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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 CXA-13 CORPORATION AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFF-APPELLANTS' APPEAL TO THE NEW YORK STATE COURT OF APPEALS

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INTRODUCTION

The undersigned respectfully submits this brief to provide the Court with a clear explanation of the commercial purpose of the cure-or-repurchase provision. That explanation is missing from the parties' briefs and is crucial to the Court's consideration of this appeal.

In mortgage securitizations, investors do not purchase loans, they purchase a right to payment (evidenced by one or more Certificates). Since the bargained-for payment stream may continue for the life of the last performing mortgage loan in the pool, the Certificates typically do not mature—and the investment remains in force—for up to 30 years. Because the cure-or-repurchase obligation is designed to maintain the integrity of the *payment stream*, the obligation to cure or repurchase must remain in force through the life of the investment.

The intent to maintain the integrity of payment through the life of the investment is memorialized in the Certificates themselves. The Certificates confirm that DB Structured Products, Inc.'s ("DBSP") obligations under the Pooling and Servicing Agreement—which include the duty to cure or repurchase defective loans—will not terminate until the Certificates are paid in full or the Trust[1] is terminated pursuant to its terms. In other words, the protection against breaches of representations and warranties is a protection that spans 30 years. A

[1] ACE Securities Corp. Home Loan Trust, Series 2006-SL2.

30-year representation and warranty subject to a 6-year statute of limitations is *per se* illusory.

Properly viewed in its commercial context and applying the plain language of the Certificates, the cure-or-repurchase obligation operates much like the guaranty bonds in *Bulova Watch Co., Inc. v. Celotex Corp.*, 46 N.Y.2d 606 (1979), and a cause of action accrues anew each time DBSP failed to cure or repurchase defective mortgage loans. Accordingly, this Court should reverse the Appellate Division, First Department, and remand the matter to the trial court for further proceedings.

INTEREST OF *AMICUS CURIAE*

CXA-13 Corporation, along with its affiliates, owns stakes in more than 150 residential mortgage-backed securitizations ("RMBS") with an original face value of over $5 billion. Like all investors who have suffered losses and have been deprived of the benefit of their bargain, CXA-13 Corporation seeks to have its rights and remedies enforced and rejects the efforts of securitization sponsors like DBSP to rewrite the governing agreements and ignore the commercial purpose of the cure-or-repurchase provision. Indeed, the very Certificates issued to investors confirm that the obligations created by the governing agreements would continue through the life of the investment. Thus, CXA-13 Corporation has an interest in the outcome of this litigation.

Moreover, as an investor with substantial interests in RMBS, CXA-13 Corporation is well-positioned to assist the Court in its understanding of the cure-

or-repurchase obligation. The very purpose of the transaction was to produce a 30-year payment stream for investors and, consequently, the cure-or-repurchase obligation must be read to maintain the integrity of that payment stream. There is simply no economic rationale for terminating an obligation designed to protect a 30-year investment after six years. This Court recognized that very principle in *Bulova*, and should apply it here.

ARGUMENT

I. Properly viewed in its commercial context, it is clear that the cure-or-repurchase obligation was designed to continually maintain the integrity of the payment stream that lies at the heart of the transaction.

A. The investors in the Trust purchased a 30-year right to payment.

A typical RMBS trust is comprised of a pool of mortgage loans, which generate income for investors through borrower payments of principal and interest. *See* Brief for Plaintiff-Appellant ("HSBC Br.") at 7. The income is then distributed among investors in the trust according to a hierarchical prioritization set forth in the governing agreements, known as the "trust waterfall." R. 163-71 (PSA § 5.01); *see generally* Dapeng Hu and Robert Goldstein, *Nonagency Residential Mortgage-Backed Securities*, in The Handbook of Fixed Income Securities 662 (Frank J. Fabozzi ed., 8th ed. 2012) (hereinafter "Fabozzi"). Each level of the waterfall, referred to as a "tranche," is represented by one or more Certificates. The Certificates have a predetermined "Latest Possible Maturity Date," set forth in the PSA. R. 60-67. All Certificates in the Trust have a 30-year maturity. *Id.*

B. Purchasers of Certificates bargained for the protections of a 30-year obligation to cure or repurchase.

Because all Certificates in the Trust have a 30-year maturity, investors bought a 30-year right to payment. R. 163-71 (PSA § 5.01). To protect that payment stream, investors bargained for a cure-or-repurchase obligation that would run with the 30-year right to payment.

DBSP attempts to avoid the import of the 30-year term of the securitization by conflating the likelihood of individual loan prepayments with Certificate maturities. *See* Brief of Defendant-Respondent ("DBSP Br.") at 66. This confuses and misstates the issue. Investors do not buy loans; they buy the right to a portion of the aggregate income from borrower remittances to the Trust. *See* Fabozzi at 662 ("The [nonagency RMBS] structure separates aggregated cash flows from the underlying loans into principal and interest and redistributes the cash flows and associated losses to individual tranches (bonds) according to the rules specified in the deal prospectus…."). Whether or not some individual loans may prepay, the investment remains in effect.

Indeed, even if the Trust were prematurely terminated, the Trust—and therefore the investors—would be entitled to the then-remaining value of the mortgage loans, REO properties, and other value held for their benefit. *E.g.*, R. 207-09 (PSA Art. X). Thus, while the Trust can be terminated or the Certificates sold at any time during the span of 30 years, the Certificates have a value that accounts for this 30-year right to payment.

DBSP should not be permitted to—just six years into the life of a payment stream—abandon its promise to protect that stream from breaches of representations and warranties. Although investors bargained for certain risk when they purchased Certificates (e.g., credit risk), they did not bargain for the risk associated with breaches of representations and warranties. When mortgage loans are in breach of representations and warranties that materially and adversely affect the value of the mortgage loans or the interests of the investors therein, R. 121-22 (PSA § 2.03), a portion of the payment stream the investors bought becomes impaired, R. 35 (Complaint ¶ 11).[2] The governing agreements afford two protections against that impairment.

First, DBSP was required to sell only mortgage loans that conformed to the representations and warranties. *Cf.* R. 292 (MLSA § 4(e) [requiring removal of nonconforming loans from the sale]); *see also* R. 120 (PSA § 2.01 [assigning all of the Depositor's rights under the MSLA to the Trustee on behalf of the Trust]).

Second, DBSP promised to cure or repurchase any loans that violated the representations and warranties. R. 121-22 (PSA § 2.03).

Generally-speaking, if DBSP was able to cure the defect and ensure continued performance, the payment stream would be restored. If DBSP was unable or refused to restore the payment stream through cure, it was obligated to

[2] Through the process of "subordination," the most junior tranche in the capital structure absorbs the loss, and the senior tranches lose the credit support offered by the affected subordinate tranche. R. 175-77 (PSA § 5.04); Fabozzi at 665-65 (describing subordination).

replace the payment stream with the Purchase Price. *See* R. 99 (defining "Purchase Price"). Either way, the risk associated with DBSP's breaches was squarely allocated to DBSP by virtue of its promise to cure or repurchase, R. 121-22 (PSA § 2.03); and since the payment stream may continue as long as 30 years, the cure-or-repurchase obligation must also be read to continue through maturity or Trust termination.[3] To read the protection any other way would arbitrarily—and contrary to the governing agreements—curtail an express contractual right.

C. The intent to protect the 30-year payment stream is memorialized in the Certificates themselves.

Regardless of how one might view the commercial purpose of the cure-or-repurchase provision, the Certificates themselves confirm that DBSP's obligations under the PSA, including the obligation to cure or repurchase, continue until maturity or termination:

> The obligations created by the Agreement and the Trust Fund created thereby shall terminate upon payment to the Certificateholders of all amounts held by the Securities Administrator and required to be paid to them pursuant to the Agreement following the earlier of (i) the final payment or other liquidation (or any advance with respect thereto) of the last Mortgage Loan remaining in REMIC I and (ii) the purchase by the party designated in the Agreement at a price determined as provided in the Agreement from REMIC I of all the Mortgage Loans and all property acquired in respect of such Mortgage Loans.

R. 224.

As DBSP itself points out, "[i]n interpreting a contract what is relevant are its actual terms…." DBSP Br. at 62; *see also Slamow v. Del Col*, 79 N.Y.2d 1016,

[3] As Appellant points out, a number of major RMBS sponsors have accurately reported their long-term repurchase exposure, further demonstrating that parties to securitization transactions intended the cure-or-repurchase obligations to be continuing. HSBC Br. at 15 n.4.

1018 (1992) ("The best evidence of what parties to a written agreement intend is what they say in their writing."). Here, the parties chose to memorialize that the cure-or-repurchase obligation would continue through the life of the investment precisely because it was designed and intended to protect the continuing payment stream at the very heart of the transaction.

II. DBSP's failure to perform its continuing obligation to cure or repurchase defective mortgage loans is an independent breach of contract, which claim accrues each time DBSP failed to cure or repurchase.

In *Bulova Watch Co., Inc. v. Celotex Corp.*, 46 N.Y.2d 606, 611-12 (1979), this Court held that where a product seller agrees to perform a service to maintain the integrity of a product, the seller's failure to perform that service constitutes an independent breach, which carries with it a new statute of limitations. *Id.; see also* HSBC Br. at 21-27 (collecting authorities[4]).

DBSP seeks to distinguish *Bulova* by arguing that the cure-or-repurchase obligation is not separate from or in addition to some other obligation. DBSP Br. at 30. The *Bulova* Court, however, did not condition its holding on the existence of two separate obligations. Rather, it merely observed that the guarantee bonds served "as a special, separate and additional incentive" in that case. *Bulova*, 46 N.Y.2d at 611. Indeed, the language the *Bulova* Court actually used refutes any reading that dual obligations were necessary as a condition to the continuing obligation to fix Bulova's roof:

[4] In the interest of brevity, *Amicus* will not restate—but incorporates—HSBC's legal authorities.

> [T]he defendants did not merely guarantee the condition or performance of the goods, but agreed to perform a service—to repair the roof. Since breaches of **this** fully bargained-for **promise** are actionable for six years from their occurrence, Bulova may recover for all of the defendants' derelictions of duty that it can prove took place between [a date six years prior to the lawsuit] and the date on which the bonds expired.

Bulova, 46 N.Y.2d 606 at 612 (emphasis added). The singular terms "this" and "promise" demonstrate that the Court's holding applied even if the only obligation was to perform the curative service.

In any event, even if dual obligations are required, DBSP's argument that it had no obligation aside from the cure-or-repurchase provision is counterfactual. DBSP had a threshold obligation to sell to the Trust only loans that met the Trust's purchase requirements, as reflected in the Trust's right to delete nonconforming loans from the sale:

> Examination of Mortgage Files. Prior to the Closing Date, the Sponsor shall either (i) deliver in escrow to the Purchaser or to any assignee, transferee or designee of the Purchaser for examination the Mortgage File pertaining to each Mortgage Loan, or (ii) make such Mortgage Files available to the Purchaser or to any assignee, transferee or designee of the Purchaser for examination. Such examination may be made by the Purchaser or the Trustee, and their respective designees, upon reasonable notice to the Sponsor during normal business hours before the Closing Date and within sixty (60) days after the Closing Date. **If any such person makes such examination prior to the Closing Date and identifies any Mortgage Loans that do not conform to the requirements of the Purchaser as described in this Agreement, such Mortgage Loans shall be deleted from the Closing Schedule.** The Purchaser may, at its option and without notice to the Sponsor, purchase all or part of the Mortgage Loans without conducting any partial or complete examination. The fact that the Purchaser or any person has conducted or has failed to conduct any partial or complete examination of the Mortgage Files shall not affect the rights of the Purchaser or any assignee, transferee or designee of the Purchaser to demand repurchase or other relief as provided herein or under the Pooling and Servicing Agreement.

R. 292 (MLSA § 4(e) [emphasis added])[5]; *see also* R. 120 (PSA § 2.01 [assigning all of the Depositor's rights under the MSLA to the Trustee on behalf of the Trust]).

This provision directly refutes DBSP's effort to distinguish *Bulova* on grounds that "the cure-or-repurchase remedy is 'separate' from, and 'additional' to, precisely *nothing*," and that "Appellant has *no other rights or remedies* with respect to DBSP's representations and warranties." DBSP Br. at 30. The Trust had a right to receive mortgage loans that met the trade requirements in the first place; and the cure-or-repurchase provision is properly viewed as a guaranty that is additional to, and separate from, DBSP's initial promise to provide defect-free loans.

Finally, and whether or not the cure-or-repurchase provision is separate from, and in addition to, the promise to provide defect-free loans, the cure-or-repurchase provision—just like the guarantee bond in *Bulova*—was designed to protect the integrity of a product that was expected to perform over a set period of time. In order to ensure that performance, DBSP undertook a continuing curative obligation and upon each such failure a new cause of action accrues.

[5] Notably, DBSP's block quote of Section 4(e) omits the bolded language above, in favor of ellipses. DBSP Br. at 35-36.

III. DBSP's argument that a continuing cure-or-repurchase obligation would render it subject to perpetual obligations is a counterfactual scare tactic.

DBSP paints a chaotic picture of never-ending repurchase litigation if this Court follows its common sense precedent that a new claim accrues each time a party breaches a continuing duty. DBSP Br. at 3-5. But holding DBSP to its promise to cure-or-repurchase defective mortgage loans through Certificate maturity or Trust termination, R. 224, would not create an "indefinite," "open-ended," "indeterminate," or "perpetu[al]" obligation. DBSP Br. at 3-5. Rather, it would enforce the definite and closed-ended obligation created by the PSA and the Certificates. R. 224. In no event would DBSP's "obligations created by the Agreement and the Trust Fund created thereby" extend beyond the specified terms of the governing agreements, namely:

> payment to the Certificateholders of all amounts held by the Securities Administrator and required to be paid to them pursuant to the Agreement following the earlier of (i) the final payment or other liquidation (or any advance with respect thereto) of the last Mortgage Loan remaining in REMIC I and (ii) the purchase by the party designated in the Agreement at a price determined as provided in the Agreement from REMIC I of all the Mortgage Loans and all property acquired in respect of such Mortgage Loans.

Id.

Thus, the governing agreements place a clear time limit on DBSP's bargained-for obligations, and its effort to have this Court relieve it of those obligations out of concerns that it will be subjected to perpetual and uncertain obligations is groundless.

Nor can DBSP offer any explanation for is speculation that investors or the Trust would fail to give prompt notice of breaches, as required by the governing agreements. DBSP Br. at 3-5. The entire purpose of the transaction is to provide payments to investors for a period estimated to be as long as 30 years; it makes no sense for investors to suffer losses then sit on their cure or repurchase rights.

CONCLUSION

DBSP's arguments against a continuing duty to cure-or-repurchase defective mortgage loans ignores the commercial purpose of the obligation it assumed. The continuing obligation is reflected in the Certificates issued to investors and appended to the Pooling and Servicing Agreement. The instant case falls squarely within this Court's precedent establishing a new cause of action for each of DBSP's "derelictions of duty" occurring "between [a date six years prior to the lawsuit] and the date on which the [Certificates matured or the Trust terminated]." *Bulova*, 46 N.Y.2d 606 at 612. This is the bargain DBSP struck. Having accepted the benefit of selling mortgage loans into the Trust, DBSP may not now escape the burdens of the very same agreement. *See Ionosphere Clubs, Inc. v. Eastern Air Lines, Inc.*, 85 F.3d 992, 999-1000 (2d Cir. 1996) ("[O]nce a party accepts the proceeds and benefits of a contract, that party is estopped from renouncing the burdens the contract places upon him.") (citations omitted).

For the foregoing reasons, *Amicus* respectfully submit that this Court reverse the Appellate Division, First Department, and remand to the trial court for further proceedings.

Respectfully submitted this 14th day of November, 2014.

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