

IN THE COURTS

Divergent RMBS Rulings Highlight Issue of Uniformity

BY SUEVON LEE

WHEN Manhattan Supreme Court Justice Sherry Klein Heitler ordered that all new residential mortgage-backed securities cases be assigned to a single Commercial Division judge, she said the administrative change was made to promote “efficiency” and to avoid “inconsistent rulings.”

Perhaps no better illustration of inconsistent rulings exists in recent weeks than the pair of opposing decisions handed down from two Commercial Division judges in mid-May.

In separate cases, Justices O. Peter Sherwood and Shirley Kornreich differed on when New York’s six-year statute of limitations is triggered for breach of contract cases involving allegedly misleading offering agreements for the sale of residential mortgage-backed securities.

In *Nomura Asset Acceptance Alternative Loan Trust v. Nomura Credit & Capital*, 653541/11 (May 10), and *Ace Securities v. DB Structured Products*, 650980/12 (May 13), the plaintiff investors filed breach of contract claims after the defendant banks failed to repurchase allegedly faulty loans arising from these securitizations. The banks argued that the statute of limitations barred investors from filing their claims and thus, their complaints should be dismissed.

In *Nomura*, Sherwood agreed with the bank, holding that the limitations period begins on the transaction’s closing date. In *Ace Securities*, however, Kornreich sided with the plain-



Justice
Sherwood



Justice
Kornreich

tiff investors, finding that the time frame kicks in upon the bank’s refusal to repurchase these loans.

“This is the first instance I have seen of such starkly opposed rulings from within New York’s Commercial Division on RMBS litigation issues,” said Isaac Gradman, an attorney at California law firm Perry Johnson Anderson Miller & Moskowitz who specializes in mortgage-backed securities litigation.

DB Structured Products (DBSP) has already filed a notice to appeal Kornreich’s order. Nomura is expected to appeal Sherwood’s decision. The parties will wait on the Appellate Division, First Department, to settle the conflict, but that could take months.

Kasowitz Benson Torres & Friedman represents the plaintiffs in both cases. Orrick, Herrington & Sutcliffe represents Nomura Credit & Capital, while Simpson Thacher & Bartlett represents DBSP.

Attorneys for those firms declined to comment.

The significance of the rulings is

not lost on outside experts.

“These two decisions really have the capacity to define the scope of RMBS put-back litigation and the potential liabilities,” Gradman said. “The argument that the cases could be brought after the six-year window [always existed] but there was always an understanding it would be much harder after those six years. The theory to an extent hadn’t been tested before.”

There are at least 14 other RMBS cases involving put-back claims pending in the Commercial Division. Sherwood has agreed to stay discovery in eight other cases against Nomura Capital on his docket pending an appellate ruling; four of those cases involve this same put-back claim.

Striving for Uniformity

Under Heitler’s administrative order, all new RMBS cases are being diverted to Justice Marcy Friedman, who, having taken her seat in July 2012, is the newest member of the Commercial Division in Manhattan, which counts nine judges in total.

“We felt because of the issues involved it would be best for one judge to handle and for judicial economy,” Heitler told Commercial Litigation Insider, a Law Journal affiliate, in an interview.

The other full-time commercial judges will still keep their existing RMBS cases. Parties, meanwhile, can request their cases be assigned to a specific judge if they believe it relates to a pending case.

That prerogative exists in federal court as well: Litigants can always

request that a case be assigned to a specific judge if they feel it's relational to another pending case.

"That's to economize efficiency, because you have a judge familiar with the questions of law and facts in an area rather than have another judge get up to speed," said Stephanie Cirkovich, public information officer for the U.S. District Court for the Southern District.

The time-consuming nature of RMBS claims has tested the patience of some Commercial Division judges. At a motion-to-dismiss hearing in late April, Justice Charles Ramos expressed his frustration with the scope of one RMBS action.

Holding up a thick stack of papers that constituted the complaint in *Phoenix Light SF v. J.P. Morgan Securities*, 651755/2012, Ramos stated from the bench, "It'll be a nightmare to manage this in its present state."

"This is impossible to go through," he told the plaintiffs' attorneys. "I'm only one person. This is a mess. This is too vague, it's not gonna happen."

He advised the plaintiffs' lawyers to create an appendix and plead their claims with more particularity.

The Office of Court Administration does not separately track how many pending RMBS cases there are, or how many new filings have been diverted to Friedman since the issuance of Heitler's administrative order.

Same Claim, Different Rulings

Sherwood's ruling in *Nomura* was emailed to reporters shortly after 3 p.m. on May 14. Less than two hours later, Kornreich's chambers emailed her decision in *ACE Securities*. Her law clerk specifically noted in the body of the email that Kornreich's ruling "declines to follow a recent Commercial Division case and two federal district court cases that address the accrual of a breach of contract 'put-back' claim involving mortgage backed securities."

The *Nomura* case deals with the issuance of more than \$259 million in RMBS certificates managed through a mortgage loan purchase agreement dated Dec. 1, 2005. Defendant Nomu-

ra made 39 representations and warranties that the plaintiff trust alleges were breached.

The defendant bank argued that the clock on the statute of limitations began when it made the mortgage representations on Dec. 1, 2005, and the transaction closed. Because the date of the amended complaint, Aug. 24, 2012, was beyond the six-year window, the bank argued, the complaint should be dismissed.

Plaintiff Nomura Asset, however, argued that "each refusal of Nomura to repurchase the defective mortgages is an independent breach of contract separate and apart from the representations" and since the bank had a "continuing obligation to repurchase all defective mortgages," each failure to do so constituted a separate breach of obligation.

Sherwood didn't accept the plaintiff's argument. "In this case, the Mortgage Representations are alleged to have been false when made. Those representations did not arise or change over time," he wrote. "If the Mortgage Representations were false when made, they are still false today. If they were true when made, they are still true today. The repurchase obligation in this case is merely a remedy. It is not a duty independent of the Mortgage Representation breach of contract claims."

The *Ace Securities* action involved more than \$500 million in certificates sold in an MLPA dated March 28, 2006. The complaint alleged that Deutsche Bank Structured Products made over 50 representations and warranties about the quality of the loans and were required to repurchase the loans in the event of breach.

Exactly six years later, two certificate-holders filed suit for breach of contract (later to be substituted by the Trustee since the original plaintiffs lacked standing to sue).

In her ruling, Kornreich stated she disagreed with the holding in a 2003 federal case, *Structured Mort. Trust 1997-2 v. Daiwa Finance*, 2003 WL 548868, where the Southern District of New York held that the statute of limitations runs from the

execution of the contract.

"The Representations and the Repurchase Protocol functioned as insurance for the Trustee and was likely priced accordingly. Consequently, to contend, as the Daiwa court and DBSP do, that the Trustee's claims accrued in 2006 because the Trustee could have made a demand at that time utterly belies the parties' relationship and turns the PSA on its head," Kornreich wrote.

She found that DBSP had a "recurring obligation" under the PSA to follow this repurchase protocol when informed of a problem.

Robert Scheef, who served as counsel to the non-profit group Association of Mortgage Investors, which filed an amicus brief in *Nomura* in support of the plaintiff, said that if Sherwood's ruling is upheld on appeal, it could "adversely affect the rights of all investors to these securities."

To hold that the statute of limitations kicks in at the point of contract "really upsets that straightforward commercial balancing that the parties did when they structured these transactions," Scheef said.

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