

RMBS Repurchases: When Does the Statute of Limitations Clock Start Running?

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Two recent decisions out of the New York State Commercial Division have introduced uncertainty regarding application of the statute of limitations in residential mortgage-backed securities (RMBS) repurchase actions. The divergent rulings, issued by Justices Peter O. Sherwood and Shirley Kornreich within days of each other, address when New York’s six-year statute of limitations begins to run for breach of contract causes of action arising from representations and warranties (R&Ws) in RMBS transaction documents. Both decisions are being appealed. Although the New York State Appellate Division’s First Department declined to hear the cases together, one of the appeals, *ACE Securities v. DB Structured Products*, is scheduled for December and could be decided this year. The outcome could have implications beyond RMBS, as the interpretation of these provisions may impact the drafting more generally of indemnification and remedy provisions concerning R&Ws.

Justice Sherwood’s Decision in *Nomura*

In *Nomura Asset Acceptance Alternative Loan Trust v. Nomura Credit & Capital*,¹ the plaintiff trustee brought claims to enforce R&Ws after the defendant failed to repurchase allegedly breaching loans underlying the RMBS securitization at issue. The defendant argued that the action was time-barred by New York’s six-year statute of limitations, which begins to run at the time of the breach, *i.e.*, when the R&Ws are first made. Because the agreement containing the R&Ws had a closing date of December 21, 2005, the defendant asserted that the six-year limitations period expired on December 21, 2011 — nearly eight months prior to the time that the trustee asserted its claims. In response, the trustee argued that: (1) its complaint related back to an earlier summons with notice filed by a certificateholder on December 20, 2011, which alleged breaches of R&Ws with respect to the same securitization; and (2) the six-year limitations period began to run not from the date of the transaction, but from the date of defendant’s refusal to repurchase the allegedly breaching loans.

Regarding the first argument, Justice Sherwood held that the trustee’s complaint could not relate back to the certificateholder’s earlier-filed summons with notice. Relying upon the New York Court of Appeals’ decision in *Goldberg v. Camp Mikan-Recro*,² Justice Sherwood held that “[r]elation-back applies to the amendment of claims and parties and is dependent upon the existence of a valid preexisting action.” Noting that the certificateholder did not have standing to commence the action when it did, the court concluded that there was no “valid preexisting action” to which the later-filed trustee complaint could relate, and thus the controlling date for statute of limitations purposes was August 24, 2012, the date of the complaint first naming the trustee as plaintiff.

As to the second argument, Justice Sherwood rejected the notion that the statute of limitations begins to run anew each time the defendant failed to repurchase an

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¹ Index No. 653541/2011, 2013 WL 2072817 (Sup. Ct. N.Y. County May 10, 2013).

² 42 N.Y.2d 1029, 1030 (1977).

allegedly breaching loan. Specifically, the court held that the defendant's repurchase obligations were "merely a remedy" for breaches of R&Ws, "not a duty independent of the [R&W] breach of contract claims." In so doing, Justice Sherwood explicitly distinguished *Bulova Watch Co. v. Celotex Corp.*,³ in which the New York State Court of Appeals held that a defendant's continuing obligation to make roof repairs caused the statute of limitations to accrue separately each time that obligation was breached. Characterizing *Bulova* as "inapposite," the court held that, far from creating a continuing obligation to perform a service, "the [R&Ws] are alleged to have been false when made. Those representations did not arise or change over time. If the [R&Ws] were false when made, they are still false today. If they were true when made, they are still true today." The court emphasized that "[t]o find otherwise would allow [plaintiff] to essentially circumvent the statute of limitations by indefinitely deferring its demand for payment."⁴ Accordingly, the defendant's motion to dismiss was granted and the action was dismissed.

Justice Kornreich's Decision in *ACE Securities*

Three days after Justice Sherwood's decision in *Nomura*, Justice Kornreich addressed the same issues in *ACE Securities*.⁵ In contrast to *Nomura*, Justice Kornreich held that "three steps must be followed before the [plaintiff] can sue [defendant] for breach of its repurchase obligations: discovery or receipt of notice by the bank, cure, and repurchase." The court stated that "[i]t, therefore, follows that [defendant] does not breach the [agreement] and the claim for the breach does not accrue until [defendant] fails to timely cure or repurchase a loan." Justice Kornreich continued: "the mere fact that a Representation is false does not mean that [defendant] 'breached' the [agreement]." Accordingly, the court concluded that the defendant "commits an independent breach of the [agreement] each time it fails to abide by and fulfill its obligations under the Repurchase Protocol, and each breach may begin the running of the statute [of limitations] anew."⁶

In so holding, the court explicitly drew comparisons to the context of reinsurance, "where the insurance company is often contractually obligated to make a demand on its reinsurer when it pays out a claim to the underlying insured." Relying upon Second Circuit authority,⁷ the court noted that reinsurers are "not in breach of their contract to indemnify until they reject[] the demand." Applying this concept to the RMBS context, the court concluded that "[t]he statute of limitations began to run when [defendant] improperly rejected the Trustee's repurchase demand. Ergo, the breach is the failure to comply with the demand."

Addressing the defendant's argument that a plaintiff may unilaterally delay accrual of the statute of limitations by indefinitely delaying its demand for repurchase, Justice Kornreich stated that "[o]f course, plaintiff cannot put off the running of the Statute of Limitations indefinitely by waiting an unreasonable time to make the demand," and thus "[h]ad the Trustee not made its demand in 2012 and instead waited a number of years to file suit, the inquiry might be different."⁸

3 46 N.Y.2d 606 (1979).

4 Quoting *Lehman Bros. Holdings, Inc. v. Evergreen MoneySource Mortg. Co.*, 793 F. Supp. 2d 1189, 1194 (W.D. Wash. 2011).

5 965 N.Y.S.2d 844 (Sup. Ct. N.Y. County May 13, 2013).

6 Internal quotation omitted.

7 *Continental Casualty Co. v. Stronghold Ins. Co.*, 77 F.3d 16 (2d Cir. 1996).

8 The *ACE Securities* court did not address the relation-back argument decided by Justice Sherwood in *Nomura*.

Observations

As the appellate court prepares to hear the *ACE Securities* appeal in December, we believe that the *Nomura* opinion was decided correctly. A remedy provision does not alter the fundamental claim — which is for breach of a representation and subject to the six-year statute of limitations.

Indeed, it would be ironic for a provision that limits remedies to be interpreted as expanding the ability to bring claims from six years to the potentially 30- or 40-year life of the underlying securities. If that occurs, drafters of agreements certainly will need to rethink the wording of such language in the future.