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# Court Ruling Could Impact Clean-Up Call Activity

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A recent ruling by the Orange County Superior Court could have far-reaching consequences on non-agency MBS clean-up call price calculations.

The case focused on whether \$75 million of deferred principal payments owed by borrowers who had entered into loan modification programs following the 2008 financial crisis should factor into the clean-up call price of MBS held by Deutsche Bank.

PHH Mortgage, the servicer of the loans in the MBS, had announced intentions to exercise its clean-up call rights for a price that did not include deferred principal payments.

Rights to clean-up calls can typically be exercised when the outstanding balance of the MBS is lower than 10% of the original balance.

MBS investors represented by the McKool Smith law firm argued that deferred amounts previously applied as realized losses should be included in the call price under the governing pooling and servicing agreement. The court agreed with the plaintiffs' argument.

"It is entirely within the discretion of PHH whether to exercise its call right," Judge Peter Wilson wrote. "Before doing so, PHH has every right and ability to assess the risk of collectability of deferred amounts. [MBS investors], on the other hand, may have the call right imposed on them, regardless their wishes in the matter, and in that event are entitled to receive what the PSAs plainly provided for."

In a statement to Inside MBS & ABS, PHH said, "We are aware of the court's decision and are considering all our options." Deutsche Bank declined to comment on the case.

The summary judgment establishes grounds for investors to seek remuneration if MBS they had a stake in were called without deferred payments calculated in the price. The ruling may also result in MBS clean-up call prices having deferred payments included moving forward.

The 2008 financial crisis exacerbated the issue as many loans taken out in the vintage included deferred principal payment agreements. Many securitized post-crisis mortgages were modified under the Home Affordable Modification Program to include deferred principal payments that could ensure mortgage borrowers were not foreclosed upon.

Courtney Statfeld, a principal at McKool Smith, who represented NAV LLC and Stephen Finkelstein in the case, said investors should examine past clean-up calls to ensure the prices paid align with the new ruling's judgment.

"Thousands of residential MBS trusts containing mortgages with deferred payments are reaching the point where clean-up call rights are about to be exercised," Statfeld said. "This ruling sets the stage for fair compensation for investors in future clean-up calls. Investors should carefully review past clean-up calls to ensure they were paid the price the contract required."

The California superior court case was just one lawsuit involving clean-up calls for MBS. A similar case involving U.S. Bank is set to be heard in a New York court this month.