

NY Court Sides With Junior Investors In RMBS Trust Dispute

By **Grace Dixon**

Law360 (July 25, 2025, 7:57 PM EDT) -- A New York state court resolved a dispute between bondholders in 34 residential mortgage-backed securities trusts about how to handle repayment of principal amounts deferred during the 2008 financial crisis, siding with junior bondholders after a 17-day bench trial.

New York Supreme Court Justice Andrew Borrok weighed in on a dispute over how to classify belated mortgage payments made on loans that received some form of principal forbearance during the financial crisis, via programs like the U.S. Treasury's Home Affordable Modification Program.

Despite senior bondholders' arguments to the contrary, the court ruled that servicer Wells Fargo was correct to treat the payments as "subsequent recoveries," Justice Borrok ruled.

Under an earlier court ruling in separate litigation brought against JPMorgan for its handling of RMBS investments in the lead-up to the financial crisis, New York appellate courts had already clarified that the language in functionally identical contracts stipulated that subsequent recoveries should be paid out to subordinate bondholders, not senior bondholders.

The court clarified that pooling and serving agreements governing the 34 RMBS trusts laid out a process for how to handle realized losses stemming from liquidating mortgages, bankruptcy losses or servicer modifications.

The governing contracts stipulate that in cases where the servicer recovers a previously realized loss, as was the case when homeowners made deferred principal payments, this is done via subsequent recovery, per the ruling.

"Subsequent recoveries are the 'only mechanism' to 'write up certificates after a realized loss,'" Justice Borrok said.

In order to establish that the deferred principal payments were, in fact, subsequent recoveries of realized losses, the servicer had to believe that it would not receive the funds down the road from the homeowner and the loan had to have been liquidated, per the ruling.

At the time, the industry understood the forborne principal to be "worth pennies on the dollar" amid massive defaults and recurring defaults, per the ruling.

"When servicers reported the extinguished interest and deferred principal as a realized loss, they did not

expect repayment," Justice Borrok ruled.

Ratings agencies and servicers treated the deferred portion of the loan as a partial liquidation. Though homeowners were obligated to pay this portion, forbearance could be extended up to 40 years, and the industry did not have high hopes for repayment, the court noted.

Robert Scheef, counsel to the subordinated certificateholders, told Law360 on Friday that the court rejected senior certificateholder's arguments that there had to have been a full liquidation similar to a foreclosure.

"The court rejected that because he recognized that partial liquidations existed beforehand, and that's what the Treasury was essentially doing, and that's how the industry understood things at that time," Scheef said.

Senior certificateholders had also argued that they were not made aware Wells Fargo was treating the deferred principal payments as subsequent recoveries, but Justice Borrok refuted this argument.

The ruling pointed to stipulations, a lawyer's affidavit and briefing in the JPMorgan litigation which explicitly acknowledged Wells Fargo's treatment of the deferred principal payments as subsequent recoveries, as well as monthly reports prepared by the servicer.

"Wells Fargo's treatment of deferred principal payments as subsequent recoveries was not a secret," Judge Borrok ruled. "There simply was not credible evidence adduced at trial that any certificateholder did not understand that the payment of previously deferred principal was being treated as a subsequent recovery by Wells Fargo."

Courtney Statfeld, also counsel to junior certificateholders, told Law360 that the dispute over whether Wells Fargo made clear its approach to handling the deferred principal payments was one of the "more fun" parts of the nearly four-week trial.

"You had these senior holders who were effectively saying ... 'We didn't know they were treating them like this,'" Statfeld said. "And then we had evidence after evidence after evidence that got admitted, including letters from their own counsel, including briefings and prior cases that said you knew."

Counsel for Wells Fargo and the senior certificate holders did not return requests for comment on Friday.

Wells Fargo is represented by Clay J. Pierce, Julie R. Landy, Paige A. Naig, Mark D. Taticchi, Elizabeth M. Casey and Kyle E. Darch of Faegre Drinker Biddle & Reath LLP.

DW Partners LP and the Reliance parties are represented by David I. Greenberger of Bailey Duquette PC and Isaac M. Gradman, Michael E. Tracht and Alexander A. Wiegel of Perry Johnson Anderson Miller & Moskowitz LLP.

Deer Park Road Management Co. LP, STS Master Fund Ltd., Deer Park 1850 Fund LP, Northern Lights Fund Trust — Deer Park Total Return Credit Fund, One William Street Capital Master Fund Ltd., OWS Credit Opportunity I LLC, Baldr Sherwood Fund Inc., OWS ABS Master Fund II LP and 1WS Credit Income Fund are represented by Samuel J. Lieberman, Frank S. Restagno and Lily Cron of Sadis & Goldberg LLP.

Axonic Capital LLC and Axonic Funds are represented by Justin M. Ellis and Alex Eynon of MoloLamken LLP.

PIMCO is represented by Kenneth E. Warner of Warner Partners PC, Caitlin Halpern, Peter J. McDonald and Nick Beachy of Gibbs & Bruns LLP and David Sheeren of Sheeren Law PLLC.

Solula LLC, La Verdad Holdings LLC, Robert Dechert and 400 Capital Credit Opportunities Master Fund Ltd. are represented by Robert W. Scheef, Courtney B. Statfeld, Daniel I. Hendler, Hal M. Shimkoski and Lauren H. Simenauer of McKool Smith PC.

HBK Master Fund LP is represented by Uri A. Itkin, Richard D'Amato, Michael Chen, Andrew McWhorter and Rebecca Kanner of Akin Gump Strauss Hauer & Feld LLP.

The case name is Wells Fargo Bank NA v. All Respondents for this Special Proceeding, case number 154984/2021, in the Supreme Court of the State of New York, County of New York.

--Editing by Dave Trumbore.

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