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Subprime RMBS repurchase actions may be too late

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Liability for alleged breaches of representations and warranties made in connection with the issuance of subprime residential mortgage-backed securities (RMBS) remains a concern for sellers, sponsors and other securitisation participants. As so-called 'forensic analyses' on pooled loans are completed by or on behalf of certificate holders in securitisations that closed more than six years ago, demands to repurchase affected mortgage loans have become a common occurrence. A key question in repurchase (or 'put-back') actions to enforce such demands is whether the claims are barred by applicable statutes of limitations. Under New York law, which has been applied in some of the most significant court decisions to date, litigants have debated multiple issues regarding the application of the six-year limitation period for breach of contract. The developing case law has set parameters for future litigation, affording litigants an opportunity to sharpen their arguments.

A major issue regarding the timeliness of repurchase actions is whether a claim accrues upon the breach of representations and warranties that underlie a repurchase demand (the 'accrual-at-breach' rule) or upon the denial of a

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repurchase demand. Because almost all subprime RMBS deals closed before 2008, a court following the accrual-at-breach rule would likely consider the six year window in which to bring put-back claims closed. In contrast, if a claim is considered not to have accrued until the denial of a repurchase demand, plaintiffs could theoretically bring actions at any time in the future – a result that likely was not intended by the parties.

In May 2013, two New York state trial judges issued divergent opinions on this issue. In *Nomura Asset Acceptance Corp. v. Nomura Credit & Capital, Inc.*, the court followed the accrual-at-breach rule, reasoning that "[t]o find otherwise would allow [a plaintiff] to essentially circumvent the statute of limitations by indefinitely deferring its demand for payment". In contrast, in *ACE Securities v. DB Structured Products*, a different judge held that the contract in question was breached when the defendant rejected a repurchase demand. The conflicting approaches were resolved at the end of 2013 when the First Department of New York's Appellate Division, the state's intermediate appellate court, unanimously reversed the *ACE* decision.

Although the First Department's decision in *ACE* aligns with *Nomura* and two prior federal court decisions (*Structured Mortgage Trust 1997-2 v. Daiwa Finance Corp*. and *Lehman Brothers Holdings, Inc. v. Evergreen Moneysource Mortgage Co.*), the *ACE* plaintiffs have requested leave to appeal the decision to the Court of Appeals, New York's highest court. Furthermore, federal courts applying New York law possibly may choose not to follow the *ACE* decision. Decisions of the Appellate Division are not considered to be controlling precedent by federal courts applying New York law (though they are deemed 'persuasive'). As a case in point, in December 2013, Southern District Judge Hellerstein denied a defendant's request in *Federal Housing Finance Agency v. WMC Mortgage* that, in light of the *ACE* decision, he reconsider his earlier ruling that the claim for breach of contract accrued upon failure to repurchase. In contrast, Southern District Judge Scheindlin explicitly chose to follow the First Department's *ACE* decision in her January 2014 opinion in *Lehman v. Greenpoint Mortgage Funding*. Until either the New York Court of Appeals or the Second Circuit addresses the issue, federal district courts may continue to issue divergent opinions.

Some plaintiffs have argued that a claim for breach of contract cannot accrue until all conditions to the making of a repurchase demand under the governing contract have been satisfied. This argument has been rejected on policy grounds by the federal district courts in *Greenpoint* as well as *Evergreen*, a Western District of Washington case applying New York law. In *Greenpoint*, the purchase agreement provided that "[a]ny cause of action against the Seller relating to or arising out of the Breach of any representations and warranties... shall accrue...upon (i) discovery of such Breach..., (ii) failures by the Seller to cure...or repurchase, and (iii) demand upon the Seller". In rejecting plaintiff's argument, Judge Scheindlin (citing *Evergreen*) wrote "parties may not contractually adopt an accrual provision that effectively extends the statute of limitations before any claims have accrued" and noted, citing Second Circuit precedent, that "a plaintiff does not have power to put off the running of the Statute of Limitations indefinitely".

Judge Scheindlin's reasoning echoes the rationale underlying the accrual-at-breach rule followed by the *ACE* decision and the Southern District in *Daiwa*. However, because neither the Second Circuit nor any New York

state courts have directly addressed the impact of such provisions, it is possible that contradictory opinions may yet emerge.

Even if it is conclusively resolved that a claim for breach of contract accrues upon the underlying breach of representation or warranty, there may still remain a dispute among New York courts as to when such breach occurs. This issue is relevant where the effective or 'as of' date of the governing agreement is earlier than its date of closing, and the plaintiff brought its action within six years of the closing date, but not within six years of the 'as of' date. Plaintiffs have argued that there can be no breach of contract claim before the contract has been executed, and thus the claim cannot accrue until the transaction's closing date. In *Home Equity Mortgage Trust Series 2006-5 v. DLJ Mortgage Capital, Inc.*, the trial court accepted this argument. In contrast, in *Nomura Asset Acceptance Corp. Alternative Loan Trust, Series 2006-S2 v. Nomura Credit & Capital, Inc.*, a different trial court held that the breach occurred on the effective date of the purchase agreement that included the representations and warranties, even though that agreement's effective date was earlier than the transaction's ultimate closing date, and a separate transaction document provided that the representations were "true and correct as of the Closing Date".

There is currently some debate whether this issue of timing was addressed by the First Department in the *ACE* decision when it stated that "the claims accrued on the closing date of the [purchase agreement]...when any breach of the representations and warranties contained therein occurred". Although some plaintiffs have argued that this language constitutes a holding that claims accrue on the closing date of an agreement, not the effective date, such an argument ignores context. The effective date and closing date of the purchase agreement at issue in *ACE* were the same. The distinction between effective and closing dates was never addressed.

Because repurchase litigation is fact intensive and thus costly, there is much at stake when the timeliness of the action is raised in the litigation's early stage. Court decisions to date reveal the basis for dismissal, though still developing case law has given plaintiffs just enough hope to keep the repurchase demands coming. Resolution of these issues will have a significant impact on profitability within the financial sector for years to come. ■