

NY's High Court Further Clarifies RMBS Legal Landscape

By **Christopher Malloy Robert Fumerton, Alexander Drylewski and Maria da Silva** (January 8, 2019, 1:41 PM EST)

Over the 10 years since the financial crisis, New York state and federal courts have seen a surge in litigation involving residential mortgage-backed securities, or RMBS. These cases typically have involved RMBS investors, insurers or trustees asserting claims against the various entities involved in the mortgage origination and securitization process. Given the complexity of the underlying transactions, interpreting the governing agreements has been the subject of prolonged litigation. Moreover, because the agreements at issue typically predate the financial crisis, and are many times more than a decade old, the statute of limitations frequently is invoked as a defense.

In the past year alone, the New York Court of Appeals heard four RMBS-related cases addressing the available contractual remedies and timeliness of RMBS lawsuits in various contexts. Moreover, the high court already has agreed to hear at least two additional RMBS cases on the current term's docket.

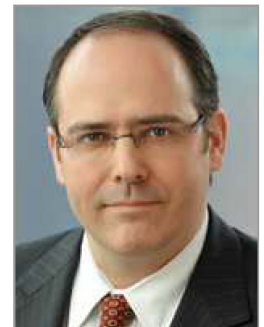
The Court of Appeals' decisions in the RMBS cases continue to generate fresh insights into recurring questions of New York commercial law, and will serve as guideposts not only to parties in pending RMBS-related litigation, but also to other commercial actors structuring complex contractual transactions.

2017-2018: The "Sole Remedy Provision"

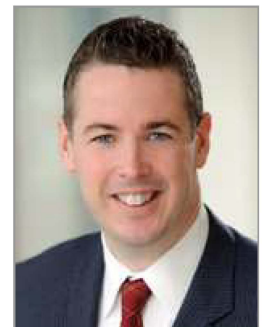
In two cases decided within the last year, the Court of Appeals addressed so-called "sole remedy provisions" in contracts underlying RMBS transactions, and relied upon traditional principles of contract interpretation to strictly hold the parties to these remedies.

In *Nomura Home Equity Loan Inc. v. Nomura Credit & Capital Inc.*[1] and *Ambac Assurance Corp. v. Countrywide Home Loans Inc.*,[2] the relevant contracts included representations and warranties, or R&Ws, by the defendants regarding the underlying mortgage loans. These "loan-level" R&Ws covered a wide range of issues, such as each loan's compliance with underwriting standards and fair lending laws. The relevant contracts provided certain remedies for breach of the loan-level R&Ws, including cure or repurchase of the nonconforming loans, and stated that these would be the "sole remedy" for these breaches.

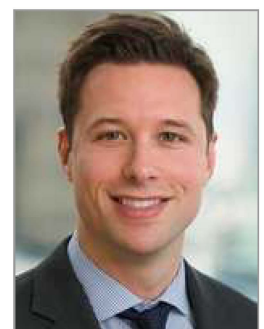
The plaintiffs (an RMBS trustee in *Nomura*, and a monoline bond insurer in *Ambac*) alleged that the underlying pools of mortgage loans contained "pervasive" and "systemic" breaches of the loan-level R&Ws. In addition to the cure or repurchase remedy, the plaintiffs sought broader monetary remedies, arguing that the purported pervasive nature of the breaches of the loan-level R&Ws caused separate breaches of other sections of the contracts, such as representations regarding the accuracy of the transaction documents, that



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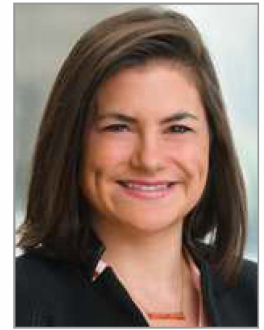


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were not expressly subject to the sole remedy provisions. The Court of Appeals therefore addressed the argument that “a sole remedy provision executed by sophisticated parties as part of a complex securitization process can be avoided by alleging ‘broader’ or numerous violations of representations and warranties contained in the governing contract.”[3]



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The court rejected the plaintiffs’ argument and enforced the sole remedy provisions as written. In doing so, the court reiterated longstanding principles of contract interpretation, including that courts should endeavor to read a contract “as a harmonious and integrated whole” to determine and give effect to its purpose and intent,” and that courts may not create a “new contract under the guise of interpreting the parties’ own agreements.”[4]

The court concluded that sole remedy provisions are “sufficiently clear to establish that no other remedy [besides the sole remedy provision] was contemplated by the parties at the time the contract was formed.” In addition, the “transaction-level” breaches for which plaintiffs sought general contract damages were “grounded in alleged breaches of the mortgage loan-specific representations and warranties,” that included the limited remedy provisions. As a result, the court rejected the position that, under the circumstances, the plaintiffs could “subvert” application of the sole remedy provisions by recharacterizing their claims as multiple systemic breaches.[5]

2018-2019: The Statute of Limitations

The Court of Appeals also has focused on the statute of limitations applicable to RMBS claims, addressing the issue in a number of contexts.

Reinforcing Day 1 Breaches

In *ACE Securities Corp. v. DB Structured Products Inc.*,[6] the court previously had held that the six-year statute of limitations for breach of R&Ws begins to run on “Day 1” — i.e., the date upon which the R&Ws were made (typically the date of the agreement containing them), rejecting the argument that accrual would be delayed until procedural prerequisites to suit — a demand by the plaintiff — had been satisfied. In *Deutsche Bank National Trust Co. v. Flagstar Capital Markets Corp.*,[7] the Court of Appeals reaffirmed this bright-line statute of limitations analysis, and upheld the overarching public policy prohibiting extensions to the statute of limitations through an indefinite contractual “accrual provision.”

The precise issue before the court in *Flagstar* was whether the rule set forth in *ACE Securities* could be varied by an express “accrual provision” specifying that a cause of action shall accrue “when, among other things, a demand upon defendant for compliance with [the RMBS agreement] is made” — in other words, whether this accrual provision could serve to extend the statutory limitations period for commencing an action, either expressly or by demonstrating the parties’ intent to do so. The plaintiff argued that this “accrual clause” represented a substantive condition precedent such that the contract could not be breached, and a cause of action would not accrue, until the events listed in the accrual clause had occurred.[8]

In *Flagstar*, the Court of Appeals once again declined the invitation to extend accrual of the limitations period beyond the date upon which the R&Ws were made, holding that “[t]he accrual clause does not create a substantive condition precedent because no provision of the accrual clause creates a condition to defendant’s performance under the contract: delivery of mortgage loans that comply with the representations and warranties.” The defendant therefore breached those R&Ws, if at all, on the closing date because they “were either true or false on that date.”[9]

Further, although the court recognized New York’s public policy favoring freedom to contract, it also observed that parties may not, by contract, violate public policy — in this case, the public policy prohibiting ex ante extensions of the limitations period indefinitely through an accrual clause. The court went one step further and emphasized that, to the extent sophisticated parties would like the option to delay the accrual date for claims in this manner, they would need to take it up with the legislature.[10]

The Savings Statute and Relation Back

On Jan. 9, 2019, in *U.S. Bank National Assoc. v. DLJ Mortgage Capital Inc.*,^[11] the Court of Appeals will hear argument in two appeals (the “ABSHE 2006-HE7 Trust Action” and the “HEAT Trusts Action”) concerning the interplay between CPLR 205(a), which allows a timely commenced action dismissed for certain non-merits reasons to be refiled within six months, and CPLR 203(f), which governs when claims asserted in an amended pleading will relate back to the filing of the original pleading for limitations purposes.

In these cases, RMBS trustees alleged breaches of R&Ws made in connection with the securitization of pools of RMBS. In one case, the ABSHE 2006-HE7 Trust Action, the trial court dismissed the case for failure to satisfy a contractual condition precedent to suit, without prejudice to refile under CPLR 205(a). The Appellate Division, First Department, held that allowing the trustee leave to refile under CPLR 205(a) was appropriate. In the HEAT Trusts Action, the trial court initially dismissed the case because the original plaintiff lacked standing and the statute of limitations had expired by the time the proper party (the trustee) was substituted as plaintiff.

The First Department held the trustee could not benefit from either statute: Although a dismissal for lack of standing might fall within the savings provision of CPLR 205(a), the trustee was not the “plaintiff” in an earlier filed action, and because there was no “valid preexisting action” to relate back to, the trustee could not invoke CPLR 203(f) to save its claims. As a result, the First Department held that the refiled claims were “time-barred on standing grounds.”^[12]

The Borrowing Statute and Choice-of-Law

On Sept. 18, 2018, the Court of Appeals granted leave to appeal in *Deutsche Bank National Trust Co. v. Barclays Bank PLC.*^[13] This case involved the application of New York’s borrowing statute, CPLR 202, as well as a New York choice-of-law provision, to an RMBS trustee. At issue is whether California’s shorter four-year statute of limitations, as opposed to New York’s six-year period, should apply to claimed breaches of R&Ws in connection with the 2007 sale of RMBS pooled in the relevant trust.

The New York borrowing statute requires that an action “based upon a cause of action accruing without the state” be timely under the respective statutes of limitations of both New York and “the place without the state where the cause of action accrued.” The First Department grappled with how this provision should apply where the plaintiff is a trustee. In cases involving economic injury, the general rule is that, for purposes of CPLR 202, the cause of action is deemed to have accrued in the jurisdiction of the plaintiff’s residence, where the impact of the loss is felt.

In *Barclays*, however, the plaintiff argued that because it was suing solely in its capacity as trustee, a different, multi-factor test should be applied to determine where the injury occurred. The First Department reasoned that it did not need to resolve this question because either proposed test would lead to application of California’s shorter four-year statute of limitations: The plaintiff/trustee resided in California and, among other things, the mortgage loans comprising the trust’s assets had been originated by California lenders and encumbered California properties, and the trust was administered and paid taxes in California.^[14]

In addition, because the New York choice-of-law clauses in the relevant agreements did not expressly incorporate the New York statute of limitations, they could not be read to encompass that limitations period. Accordingly, the First Department found the claims time-barred under California’s shorter four-year limitations period.^[15]

Limitations Under the Martin Act

Finally, this year in *People v. Credit Suisse Sec. (USA) LLC*,^[16] the Court of Appeals resolved an issue of first impression related to the limitations period for certain RMBS claims brought under the Martin Act, which authorizes the New York state attorney general to investigate and enjoin fraudulent practices in the marketing of stocks, bonds and other securities within or from New York State.

In 2012, the AG commenced an action concerning the 2006 and 2007 issuance of certain RMBS, and the issue before the Court of Appeals was which of several statutorily-defined limitations periods applied to the claims at issue. Because the court found that the Martin Act imposes “liabilities”

beyond those cognizable at common law, it applied the three-year statute of limitations under CPLR 214(2), which covers actions “to recover upon a liability, penalty or forfeiture created or imposed by statute.” As a result, the court dismissed the Martin Act claims as time-barred (though the court preserved certain other common law claims).[17]

Notably, although the Martin Act is nearly a century old, the Court of Appeals had not considered the statute of limitations applicable to Martin Act claims until this RMBS-related case came before it.

Implications for RMBS Cases and Beyond

Given the passage of time and the complexity of the underlying transactions in most RMBS litigations, the Court of Appeal’s recent adherence to traditional contract principles and application of bright-line statute of limitations guidelines provides further clarity and guidance to parties in this area. While numerous questions remain, this year the Court of Appeals took significant steps to protect RMBS defendants’ reasonable expectations and to avoid the potential for open-ended liability.

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[1] *Nomura Home Equity Loan Inc. v. Nomura Credit & Capital Inc.*, 30 N.Y.3d 572 (2017).

[2] *Ambac Assurance Corp. v. Countrywide Home Loans Inc.*, 31 N.Y.3d 569 (2018).

[3] *Ambac*, 31 N.Y.3d at 581 (citing *Nomura*, 30 N.Y.3d at 585-86).

[4] *Nomura*, 30 N.Y.3d at 581 (citations omitted); see also *Ambac*, 31 N.Y.3d at 581-82.

[5] *Nomura*, 30 N.Y.3d at 584; see also *Ambac*, 31 N.Y.3d at 582-83.

[6] *ACE Securities Corp. v. DB Structured Products Inc.*, 25 N.Y.3d 581 (2015).

[7] *Deutsche Bank National Trust Co. v. Flagstar Capital Markets Corp.*, 32 N.Y.3d 139 (2018).

[8] *Flagstar*, 32 N.Y.3d at ____, 2018 WL 4976777, at *2-3.

[9] *Id.*

[10] *Id.* at *4.

[11] *U.S. Bank National Assoc. v. DLJ Mortgage Capital Inc.*, 141 A.D.3d 431 (1st Dep’t 2016), granting leave to appeal, 29 N.Y.3d 910 (2017).

[12] *Id.* at 432-33.

[13] *Deutsche Bank National Trust Co. v. Barclays Bank PLC.*, 156 A.D.3d 401 (1st Dep’t 2017), granting leave to appeal, 32 N.Y.3d 904 (2018).

[14] *Id.* at 402-03.

[15] *Id.*

[16] *People v. Credit Suisse Sec. (USA) LLC*, 31 N.Y.3d 622 (2018).

[17] *Id.* at 632-33.

