



New York Appellate Court Decision Raises New Questions in RMBS Litigation

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The New York Courts continue to define the rights and duties of the various entities that are parties to, or claim rights under, the contracts that govern Residential Mortgage Backed Securities (RMBS). Given the increasing number of litigations being seen in New York brought by entities seeking to reallocate the losses suffered by Certificateholders and Insurers as a result of the financial crisis' effect on RMBSs, the courts' actions are not unexpected but warrant close scrutiny since each decision does have consequences that are not always readily obvious.

Most recently, on October 16, 2014, the New York State Supreme Court, Appellate Division First Department issued a decision in *Ambac Assurance Corp. v. EMC Mortgage LLC*, Index No. 651013/12 (N.Y. App. Div., 1st Dep't). In that decision, the First Department found that an insurer named as a third-party beneficiary in a Pooling and Servicing Agreement did not have standing to enforce the repurchase provisions of that agreement because, the court held, those provisions were reserved to the trustee. This decision clarifies the way courts will treat certain direct claims under the repurchase provisions, but raises questions about the relationship between the insurer and the party entitled to enforce the repurchase provisions, in light of the insurer's third-party beneficiary status.

Ambac Assurance brought suit alleging that EMC Mortgage, the sponsor of the various RMBSs at issue, breached the terms of the agreements that govern each RMBS and engaged in fraud by, first, not complying with various representations and warranties concerning the characteristics of the individual loans pooled into the trusts and, second, by making misrepresentations about the way those loans were underwritten. Ambac Assurance partially insured a series of RMBS transactions that EMC Mortgage sponsored. As the sponsor, EMC Mortgage purchased the loans that made up the RMBSs and then deposited them (through special purpose entities) into the various trusts at issue.

Ambac is not a party to either the Mortgage Loan Purchase Agreements (MLPAs) or the Pooling and Servicing Agreements (PSAs) governing the relevant RMBSs, but is named as a third-party beneficiary under the PSAs with respect to the rights of the insured certificateholders. The transactions at issue did not include separate insurance and indemnity agreements setting out Ambac's rights.

The Court's analysis focused on two provisions of the MLPAs and two provisions of the PSAs. Section 7 of the MLPAs contains representations and warranties made by EMC about the characteristics of the individual loans and Section 8 contains a representation by EMC that the prospectus supplement describing the mortgage loans did not contain untrue statements. Section 7 of the PSAs creates a repurchase protocol under which certain parties to the RMBS transactions can force EMC to



repurchase loans that are determined to not conform to the representations and warranties given in the MLPAs. Critically, Section 7 of the MLPAs states that the repurchase protocol set forth in the PSA is the “sole remedy” available to the “Purchaser,” “Trustee,” and “Certificateholders” for breach of the representations and warranties. Section 2.03 of the PSA also states that the repurchase protocol would be the “sole remedy” available to the Trustee and Certificateholder.

Ambac argued that the “sole remedy” language contained in Section 7 of the MLPAs did not apply to it because it was not identified by the PSAs as a party whose rights were limited to enforcement of the repurchase protocol, and that it could enforce the repurchase protocol because there is no language explicitly barring it from doing so. The Court rejected both arguments because the “sole and exclusive” remedy provisions applied to all breaches of the relevant warranties and that Ambac did not have standing to bring its claims.

The logic of this decision depends on the Court’s finding: 1) that the depositor’s “right, title and interest” in the MLPAs, including its right to pursue breaches of the representation and warranty provisions of the agreements, was assigned into the securitization trust; the trust empowers the trustee to enforce those claims on behalf of the certificateholders and, expressly, on behalf of the certificate insurer – namely, Ambac; and 2) that the trustee is empowered to pursue claims for “breach of any of the representations and warranties set forth in the [MLPAs].” Thus, while the “sole and exclusive” remedy clause does not, on its face, technically limit Ambac, the Court held that Ambac does not have standing to pursue its claims because section 2.03 of the PSAs prevents it from doing so.

The decision ends by addressing Ambac’s contention that it is left “without a remedy” if it is not able to bring suit under the PSAs. The First Department notes that this is not so because: “trustees may, and often do, seek repurchase of mortgage loans where they are dissatisfied with a sponsor’s response.”

Ultimately, *Ambac Assurance Corp. v. EMC Mortgage LLC* may have consequences beyond what the Court intended. By holding that the enforcement of repurchase provisions under standard language found in many MLPAs and PSAs is reserved to the Trustee, it appears that the Court may have unintentionally redefined the Trustee-insurer relationship by limiting the insurer’s rights, notwithstanding that the insurer is an express third-party beneficiary. While the New York Appellate Court does not appear to have fully explored its interpretation of that relationship in this decision, it certainly invites future RMBS litigation holdings to address this issue. This is a question that does not appear to have been considered by the New York Appellate Court but one that may have far reaching implications.

For more information on the matters discussed in this Locke Lord QuickStudy, please contact the authors.

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