers themselves have repeatedly asserted—until a loan seller fails to cure or repurchase a defective loan, there has been no breach upon which the trustee can sue (absent justifying circumstances), and thus the claim does not accrue. *See Lehman Bros. Holdings, Inc. v. Nat'l Bank of Ark.*, 875 F. Supp. 2d 911, 917 (E.D. Ark. 2012) (under New York law, repurchase claim did not accrue until defendant failed to cure or repurchase the loans because the Trustee "could not have sued on that independent breach until that time"); *see also Hahn*, 18 N.Y.3d at 770 (explaining that a cause of action accrues "'when all of the facts necessary to the cause of action have occurred so that the party would be entitled to obtain relief in court'") (quoting *Aetna Life &*

Cas. Co. v. Nelson, 67 N.Y.2d 169, 175 (1986)). Thus, the statute of limitations does not run from the closing date of the transaction when the representations and warranties are made, but rather from the date of seller's failure to cure.

II. The Repurchase Protocol Is a Continuing Obligation and a New Limitations Period Begins to Run Each Time a Loan Seller Fails to Cure or Repurchase.

The IAS Court correctly concluded that DBSP "has a 'recurring obligation' under the PSA to follow the Repurchase Protocol when it is informed of a problem with a Representation," and that each breach of the "Repurchase Protocol . . . may begin the running of the statute of limitations anew." IAS Order at 7 (R. 16). Although the First Department did not address this part of the IAS Court's decision, this Court has made clear that where a party has a continuing obligation under a contract, a claim for breach of that obligation accrues each time the party fails to comply. *Bulova Watch Co. v. Celotex Corp.*, 46 N.Y.2d 606, 611 (1979). The cure or repurchase obligation fits squarely within that rule.

The governing agreements for RMBS trusts make clear that the parties intended the cure or repurchase obligation to continue for the life of the trust. The PSA and MLPA at issue here are representative. First, the parties agreed that prophylactic diligence of the loans was not necessary to preserve the Trust's rights under the repurchase protocol either before or after the securitization closed. They expressly agreed that the "representations and warranties . . . *shall not be* *impaired*" by "*any* failure" on the part of the trustee or the seller "to review or examine" the loan files or other documents evidencing or relating to the loans. MLPA § 7(a) (emphasis added). (R. 300.) Second, DBSP bargained for an opportunity to cure or repurchase defective loans, and that cure period does not start until DBSP discovers the breach or another party provides notice to it. PSA § 2.03(a) (R. 171); *see also* MLPA § 7(a) (R. 300). This was a fast, efficient, practical solution to the informational asymmetries the parties faced.

Further, the parties established clear time periods within which a party must act when they intended there to be one. For example, the PSA specified that if discovery of the breach occurred within the first two years after the closing of the PSA, DBSP had the right to substitute a compliant loan for the noncompliant loan rather than repurchase. *See* PSA § 2.03(a)-(b) [R. 121-123]. And today, the agreements for some recent RMBS transactions specifically provide for sunset provisions limiting the loan seller's obligation to repurchase to as little as three years from the trust's closing.[60] If the parties intended the cure or repurchase obligation to cease after a certain period of time, they clearly knew how to say so. Indeed, such a material fact would have been disclosed when the RMBS were first

[60] *See, e.g.,* Reuters, "Private RMBS take first steps to US Comeback," *available at http://www.reuters.com/article/2013/03/22/abs-rmbs-us-idUSL1N0CE9HS20130322* ("While older R&W provisions and repurchase obligations were for the life of the loan, some recent RMBS proposals contain 'sunset provisions' that free lenders from repurchase obligations after less than 36 months.").

offered for sale. The recent introduction of temporal limitations on loan seller repurchase obligations has, not surprisingly, adversely affected investor interest in RMBS.[61]

The repurchase protocol establishes precisely the type of continuing obligation that this Court recognized in *Bulova Watch Co.* There, the plaintiff contracted for roofing materials and the manufacturer's promise to repair the roof should defects arise. 46 N.Y.2d at 608. Over the next twenty years, the plaintiff had numerous problems with the roof—it was "no more waterproof than a sieve"—but the defendant failed to make the necessary repairs after notice from Bulova. *Id.* at 609. The plaintiff sued for breach of the implied warranty of fitness *and* for the failure to repair. The defendant argued that the claims, brought twenty years after the agreements were executed, were time barred. This Court held that although the limitations period on the implied warranty claim began to run when the contract was executed and expired six years later, the claim for failure to repair was timely. *Id.* at 611. Even though an initial warranty breach was time barred, the obligation to repair was a continuing one and each time the defendant failed to make repairs, the statute of limitations began to run at that time. *Id.* The language, structure and context of the repurchase obligation provide for the same result.

[61] *See id.* ("One factor slowing development of the market is that investors are starting to push back over provisions in deals that protect banks from lawsuits and loan repurchase obligations if a deal's loans go sour.").

DBSP erroneously characterizes this interpretation of the agreements as delaying accrual based on "vague assertions as to when [the trustee] supposedly could have or should have discovered the breaches." Resp. Br. at 4. Not so. When repurchase claims accrue is neither vague nor dependent on a trustee discovering that a loan breaches a representation and warranty. Although "[k]nowledge of the occurrence of the wrong on the part of *the plaintiff* is not necessary to start the Statute of Limitations running," the plaintiff's knowledge is not the point. The repurchase protocol focuses on the *defendant's* knowledge of the defective loan. *Ely-Cruikshank Co. v. Bank of Montreal*, 81 N.Y.2d 399, 403 (1993) (internal quotations omitted; emphasis added). Discovery by or notice to the loan seller of defective loans triggers its cure or repurchase obligation. The seller's knowledge that the loan breaches a representation and warranty is obviously necessary for it to attempt to cure; so that it can "pick[] up the scent and nose[] to" the source. *Morgan Guar. Trust Co. v. Bay View Franchise Mortg. Acceptance Co.*, 2002 U.S. Dist. LEXIS 7572, at *39 (S.D.N.Y. Apr. 23, 2002). This focus reflects the continuing nature of the loan seller's obligation: if it learns of a breach, it agrees to investigate and either cure the defect or repurchase the loan. It also provides a bright line date for accrual of the claim—the date the cure period expires—that is in plain view for all parties as a result of each party's obligation to provide notice to the other parties. The fact that the accrual date may be different for different loans does not make the accrual analysis or the accrual date vague or uncertain.

Indeed, the recurring nature of the repurchase obligation was so well understood in the industry that many loan sellers with significant repurchase liability publicly acknowledged in SEC filings, on earnings calls or in court filings the continuing nature of their cure or repurchase obligation. For example:

- **Bank of America (3Q10 Earnings Call):** "[T]here's no technical statute of limitations from a standpoint on the repurchase."[62]
- **Citigroup (Feb. 2011 10-K):** "Citi's representations and warranties are generally not subject to stated limits in amount *or time of coverage*."[63]
- **H&R Block, Inc. (June 2009 10-K):** "These representations and warranties and corresponding repurchase obligations generally are not subject to stated limits *or a stated term and, therefore, may continue*."[64]
- **Wells Fargo (Nov. 2010 10-Q):** "[I]nvestors *may demand repurchase at any time*."[65]

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[62] Bank of America Corporation, Transcript of Q3 2010 Earnings Call held Oct. 19, 2010, *available at* http://www.morningstar.com/earnings/18372176-bank-of-america-corporation-bac-q3-2010.aspx.

[63] Citigroup Inc., Annual Report (Form 10-K), at 110 (Feb. 25, 2011) (emphasis added), *available at* http://sec.gov/Archives/edgar/data/831001/000120677411000316/citigroup_10k.htm.

[64] H&R Block, Inc., Annual Report (Form 10-K) , at 66 (Jun. 29, 2009) (emphasis added), *available at* http://sec.gov/Archives/edgar/data/12659/000095012309018620/c51997e10vk.htm. H&R Block's disclosures relate to the discontinued operations of its mortgage origination subsidiary Sand Canyon Corp., formerly known as Option One.

[65] Wells Fargo & Co., Quarterly Report (Form 10-Q), at 38 (Nov. 5, 2010), *available at* http://sec.gov/Archives/ edgar/data/72971/000095012310101484/f56682e10vq.htm .

Even in the midst of litigation, JPMorgan Chase conceded the point in unequivocal terms: "[JPMorgan] understands how the statute of limitations works: it begins to run when there is a breach of an access, notice or repurchase obligation."[66]

The IAS Court correctly concluded that the same rule applies here. DBSP sold the trust a pool of mortgage loans subject to express representations and warranties. It also promised to cure any breach within sixty days of discovery or notice of the breach, and if it failed to do so, either (1) substitute a compliant loan if the breach was discovered within the first two years, or (2) repurchase the loan within 90 days of discovery or notice. The obligation to cure or repurchase is only triggered as breaches are discovered. Like the obligation to fix the roof in *Bulova*, DBSP's obligation is a continuing one that lasts for the life of the trust. Indeed, the fact that the parties specified a limited two-year time frame in which DBSP could substitute a new loan for the noncompliant one demonstrates an intent to have DBSP's repurchase obligation continue beyond the two years and for the remainder of the contract term. Like the roof in *Bulova*, the mortgage pool turned out to be rife with defects. The trustee and investors investigated the breaches and notified DBSP. DBSP failed to cure the defects and then failed to repurchase the loans. DBSP therefore breached the PSA when it "improperly rejected the

[66] *Deutsche Bank Nat'l Trust Co., as Trustee for the Trusts listed in Exhibits 1-A and 1-B v. FDIC*, No. 09-1656 (RMC), Dkt. No. 59, Reply Mem. of Law in Further Support of JPMorgan Chase Bank, N.A. and Washington Mutual Mortgage Securities Corp.'s Motion to Dismiss and Motion for Partial Summary Judgment at 12 (D.D.C. Feb. 11, 2011) (emphasis added).

trustee's repurchase demand." IAS Order at 6 (R. 17). The statute of limitations began to run at that time, and the trustee's claims in this action are timely.

III. The First Department's Holding Would Cause Severe Harm to Investors and the RMBS Capital Markets.

The SOL Decision to curtail a loan seller's obligation to repurchase defective loans to the first six years (or five years and nine months) of a securitization ignores the painful lessons learned in the financial crisis. The originate-to-distribute model encouraged loan sellers to ignore, bypass and undercut prudent lending standards—standards reflected and guaranteed in their representations and warranties—because they were passing the consequences of imprudent lending on to investors, who with limited access to information about the loans might never discover the breaches. DBSP's argument, which is inconsistent with loan sellers' statements in litigation and in public, would create the same perverse consequences—loan sellers would have the opportunity to gamble that noncompliant loans would perform just long enough so that investors would not have time to detect and investigate potential representation and warranty breaches and then trigger the cure or repurchase mechanism.

Overruling the SOL Decision will not curtail loan sellers' potential exposure as DBSP wants, but neither will it overwhelm the courts with a deluge of additional litigation. In the wake of the financial crisis, investors, trustees and others have assiduously investigated and pursued repurchase claims in hundreds of trusts. Hundreds more are caught in the bankruptcy proceedings of the loan sellers themselves. While some additional lawsuits will no doubt be filed, courts are likely already handling the bulk of potential cases. In any event, concerns about judicial economy should bend to the paramount judicial concern that plaintiffs with legitimate and timely claims have an opportunity to resolve them in court. A valid claim should not be denied simply because others may also have valid claims. "It suffices that if a cognizable wrong has been committed that there must be a remedy, whatever the burden of the courts." *Tobin v. Grossman*, 24 N.Y.2d 609, 615 (1969). This Court's decisions in *Hahn*, *Kassner* and *Bulova* say that RMBS trustees and investors have just such causes of action.

Adopting the rule of the IAS Court—which recognizes that the recurring obligation to repurchase defective loans is only triggered when the defects are identified, and thus such identification is a condition precedent to the accrual of a claim for breach—protects the commercial incentives necessary to sustain sound securitization and mortgage lending practices. The obligation to cure or repurchase only incentivizes prudent lending if it forces sponsors and lenders to retain equivalent "skin in the game" as they would have had if the loan remained on the sponsor's or lender's balance sheet. Risk retention in an originate-to-distribute paradigm only aligns loan sellers' incentives with those of investors if that risk continues for the life of the trust (just as it would if the loan seller owned the loan). If loan sellers do not want to retain this risk in future securitizations, they have the ability—unlike investors—to negotiate for limitations to their liability. Investors would then have notice of the relevant limitations prior to purchasing RMBS, and could fairly assess the resulting risk. The IAS Court's holding thus fosters not only prudent lending, but more fulsome disclosure as well.

CONCLUSION

For the foregoing reasons, AMI respectfully requests that the Court reverse the SOL Decision.

Dated: New York, NY
March 13, 2013

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BRIEF OF *AMICUS CURIAE* THE ASSOCIATION OF MORTGAGE INVESTORS IN SUPPORT OF PLAINTIFF-APPELLANT'S MOTION FOR LEAVE TO APPEAL

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